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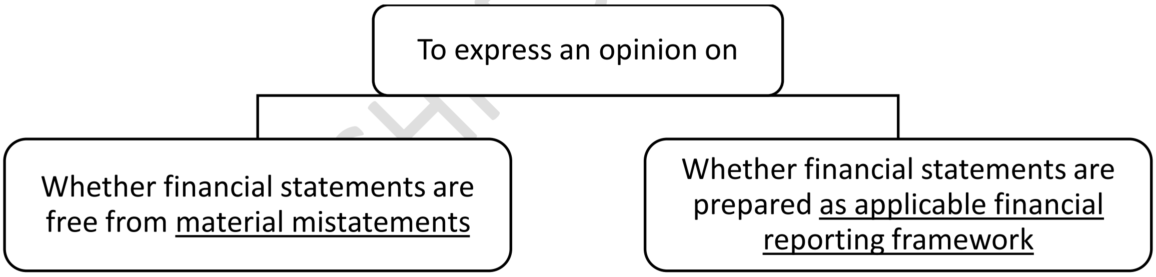
1. INTRODUCTION TO AUDITING

1. **AUDITING:** An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to expressing an opinion thereon.

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

2. **FINANCIAL STATEMENTS:** As per the Companies Act 2013, financial statements in relation to a company, includes
   a. a balance sheet as at the end of the financial year;
   b. a profit and loss account
   c. cash flow statement for the financial year;
   d. a statement of changes in equity, if applicable; and
   e. any explanatory note annexed to, or forming part of,

3. **OBJECTIVES OF AUDIT/AUDITOR:**



4. **APPLICABLE FINANCIAL REPORTING FRAMEWORK:** Financial Reporting framework means set of rules and regulations that are required to be followed in the process of preparation and presentation of financial statements.
   E.g.: Sch III and AS
   In view of nature of entity, the management of the entity will adopt applicable financial reporting framework.

5. **MISTATEMENT:** The difference between amount, classification, presentation and disclosure in the reported financial statements and amount, classification, presentation and disclosure required as per applicable financial reporting framework.
   In simple terms misstatement means, a mistake in the financial statements.
   A misstatement can result from either fraud or error. Fraud is intentional, whereas, error is unintentional.

6. **ERROR VS. FRAUD:**

Point of Difference	Error	Fraud
Intention	It is unintentional.	It is intentional.
Impact	The impact of the error on the organisation is generally not serious.	The impact of fraud on the organisation is usually very serious. It can damage the goodwill of the organisation.
Involvement	Lower-level employees are usually involved in an error.	Higher or lower-level employees are involved in fraud.
Liability	It results in civil liability.	It leads to criminal liability.

7. **MATERIAL:** Material means significant or important. A misstatement will be considered as material if it influences the decision of users of financial statements.

8. **LEGAL FORM:** There are several types of legal forms in which people ordinarily conduct businesses. This is similar to "Person" Definition under Income Tax. The following are the various types of legal forms:
   a. Proprietorship firm
   b. Partnership firm
   c. Limited Liability Partnership
   d. Society and
   e. Company
   f. AOP or BOI
   g. Any other artificial Judicial Person

2. NATURE, SCOPE, OBJECTIVE AND SIGNIFICANCE OF AUDITING

Q.NO.1 DEFINE THE TERM AUDITING AND EXPLAIN ABOUT NATURE OF AUDITING.

ANSWER:

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

B. **NATURE OF AUDITING:** The nature of auditing is summed up below:
   1. Auditing is a systematic and scientific examination of the books of accounts of a business.
   2. Auditing is undertaken by an independent person or body of persons who are duly qualified for the job.
   3. Auditing is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.
   4. Auditing is a critical review of the system of accounting and internal control.
   5. Auditing is done with the help of vouchers, documents, information and explanations received from the authorities.
   6. The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.
   7. The auditor has to inspect, compare, check, review, scrutinise the vouchers supporting the transactions and examine correspondence, Memorandum of Association and Articles of Association, etc. in order to establish the correctness of the books of accounts.

TEST YOUR KNOWLEDGE:

1. Write about essential features of auditing.

A. Write the above answer completely.

Q.NO.2 WRITE A SHORE NOTE ON SCOPE OF AUDITING. / ENUMERATE THE SCOPE OF AUDITING.

ANSWER:

A. **PRONUNCEMENTS:** The scope of auditing of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute of Chartered Accountants of India (ICAI)

B. **COVER ALL ASPECTS:** Moreover, the auditor must also ensure that no relevant aspect of the organisation is left unchecked.

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

- **a.** The auditor shall assess the reliability and sufficiency of the information contained in the underlying accounting records.
- **b.** The auditor has to determine whether the relevant information is properly disclosed in the financial statements in conformity with the applicable generally accepted accounting principles and statutory requirements (i.e. requirements as per Accounting Standards and Companies Act).
- **c.** The auditor be principally concerned with items that either individually or as a group are material in relation to the affairs of an organisation.

D. FACTORS EFFECTING SCOPE: The scope of auditing, thus, depends on the following factors:

- **a.** The size of the organisation,
- **b.** Legal form of the organisation
- **c.** Purpose of audit,
- **d.** Agreement between the auditor and owners (in case of non-statutory audit),
- **e.** Accounting system of the organisation,
- **f.** Published guidelines and standards on auditing,
- **g.** Relevant statutes prevalent in the country,
- **h.** Legal decisions on different cases.

TEST YOUR KNOWLEDGE:

1. What are the factors which affect the scope of auditing.

A. Write the above answer completely.

Q.NO.3 WHAT ARE OBJECTIVES OF AUDITING?

ANSWER:

The objectives of an audit can be grouped into two categories:

PRIMARY OBJECTIVES	**a.** The primary objective of the auditor is to express an opinion. **b.** The auditor has to verify the accuracy and judge the reliability of the financial statements of a particular accounting period of the organisation. **c.** Expressing an opinion opinion on financial statements by the auditor is specifically included in SA 200.
SECONDARY OBJECTIVES	**a.** The auditor is also responsible for detecting frauds and errors in the books of accounts and financial records of the client's business. **b.** Such detection of frauds and errors is called the secondary objective of audit because the primary responsibility for safeguarding the business assets rests with the management.

	c. He is required to report on the existence of such misstatement and their magnitude through his audit report.
SOCIAL OBJECTIVES	**a.** To protect the shareholders' interest of shareholders. **b.** To stop evasion of taxes **c.** To safeguard against capital erosion **d.** To ensure fair return on investors **e.** To ensure reasonable price to customers **f.** To ensure fair compensation to workers **g.** Complying with polices regarding corporate social responsibilities

TEST YOUR KNOWLEDGE:

1. Write about social objectives of auditing.

A. Write only social objectives point.

Q.NO.4 DISTINGUISH BETWEEN STATUTORY AUDIT AND NON-STATUTORY AUDIT?

ANSWER:

POINTS OF DIFFERENCE	STATUTORY AUDIT	NON-STATUTORY/VOLUNTARY/ PRIVATE AUDIT
LEGAL COMPULSION	It is compulsory under statute or law.	It is not mandatory. Rather it is optional.
SCOPE	The scope is determined by the Statute.	The scope is determined by the management.
EXAMPLE	Audit of companies, banks, cooperative societies, trusts etc. are examples of statutory audit.	Audit of a sole proprietorship, partnership firms, clubs, associations etc. are examples of non-statutory audit.
QUALIFICATION	A statutory auditor must possess the requisite qualification as per the concerned statute.	No specific qualification is prescribed for non-statutory auditor.
RIGHTS AND DUTIES	Rights and duties of a statutory auditor are governed according to the provisions of the concerned statute.	Rights and duties of a non-statutory auditor are determined on the basis of agreements entered into between the auditor and his appointing authority.
LIABILITY	Liabilities of a statutory auditor are two-fold: ((a) Liabilities as per the concerned statute and ((b) Liabilities under the common law of the country.	A non-statutory auditor can be held liable only under the common law of the country.

PUBLICATIONS OF AUDIT REPORT	The audit report is published for the public.	The audit report is made known to the employers or partners.

TEST YOUR KNOWLEDGE:

1. What are various types of Audit as per the requirements of law.

A. Write the above answer.

Q.NO.5 EXPLAIN ABOUT IMPORTANCE/SIGNIFICANCE OF AUDIT?

ANSWER:

The tasks of an auditor are of great importance to all concerned. The auditor must prepare his audit report impartially and effectively based on facts and actual figures. The following significance can be expected from auditing:

FROM LEGAL POINT OF VIEW	a. **Filing of Income Tax Return:** Income Tax authorities generally accept the profit and loss account that has been prepared by a qualified auditor. b. **Borrowing of Money from External Sources:** Money can be borrowed easily on the basis of audited balance sheet from the external sources. c. **Statement of Insurance Claim:** In case of flood, fire, other natural calamities and the like unexpected happenings the insurance company will use audited financial statements, for deciding claim amount. d. **Action Against Bankruptcy:** The audited accounts serve as a basis to determine action in bankruptcy and insolvency cases.
FROM INTERNAL/ MANAGEMENT POINT OF VIEW	a. **Quick Discovery of Errors and Frauds:** Errors and frauds are located at an early date, so that in future no attempt is made to commit such frauds. b. **Moral Check on the Employees:** The accountants of the company will remain alert, as the auditor would report to the management, regarding their irregularities. c. **Advice to the Management:** It may happen that the management may consult the auditor and seek advice of auditor although it is not the duty of the auditor to give advice.
FROM EXTERNAL AFFAIRS POINT OF VIEW	a. **Settlement of accounts:** The audited accounts would facilitate the settlement of accounts of a deceased partner. b. **Valuation of assets and goodwill:** When the business is getting sold, audited financial statements will help in calculation of goodwill. c. **Future trend of the business**: From the audited books of accounts, the future trend of the business can be assessed easily with certainty.

TEST YOUR KNOWLEDGE:

1. What are Advantages of audit/Statutory audit?

A. Write the above answer without any side headings

2. What are Benefits of audit/Statutory audit?
A. Write the above answer without any side headings

Q.NO.6 WHAT ARE THE BASIC PRINCIPLES GOVERNING AN AUDIT?

ANSWER:

SA 200 issued by ICAI (CA) gives the following basic principles that govern the auditor's responsibilities whenever an audit is carried out:

1. **INTEGRITY, OBJECTIVITY AND INDEPENDENCE:** The auditor should be straight-forward, honest, sincere and free form any influence on his audit work. He should maintain impartiality and be free of any interest.
2. **CONFIDENTIALITY:** He should not disclose the client's information to anybody without the client's permission or under any regulatory requirement.
3. **SKILLS AND COMPETENCE:** The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.
4. **WORK PERFORMED BY OTHERS:** The auditor should carefully supervise the work performed by others (such as his subordinates, other auditors, experts etc.).
5. **DOCUMENTATION:** Proper documentation should be maintained by the auditor to evidence the audit work.
6. **PLANNING:** The auditor should obtain the knowledge about client's business to determine the nature, timing, and the extent of the audit procedures.
7. **AUDIT EVIDENCE:** The auditor should obtain sufficient appropriate audit evidence through performing the audit procedures.
8. **ACCOUNTING SYSTEM AND INTERNAL CONTROLS:** An understanding of the accounting system and the related internal controls help in determining the nature, timing, and extent of other audit procedures.
9. **AUDIT CONCLUSIONS AND REPORTING:** Based on conclusions drawn from the audit evidence obtained the auditor should give appropriate opinion.

TEST YOUR KNOWLEDGE:

1. What are ethical requirements governing an audit?
A. Write the above answer
2. What are various principles governing an audit?
A. Write the above answer

Q.NO.7 WHAT ARE INHERENT LIMITATIONS OF AUDIT?

ANSWER:

1. Management is responsible for the preparation of financial statements whereas, the auditor is responsible for verifying them. The audit of financial statements does not relieve the management of its responsibilities.
2. As per SA 200, the objective of an audit is to express an opinion as to the true and fair view of the financial statements. The auditor can only obtain reasonable assurance but not absolute assurance.
3. The user should not believe that this option is as assurance as to
   a. the future viability of the enterprise or
   b. the efficiency or effectiveness with which the management has conducted the affairs of the enterprise.
4. An audit does not guarantee that all the material misstatements will be detected because of the following inherent limitations of audit:
   a. **TEST NATURE OF THE AUDIT:** In most cases, it is not possible for the auditor to check each and every transaction due to time and cost constraints. He has to rely on test checking.
   b. **NON-DETECTION OF ERRORS AND FRAUDS:** It may not be possible for the auditor to detect certain errors and frauds which are committed very cleverly.
   c. **POST-MORTEM ACTIVITY:** Critics argue that it is not useful because it starts only after the events have taken place.
   d. The audit evidence available to the auditor is persuasive rather than conclusive in nature.

TEST YOUR KNOWLEDGE:

1. Explain the reasons why the auditor's opinion cannot be taken as guarantee?

A. Write the above answer

Q.NO.8 DISTINGUISH BETWEEN ACCOUNTING AND AUDITING?

ANSWER:

Accounting	Auditing
It is the collection, classification and summarization of data for preparation of books of accounts, and to make financial statements.	Auditing is an analytical and critical examination of books of accounts, financial records and the financial statements prepared thereon.
It is the recording of transactions at the time of occurrence.	It is the post mortem examination of recorded transactions.
It measures the business events in monetary terms, records them, and communicates the financial results through Financial Statements.	Auditing reviews financial records to form an opinion on the authenticity of Financial State
Its primary responsibility is of the management towards the shareholders or owners, to maintain the financial records in such a manner	The auditor is an independent person appointed by the business entity to review the Financial Statements and to give his opinion thereon.

that Financial Statements can be prepared from the records.	
An accountant is not expected to review or report on the Financial Statement but to report the compilation of records to the management.	An auditor is required to submit a report with his opinion on 'true and fair' assertions made in the Financial Statements to the owners.
An accountant works for the management.	The auditor is an independent person accountable to the owners or shareholders and not to the management.
No such liability is there in accounting.	In certain circumstances, the auditor could be held liable to third parties also.
Maintenance of accounts may not be mandatory for small individuals or partnership firms, e. g. under section 44AA of the Income Tax Act, but could be mandatory under other laws, e.g., for companies under the Companies Act.	Audit could be exempt for various individuals or small partnerships, e. g. under section 44AB of the Income tax Act, and even in case where maintaining books of accounts is a statutory requirement under section 44AA, but may be mandatory under other laws e. g. for Companies under the companies Act.
Accounting is done as per the principles set by Indian Accounting standards (Ind AS)	Auditing is done as per the principal set in standards on auditing.

Q.NO.9 DISTINGUISH BETWEEN AUDIT AND INVESTIGATION?

ANSWER:

Points of Difference	Auditing	Investigation
MEANING	Auditing is an independent and systematic examination of the evidence underlying the accounting or other data in accordance with the generally accepted auditing practices to ascertain the true and fair view of the financial statements of an enterprise.	An investigation may be defined as an examination of accounts and records with a view to ascertain any fact for some special purpose which varies from assignment to assignment.
SCOPE	The audit has a wide scope. In statutory audit, the scope is determined by the relevant law and in case of a private audit (e.g., management audit) by a client.	The scope of investigations, on the other hand, is limited as regards the period or areas to be covered.
OBJECTIVE	In audit, the accounts and records are verified as to their truth and fairness.	Investigation is for special purpose (e.g., investigation on the behalf of incoming partner)
AUDIT PROCEDURE	The audit is conducted in accordance with the auditing standards.	Investigations involve an extended auditing procedure.

EVIDENCE	An auditor will evaluate the accounting records predominantly based on persuasive evidence.	An investigator can draw his conclusions only on the basis of substantial or sometimes conclusive evidence.
APPROACH	Auditor is skeptical and not suspicious.	Whereas an investigator starts with suspicion and collects evidence to either confirm or dispel that suspicion.
PERIODICITY	Auditing is a routine exercise (normally conducted annually).	Investigation may spread over a period longer than one year.

Q.NO.10 WHAT ARE STANDARDS ON AUDITING AND WHAT IS THEIR PURPOSE?

ANSWER:

1. Standards on auditing are a set of well-defined guidelines which are followed by auditors in conducting audit of the client's accounts. These are formulated by professional bodies of accountants like ICAI
2. The Standards provide principles and techniques expected to be followed by an auditor in order to improve the quality of his audit work.
3. Purpose of Standards of Auditing:
    a. Standards act as a ready reference of the procedures to be followed by an auditor under a given situation.
    b. Adherence to Standards reduces audit risk considerably.
    c. An auditor conducting the audit work based on the relevant standards can always defend himself against possible allegations of negligence.
    d. Standards improve the quality of audit work and thereby restore the public trust on the profession.

Q.NO.11 EXPLAIN THE PROCEDURE FOR ISSUING STANDARDS ON AUDITING?

ANSWER:

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

1. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.
2. In the preparation of Auditing Standards, AASB is assisted by study groups/task force to consider specific project. Study group comprising of a cross section of members of the Institute. The study group/task force will consider the specific subject and prepare the primarily draft of Standards.
3. Based on the work of the study groups, an exposure draft of the proposed Standards is prepared by the Committee and issued for comments by members of the ICAI.
4. After taking the comments into consideration, AASB finalize the draft and submit to the Council of the Institute.

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

Q.NO.12 EXPLAIN THE MEANING AND PURPOSE OF ENGAGEMENT LETTER/LETTER OF ENGAGEMENT? ALSO STATE THE CONTENTS OF THE ENGAGEMENT LETTER?

ANSWER:

1. In case of statutory audit, the appointment of the auditor and his duties and responsibilities are governed by the respective statutes. In all other organisations, however, these are decided by the agreement between the auditor and the client.
2. Letter of Engagement/Engagement Letter is a written document prepared by the auditor, which contains the terms and conditions regarding the audit.
3. Engagement letter reduces the chances of misunderstanding between auditor and client.
4. As per SA-210, Agreeing the Terms of Audit Engagements, an auditor and the client should agree to the terms of audit engagement prior to commencement of the audit.
5. However, if the law or regulation prescribes in sufficient detail the terms of audit engagement, the auditor need not record them in written agreement.
6. The following are contents of engagement letter:
   a. Objective & scope of engagement
   b. Management responsibility
   c. Existence of inherent limitations
   d. Management confirmation letter
   e. Restrictions & limitations of Auditor liabilities
   f. Basis of computation of Audit fees
   g. Billing arrangement
   h. Form of report & Other communications of engagement
   i. Validity of report
   j. Limits on submission of report to other authorities

CONTENT USEFUL FOR ANSWERING MCQ's, TRUE OR FALSE STATEMENTS AND MATCH THE FOLLWING KIND OF QUESTIONS

A. INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD (IAASB):

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

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

B. AUDITING AND ASSURANCE STANDARDS BOARD (AASB)

The Institute of Chartered Accountants of India (ICAI) is one of the founder members of the International Federation of Accountants (IFAC). Hence, it is one of the membership obligations of the ICAI to actively propagate the pronouncements of International Auditing and Assurance Standards Board (IAASB) of the IFAC to contribute towards the global harmonisation and acceptance of the Standards issued by IAASB. Accordingly, ICAI constituted the Auditing Practices Committee (APC) in 1982 to develop Statements on Standard Auditing Practices (SAPs).

In July 2002, the APC was converted into the Auditing and Assurance Standards Board (AASB). The composition of the AASB is broad-based and attempts to ensure participation of all interest groups in the standard setting process. Apart from the elected members of the Council of the ICAI, the Board includes members from profession, members from SEBI, RBI, IRDA, IIMs, industry associations etc.

C. STRUCTURE OF PRONOUNCEMENTS ISSUED BY AASB

The pronouncements by AASB are covered by the following two broad categories of Standards:

1. **Engagement Standards:** The following Standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards:
   - **a.** Standards on Auditing (SAs), to be applied in the audit of historical financial information.
   - **b.** Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
   - **c.** Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, other than audits and reviews of historical financial information.
   - **d.** Standards on Related Services (SRSs), to be applied to engagements involving application of agreed- upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.
2. **Standards on Quality Control (SQCs):** These are issued by the AASB under the authority of the Council and are to be applied for all services covered by the Engagement Standards as described above.
3. In addition to above, AASB issues the following:
   - **a.** **Statements on Auditing:** These are issued with a view to securing compliance by professional accountants on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are, therefore, mandatory.

b. **General Clarifications:** These are issued by the Board under the authority of the Council of the Institute with a view to clarify any issues arising from the Standards. General Clarifications are mandatory in nature.

c. **Guidance Notes:** these are issued to assist professional accountants in implementing the Engagement Standards and the Standards on Quality Control issued by the AASB under the authority of the Council.

3. COMPANY AUDIT

PART 1: STATUTORY AUDIT

Q.NO.1 WHAT ARE THE QUALIFICATIONS TO BECOME COMPANY AUDITOR?

ANSWER:

A. QUALIFICATIONS OF COMPANY AUDITOR [Sec 141(1)]:

1. An Individual is eligible for appointment as an auditor only if he is a chartered accountant holding certificate of practice**.**
2. **A Firm / LLP whereof majority of partners practising in India are qualified for** appointment as aforesaid may be appointed by its firm name to be auditor of a company.

B. WHO SHALL SIGN [Sec. 141(2)]: If a firm / LLP is appointed as an auditor, Only the partners who are Chartered Accountants shall sign the audit report on behalf of the firm.

Q.NO.2 WRITE ABOUT THE DISQUALIFICATIONS OF A COMPANY'S AUDITOR? OR CASES WHERE A PERSON CANNOT BE APPOINTED AS AN AUDITOR OF A COMPANY?

ANSWER:

1. DISQUALIFICATIONS OF COMPANY AUDITOR [Sec 141(3)]:

The following persons are not eligible for appointment as an auditor of a company even though they possess chartered accountancy qualification:

- **a.** A Body corporate other than a limited liability partnership.
- **b.** An Officer or Employee of the company.
- **c.** A person who is a Partner, or who is in the Employment, of an officer or employee of the company;
- **d.** A person who, or his relative or partner -
  - **i)** Is holding any security or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company (Group companies). (Ref: Note No. – i, ii, iii)
  - **ii)** Is indebted to the company or the group companies in excess of ₹ 5,00,000. (Ref Note No. – iv)
  - **iii)** Has given a guarantee or provided any security on behalf of any third person to the Company or the group companies in excess of ₹ 1,00,000.

NOTE:

- **i)** The Limit of ₹ 1,00,000/- shall applies even for companies not having share capital.
- **ii)** The relative of the auditor may hold security or interest in the company for an amount Not exceeding a face value of ₹ 1,00,000.

iii) Also, it is to be observed that if the auditor is holding securities in **HIS** name this exception does not apply.

iv) If an auditor purchases goods on credit from the company of a value exceeding ₹ 5,00,000, he shall be indebted to the company. It is immaterial that the credit period allowed to the auditor is same as allowed to other customers in the ordinary course of business.

v) If an auditor recovers fees from the company on a progressive basis, even though the audit has not been completed, it is not treated as indebtness.

e. A person or a firm (including LLP) who or which has business relationship with the Company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company or subsidiary of associate company, whether directly or indirectly

Exceptions: The term "Business relationship" includes any transaction entered for commercial purpose **except** the following commercial transactions:

i) Professional services permitted to be rendered by an auditor or audit firm under the Companies Act, 2013 and the Chartered Accountants Act, 1949.

ii) Transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and any other similar businesses.

f. A person whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel. (KMP also known as officer)

g. A person who is in full time employment elsewhere. A person or partner of a firm holding appointment of more than 20 company audits as on the date of proposed appointment.

h. A person who has been convicted by a Court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.
Note: If such conviction is held by tribunal, then prohibition is only for 5 years.

i. Any person who directly or indirectly renders any services as specified in section 144 to the company, its holding company, or its subsidiary company.

2. SUBSEQUENT DISQUALIFICATION AFTER APPOINTMENT: [SEC. 141(4)]

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate immediately his office as auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

Note: However, If the relative of auditor is holding securities exceeding Face value ₹ 1,00,000 after being appointed as an auditor then corrective action shall be taken within 60 days of such acquisition. In this case immediate vacation does not apply as 60 days' time limit is provided. Further this Exception applies only in case of relative acquiring securities in their name and NOT in name of auditor.

Note: Definition of "RELATIVE": [sec 2(77)]: 'Relative' with reference to any person, means anyone who is related to another, if

1. They are members of a Hindu Undivided Family;
2. They are husband and wife;
3. One person is related to the other in the manner as given below:
   a. Father (including step- father)
   b. Mother (including step-mother),
   c. Brother (including step- brother),
   d. Sister (including step- sister),
   e. Son (including step- son),
   f. Son's wife,
   g. Daughter,
   h. Daughter's husband.

TEST YOUR KNOWLEDGE:

1. **Mr. A, a practicing Chartered Accountant, is holding securities of XYZ Ltd. having face value of ₹ 900. Whether Mr. A is qualified for appointment as an auditor of XYZ Ltd.?**

Answer:

Provision: As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

Conclusion: In the present case, Mr. A is holding security of ₹ 900 in XYZ Ltd. Therefore, he is not eligible for appointment as an auditor of XYZ Ltd

2. **Mr. P is a practicing Chartered Accountant and Mr. Q, the relative of Mr. P, is holding securities of ABC Ltd. having face value of ₹ 90,000. Whether Mr. P is qualified from being appointed as an auditor of ABC Ltd.?**

Answer:

Provision: As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

Conclusion: In the present case, Mr. Q. (relative of Mr. P), is having securities of ₹ 90,000 face value in ABC Ltd., which is as per requirement of proviso to section 141(3)(d)(i). Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

3. **M/s RM & Co. is an audit firm having partners CA. R and CA. M. The firm has been offered the appointment as an auditor of Enn Ltd. for the Financial Year 2016-17. Mr. Bee, the relative of CA. R, is holding 5,000 shares (face value of ₹ 10 each) in Enn Ltd. having market value of ₹ 1,50,000. One of the shareholder's, complains that the**

appointment of RM & Co. as an auditor is invalid because it incurred disqualification u/s 141 of the Companies Act, 2013. Analyse and advise.

Answer:

Provision: As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

Conclusion:

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA.M.

Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of ₹ 50,000 only (5,000 shares x ₹. 10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditor of Enn Ltd. as the relative of CA. R (i.e., partner of M/s RM & Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

4. **Mr. A, a chartered accountant, has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2016, which assignment he accepted. Subsequently in January, 2017 he joined Mr. B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.**

Answer:

Provisions and explanation: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company.

Subsection (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted subsection (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited in accordance with sub-section (4) of section 141.

5. **An auditor purchased goods worth ₹ 501,500 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers. Comment.**

Answer:

Purchase of Goods on Credit by the Auditor: Section 141(3)(d)(ii) of the Companies Act, 2013 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding 5 lakh rupees.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company.

It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

6. **Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2017-2018. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd. Comment.**

Answer:

Auditor Holding Securities of a Company: As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, the relative may hold security or interest in the company of face value not exceeding ₹ 1 lakh.
Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

Conclusion: In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary.

Q.NO.3 STATE THE SERVICES WHICH AN AUDITOR OF A COMPANY IS PROHIBITED TO RENDER TO THE CLIENT BEING AUDITED AS PER SEC 144 OF THE COMPANIES ACT 2013?

ANSWER:

As per Sec. 144, Prohibited services by auditors of the company to the company, holding company or subsidiary company:

1. Accounting and book keeping services.
2. Internal audit.
3. Design and implementation of any financial information system.

4. Actuarial services.
5. Investment advisory services.
6. Investment banking services.
7. Outsourced financial services.
8. Management services.
9. Any other kind of services as may be prescribed

Therefore, any person engaged in providing any of the above services then he cannot be appointed as auditor of the same company or group companies.

If at all the proposed auditor withdraws from rendering the above services then he can be appointed as an auditor after such withdrawal.

TEST YOUR KNOWLEDGE:

1. **CA. Poshin is providing the services of investment banking to C Ltd. Later on, he was also offered to be appointed as an auditor of the company for the current financial year. Advice.**

Answer:

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company. Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the investment banking service is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

2. **What are the prohibited services for auditor as per Companies Act, 2013?**

Answer: Write above answer fully

Q.NO.4 WRITE ABOUT CEILING ON NUMBER OF AUDITS THAT CAN BE ACCEPTED BY AN AUDITOR?

ANSWER:

1. A Chartered Accountant in practice cannot hold appointments as auditor for more than 20 companies at any time. [at the date of such appointment or reappointment]
2. In case of a partnership firm the limit of 20 shall be counted per partner in practice.
3. If a person acting as partner in multiple firms, then the limit will be counted only for one partnership and in the name of such partner only.
4. In other words, the limit of 20 shall be counted per person holding COP. Whether he is a sole proprietor or partner, in one or multiple firms.
5. **COMPANIES EXCLUDED FROM CEILING LIMIT:** For the purpose of computation of ceiling limits following companies are excluded:

a. One person companies,
b. Dormant companies,
c. Small companies, and
d. Private limited companies having a paid-up capital less than Rs.100 crores provided

6. The specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is 60 numbers.

TEST YOUR KNOWLEDGE:

1. "XYZ & Co." is an Audit Firm having partners "Mr. X", "Mr. Y" and "Mr. Z", Chartered Accountants. "Mr. X", "Mr. Y" and "Mr. Z" are holding appointment as an Auditor in 3, 5 and 9 Companies respectively.

(i) Provide the maximum number of Audits remaining in the name of "XYZ & Co."

(ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. X, Mr. Y and Mr. Z.

(iii) Can XYZ & Co. accept the appointment as an auditor in 55 private companies having paid- up share capital less than ₹ 100 crore, 3 small companies and 2 dormant company?

(iv) Would your answer be different, if out of those 55 private companies, 45 companies are having paid-up share capital of ₹ 105 crore each?

Answer:

Provisions and explanations:

As per Section 141(3)(g) of the Companies Act, 2013, a person or a partner of a firm shall not be eligible for appointment as the auditor of a company if –

(i) Such person is in full time employment elsewhere; or

(ii) Such person or partner is, at the date of such appointment or reappointment, holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid up capital less than Rs.100 crore.

Conclusion:

i) In the given case, the firm having three partners is eligible to an overall ceiling of 3 x 20 = 60 company audits. Since the three partners, in their individual capacity currently holds the position of a company auditor in (3 + 5 + 9) = 17 companies, the firm is eligible to be appointed as the auditor of remaining (60 - 17) = 43 companies.

ii) The partners in their individual capacity are eligible to the following maximum additional number of company audit assignments:
Mr. X = 20 – 3 = 17
Mr. Y = 20 – 5 = 15
Mr. Z = 20 – 9 = 11

iii) Since audit assignments in dormant companies, small companies and private companies having paid up capital less than 100 crore, are excluded from the above ceiling, the firm XYZ & Co.

can accept the appointment as an auditor in 55 private companies having paid- up share capital less than ₹ 100 crore, 3 small companies and 2 dormant company.

iv) If 45 companies out of the 55 companies are having paid-up share capital of ₹ 105 crore each, the firm will be eligible to accept the appointment in only 43 such companies.

2. KBC & Co. a firm of chartered accountants has three partners, K, B & C; K is also in whole time employment elsewhere and Mr. B & Mr. C do not hold any audit in their personal capacity or as a partner of other firms. The firm is offered the audit of ABC ltd. and is already holding audit of 41 companies.

Answer:

Provisions: As per Section 141(3)(g) of the Companies Act, 2013, a person or a partner of a firm shall not be eligible for appointment as the auditor of a company if –

(i) Such person is in full time employment elsewhere; or

(ii) Such person or partner is, at the date of such appointment or reappointment, holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid up capital less than Rs.100 crore.

Analysis: In the firm of KBC & Co., K is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits,

Conclusion: Therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

Q.NO.5 EXPLAIN THE PROVISIONS RELATING TO AUDIT COMMITTEE AND SELECTION PROCESS OF THE COMPANY AUDITOR?

ANSWER:

A. APPLICABILITY OF AUDIT COMMITTEE:

The Following classes of companies shall constitute an Audit Committee -

a. Listed companies

b. All public companies

- With a paid-up capital of **₹ 10** crore or more;
- With turnover of **₹ 100** crore or more;
- With aggregate outstanding loans or borrowings or debentures or deposits, **₹ 50** crore or more.

Explanation: The above limits shall be taken as on **preceding audited balance sheet date**.

B. MANNER AND PROCEDURE OF SELECTION AND APPOINTMENT OF AUDITORS: 139(11)

Following is the manner and procedure of selection & appointment of auditors-

1. If the audit committee is constituted then they shall select the auditor (Including a case of casual vacancy) on appropriate basis and recommend to the BOD. If No audit committee is constituted then BOD shall select the auditor on an appropriate basis.
2. The BOD may agree with the proposed auditor recommended by audit committee and shall recommend the same to members at AGM.
3. If BOD disagrees with the recommendation made by audit committee, then it shall refer back to audit committee for the further revision citing reasons for reconsideration.
4. If the audit committee after considering the revision appeal made by BOD, decided not to change their recommendation then they can inform the same to the BOD.
5. Nevertheless, the BOD can finally recommend to the members the proposed auditor selected by them and fact that they disagree with the audit committee's selection and reasons thereof.
6. Finally, the members may take an appropriate action regarding the appointment of auditor.

C. COMPOSITION OF AUDIT COMMITTEE:

1. The audit Committee shall consist of minimum of three directors, Majority must be independent directors.
2. All the members of audit committee shall be able to read and understand the financial statements.

D. FUNCTIONS OF AUDIT COMMITTEE

1. The recommendation for appointment, remuneration and terms of appointment of auditors of the company;
2. Review and monitor the auditor's independence and performance, and effectiveness of audit process.
3. Examination of the financial statement and the auditors' report thereon.
4. Approval or any subsequent modification of transactions of the company with related parties.
5. Scrutiny of inter-corporate loans and investments.
6. Valuation of undertakings or assets of the company, wherever it is necessary.
7. Evaluation of internal financial controls and risk management systems.
8. Monitoring the end use of funds raised through public offers and related matters.

Note: The audit committee or Board of Directors, will take into account the size and requirements of the company, will select the auditor having such experience and qualifications that commensurate with the company size and complexities.

Q.NO.6 EXPLAIN THE PROVISIONS RELATED TO APPOINTMENT OF AUDITOR OF A COMPANY?

ANSWER:

Section 139 of the Companies Act, 2013 contains provisions regarding Appointment of Auditors. The section divides the appointment into two parts:

A. Appointment of First Auditors.

B. Appointment of Subsequent Auditors.

Further the appointment procedure is separately dealt for Government Company and Non-Government Company.

A. APPOINTMENT OF FIRST AUDITOR:

1. IN CASE OF NON-GOVERNMENT COMPANY: [SEC. 139(6)]

- **a.** The first auditor of Non-government Company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.
- **b.** If the Board fails to appoint, it shall inform the members of the company and the members shall appoint the auditor within 90 days at an extraordinary general meeting.
- **c.** Appointed auditor shall hold office till the conclusion of the first annual general meeting.

2. IN CASE OF A GOVERNMENT COMPANY: [SEC. 139(7)]

- **a.** The first auditor shall be appointed by the Comptroller and Auditor-General of India (CAG) within 60 days from the date of registration of the company.
- **b.** If CAG fails to appoint the auditor then the Board of directors shall appoint within next 30 days.
- **c.** If BOD also fails then they shall inform the members who shall appoint such auditor within 60 days at an extraordinary general meeting.
- **d.** The Auditors appointed as above shall hold office till the conclusion of the first annual general meeting.

B. APPOINTMENT OF SUBSEQUENT AUDITORS:

1. IN CASE OF NON-GOVERNMENT COMPANIES: [SEC. 139(1)]

- **a.** Every company shall at the Annual General Meeting appoint an individual or a firm as an auditor and the appointed auditor shall hold office from the conclusion of that AGM till the conclusion of its sixth AGM and thereafter till the conclusion of every sixth meeting.
- **b.** The following certificates shall be obtained from the proposed auditor:
  - Before such appointment is made, the written consent of the auditor to such appointment shall be obtained.
  - the appointment, if made, shall be in accordance with the conditions as prescribed
  - The certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141
- **c.** The company shall inform the auditor concerned of his appointment and shall file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed. (Form ADT – 1)

2. IN CASE OF GOVERNMENT COMPANIES: [SEC. 139(5)]

- **a.** The Comptroller and Auditor-General of India (CAG) shall appoint a chartered accountant in practice within a period of 180 days from the commencement of the financial year.

b. The auditor appointed as above shall hold office till the conclusion of the next annual general meeting.

Note: Where at any AGM, NO auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. **[Sec. 139(10)].** Practically this case is not possible as appointment and reappointment are ordinary businesses in an AGM which cannot be ignored.

C. DEFINITION OF GOVERNMENT COMPANY:

A "Government company" is a company:

a. In which not less than 51% of the paid-up share capital is held by the Central or any State Government or Governments or partly by the Central and partly by one or more State Governments and

b. Includes a company which is a subsidiary company of such a government company.

TEST YOUR KNOWLEDGE:

1. Managing Director of Pigeon Ltd. himself wants to appoint CA. Champ, a practicing Chartered Accountant, as first auditor of the company.

Answer:

Provisions and explanation: Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the instant case, the proposed appointment of CA. Champ, a practicing Chartered Accountant, as first auditor by the Managing Director of Pigeon Ltd. by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company.

Conclusion: In view of the above, the Managing Director of Pigeon Ltd. should be advised not to appoint the first auditor of the company.

2. The first auditor of Bhartiya petrol Ltd. a government company was appointed by the board of directors. Analyse and explain.

Answer:

Provisions and explanation: In the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. Hence, in the case of Bhartiya Petrol Ltd., being a government company, the first auditor shall be appointed by the Comptroller and Auditor General of India.

Conclusion: Thus, the appointment of first auditor made by the Board of Directors of Bhartiya Petrol Ltd., is null and void.

3. **Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.**

Answer:

Provision: Section 139(6) of the Companies Act, 2013 lays down that the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company.

Analysis and conclusion: In the instant case, the appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd. by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within 30 days of registration of the company.

In view of the above, the Managing Director of PQR Ltd. should be advised not to appoint the first auditor of the company.

Q.NO.7 EXPLAIN THE PROVISIONS TO FILL THE CASUAL VACANCY ARISES IN THE OFFICE OF AN AUDITOR?

ANSWER:

As per **Section 139(8),** any casual vacancy in the office of an auditor shall-

A. NON-GOVERNMENT COMPANY:

1. **Other than Resignation:** Shall be filled by the Board of Directors, on recommendation of audit committee, within 30 days.
2. **Resignation:** The appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

B. GOVERNMENT COMPANY:

a. It shall be filled by the CAG within 30 days.
b. In case if the CAG does not fill the vacancy within 30 days then the Board of Directors shall fill the vacancy within next 30 days.

C. PERIOD OF APPOINTMENT:

The Auditor appointed under casual vacancy shall hold the office until conclusion of Next AGM.

MEANING OF CASUAL VACANCY: If vacancy arises in the auditor's office on account of any reason other than expiry of term. In other words, concept of casual vacancy arises only before expiry of term of appointment of auditor.

TEST YOUR KNOWLEDGE:

1. **At the AGM of HDB Pvt Ltd., Mr. R was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to pursue his career in banking sector. The Board of Director has appointed Mr. L as the statutory auditor in board meeting within 30 days. Comment on the matter with reference to the provisions of Companies Act, 2013.**

Answer:

Provision: In the case of a non government company, the casual vacancy by reason of resignation shall be filled by the Board of Directors, on recommendation of audit committee, within 30 days. The appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

Analysis and conclusion: In the given case, Mr. R resigned from the company. So it is a casual vacancy is caused by reason of resignation. The Board of directors of the company appointed Mr. L as statutory auditor within 30 days. Since the shareholders approval is not obtained, the appointment is invalid.

Q.NO.8 EXPLAIN THE DUTIES OF AN AUDITOR IN CASE OF RESIGNATION?

ANSWER:

1. As per **section 140(2),** the auditor who has resigned from the company shall file a form with the company and the Registrar in ADT-3 within a period of 30 days from the date of resignation.
2. Further in case of Government Company, He shall also inform the same to CAG.
3. The statement shall indicate the reasons and other facts as may be relevant with regard to his resignation.
4. As per Sec. 140(3), in case of failure to comply with the above provisions, the auditor shall be liable with a fine not less than Rs.50,000 or Remuneration, whichever is lower and in case of continuing failure, Rs**.500 per day for** after the first failure. Also, the fine levied is subject to maximum of Rs. 2,00,000/-.

Q.NO.9 EXPLAIN THE PROVISIONS RELATING TO ROTATION OF AN AUDITOR?

ANSWER:

A. APPLICABILITY OF ROTATION OF AUDITORS: [Sec. 139(2)]

1. All Listed Companies.
2. All Unlisted Public Limited Companies:
   a. With paid up share capital of rupees 10 crore or more.
   b. With borrowings from PFI's or Banks or Public Deposits of 50 crore or more.
3. All Private Limited Companies:
   a. With paid up share capital of rupees 50 crore or more.
   b. With borrowings from PFI's or Banks or Public Deposits of 50 crore or more.

Note: This provision shall not apply to One Person Company and Small Companies. Also, Rotation shall not apply for Government companies.

B. MANNER OF ROTATION:

1. Every company to which the concept of rotation is applicable, shall not appoint or re-appoint-
   a. An Individual as auditor for more than ONE term of five consecutive years; and
   b. A Firm of auditors for more than TWO terms of five consecutive years.

   Note: CONSECUTIVE YEARS shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.
2. An individual auditor or an audit firm who or which has completed their respective term namely 5 years or 10 years (AKA retiring auditors) as the case may be, shall not be eligible for re-appointment as auditor in the same company for a period of five years from the completion of their respective term (AKA Break in service or Cooling period).
3. For the sake of convenience Retiring auditor is referred as outgoing auditor. New auditor is referred as Incoming auditor.
4. If there is a common partner(s) in incoming and outgoing auditor's firm, then such incoming auditor is not eligible for appointment under rotation for a period of 5 years.
5. Also, if the incoming auditor and outgoing auditor belong to "Same Network", then also such incoming auditor shall not be eligible for appointment.
6. The term "same network" includes the firms operating or functioning under the same brand name, trade name or common control.
7. If a partner who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Note: Subject to the provisions of this Act, members of the company may resolve that-

a. In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members. (AKA Internal Rotation) or
b. The audit shall be conducted by more than one auditor (Joint Audit).

Note: For computing number of years for the purpose of rotation, the period of appointment before commencement of this act shall also be considered i.e., auditor's period under company's act, 1956 shall also be computed for calculating 1 term of 5 years or 2 terms of 5 years.

TEST YOUR KNOWLEDGE:

1. **The Board of Directors of Moon Light Limited, a listed company appointed Mr. Tel, Chartered Accountant as its first auditor within 30 days of the date of registration of the Company to hold office from the date of incorporation to conclusion of the first Annual General Meeting (AGM). At the first AGM, Mr. Tel was re-appointed to hold office from the conclusion of its first AGM till the conclusion of 6th AGM. In the light of the provisions of the Companies Act, 2013, examine the validity of appointment/ reappointment in the following cases:**

i. **Appointment of Mr. Tel by the Board of Directors.**
ii. **Re-appointment of Mr. Tel at the first AGM in the above situation.**
iii. **In case Mr. Bell, Chartered Accountant, was appointed as auditor at the first AGM to hold office from the conclusion of its first AGM till the conclusion of 5th AGM. i.e.., 4 years tenure.**

Answer:

Provision : As per section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and such auditor shall hold office till the conclusion of the first annual general meeting.

Whereas Section 139(1) of the Companies Act, 2013 states that every company shall, at the first annual general meeting (AGM), appoint an individual or a firm as an auditor of the company who shall hold office from the conclusion of 1st AGM till the conclusion of its 6th AGM and thereafter till the conclusion of every sixth AGM.

As per section 139(2), no listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years.

Analysis and conclusion :

i. Appointment of Mr. Tel by the Board of Directors is valid as per the provisions of section 139(6).

ii. Appointment of Mr. Tel at the first Annual General Meeting is valid due to the fact that the appointment of the first auditor made by the Board of Directors is a separate appointment and the period of such appointment is not to be considered, while Mr. Tel is appointed in the first Annual General Meeting, which is for the period from the conclusion of the first Annual General Meeting to the conclusion of the sixth Annual General Meeting.

iii. As per law, auditor appointed shall hold office from the conclusion of 1st AGM till the conclusion of its 6th AGM i.e., for 5 years. Accordingly, here appointment of Mr. Bell, which is for 4 years, is not in compliance with the said legal provision, so his appointment is not valid.

Q.NO.10 BRIEFLY EXPLAIN THE PROVISIONS RELATING TO REMOVAL OF AUDITOR OF A COMPANY BEFORE EXPIRY OF HIS TERM?

ANSWER:

PROCEDURE FOR REMOVAL OF AUDITOR BEFORE EXPIRY OF TERM:

1. A BOD resolution shall be passed to remove the auditor before expiry of term.
2. An application to the Central Government for removal of auditor shall be made in Form ADT-2 within 30 days of board resolution.

3. The company shall hold the general meeting within 60 days upon receipt of approval from the Central Government for passing the special resolution.
4. Convene the General Meeting and pass the special resolution removing the auditor.

Note: An opportunity of being heard shall be given to the auditor before removing him.

As you would notice, the provisions of removal of auditor before expiry of his term are also meant to safeguard auditor's independence by imposing strict conditions like prior approval of Central government.

TEST YOUR KNOWLEDGE:

1. **Board of Directors of "XYZ Ltd" found the auditor of the company acted in a fraudulent manner, and decided to remove the auditors in board meeting. Comment on the action of BOD and describe correct procedure to be followed for removal of auditors before expiry of their term.**

Answer: Write the above answer

Q.NO.11 EXPLAIN THE PROCEDURE FOR REMOVAL OF AUDITOR BY TRIBUNAL U/S 140(5)?

ANSWER:

1. **APPLICATION BY WHOM:**
   a. The Tribunal on its own
   b. The Central Government
   c. Any person concerned
2. **APPLICATION TO WHOM:** The tribunal.
3. **PROCEDURE FOR REMOVAL:**
   a. If the tribunal is satisfied that the auditor of a company has acted in a fraudulent manner or colluded in any fraud with directors or officers of the company then it may direct the company to change its auditors.
   b. If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall make an order that he shall not function as an auditor within 15 days of receipt of such application and the Central Government may appoint another auditor in his place.
4. **PROHIBITION ON FURTHER APPOINTMENTS:** An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible for appointment as an auditor of ANY company for a period of 5 years from the date of passing of the order.

   Note: If the conviction is by court, then the prohibition shall be 10 years.

Q.NO.12 EXPLAIN THE PROVISIONS RELATING TO AUDITOR'S REMUNERATION U/S 142 OF COMPANIES ACT, 2013.

ANSWER:

1. As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.
2. Board may fix remuneration of the first auditor appointed by it.
3. The remuneration, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him.
4. The remuneration does not include any remuneration paid to him for any other service rendered by him at the request of the company.
5. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

Q.NO.13 WHAT ARE THE POWERS OF AN AUDITOR AS PER SEC. 143(1)?

ANSWER:

The auditor has the following powers/rights while conducting an audit:

A. RIGHT OF ACCESS TO BOOKS:

1. The auditor of a company shall have a right of access to the books of account and vouchers of the company at all times, whether kept at the registered office of the company or at any other place including branches.
2. Further this right can be exercised during working days and business hours.
3. Right to access to books of accounts of subsidiary company and associate companies in so far as they related to consolidated financial statements.
4. Right to access to other records namely minutes of board meeting, MIS reports and any other books as may require by the auditor.
5. Books of accounts includes statutory books like inventory books, costing records

B. RIGHT TO OBTAIN INFORMATION AND EXPLANATION:

1. The auditor has right to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor. [This is a wide and important power]
2. The information and explanation can be obtained from either officers or employees of the company.

C. RIGHT TO RECEIVE NOTICES AND DUTY TO ATTEND GENERAL MEETING (Sec. 146):

1. The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); to receive all the notices to the general meetings, which members are entitled to receive.
2. Further it is the duty of the auditor to attend the general meeting as per sec. 146.

3. So, it can be concluded that it is <u>both right and duty to attend the general meetings</u>.

Note: However, he can with the <u>prior approval of BOD can skip general meetings</u>.

D. RIGHT TO BE INDEMNIFIED:

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

<u>TEST YOUR KNOWLEDGE:</u>

1. **M/s Seeman & Co. had been the company auditor for Amudhan Company limited for the year 2015-16. The company had three branches located at Chennai, Delhi and Mumbai. The audits of branches-Chennai, Delhi were looked after by the company auditors themselves. The audit of Mumbai branch had been done by another auditor M/s Vasan & co.; a local auditor situated at Mumbai. The branch auditor had completed the audit and had given his report too. After this, but before finalization, the company auditor wanted to visit the Mumbai branch and have access to the inventory records maintained at the branch. The management objects to this on the grounds of the company auditor is transgressing the scope of audit areas agreed. Comment.**

<u>Answer:</u>

Provision: The audit of the branch of a company is dealt with in Section 143(8) of the Companies Act, 2013. According to this section, the audits of the branches can be done by the company auditor himself or by another auditor. Even where, the branch accounts are audited, the company auditor has right to visit the branch if he deems it necessary to do so for the performance of his duties as auditor.

He has also right of access at all times to the books and accounts and vouchers of the company maintained at the branch office. He can appropriately deal with the repot of the branch auditor in framing his main repot. He will disclose how he had dealt with the branch audit report.

Analysis: In this case, the audits of two branches were done by the company auditor and one branch was done by a separate branch auditor.

Applying the above provisions, to the instant case, management's objection that the company auditor is transgressing the scope of audit areas agreed, is absolutely, wrong. The right of company auditor in visiting and accessing the records of branch cannot be forfeited.

Conclusion: Even where the branch accounts are audited by another local auditor, the company auditor has right to visit the branch and can have access to the books and vouchers of the company maintained at the branch office.

Q.NO.14 WHAT ARE THE DUTIES OF THE AUDITOR REGARDING THE REPORTING ON FRAUD IDENTIFIED BY THE AUDITOR IN ACCORDANCE WITH SEC. 143(12)?

ANSWER:

According to section 143(12) and Rule 13 of the Companies (Audit and Auditors) Rules, 2014, the following are the duties of auditor in relation to any fraud identified during the course of his audit:

A. IF THE AMOUNT OF FRAUD IS ₹ 1 CRORE OR MORE:

1. **Reporting to the Central Government:** If the auditor has reason to believe that an offence of fraud involving an amount of ₹ 1 crore or above, is being or has been committed in the company ***by its officers or employees***, the auditor shall report the matter to the CG in the following manner.

2. **The manner of reporting the matter to the Central Government is as follows: [Rule 13]**
   - **i)** First, the auditor shall report the matter to the Board or the Audit Committee, as the case may be, within 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days.
   - **ii)** On receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments on such reply or observations to the CG within 15 days from the date of receipt of such reply or observations.
   - **iii)** In case the auditor fails to get any reply or observations within the stipulated period of 45 days, he shall forward his report to the CG along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
   - **iv)** The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
   - **v)** The report shall be in the form of a statement as specified in Form ADT-4**.**

B. IF THE AMOUNT OF FRAUD IS LESS THAN ₹ 1 CRORE:

a. **Reporting to the Audit Committee or Board:** If the auditor has reason to believe that an offence of fraud involving an amount of less than ₹ 1 Crore, is being or has been committed in the company ***by its officers or employees***, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases, within 2 days of knowledge of fraud, specifying the following:
   - **i)** Nature of Fraud with description;
   - **ii)** Approximate amount involved; and
   - **iii)** Parties involved.

b. **Disclosure in the Board's Report:** The following details of each of the fraud reported to the Audit committee or the Board but not reported to CG, shall be disclosed in board's report:

1. Nature of Fraud with description;
2. Approximate Amount involved;
3. Parties involved, and
4. Remedial actions taken.

C. APPLICBILITY TO COST AUDITOR AND SECRETARIAL AUDITORS:

The provisions regarding fraud reporting shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.

D. PUNISHMENT FOR NONCOMPLIANCES:

If any auditor, Cost Accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall:

1. In case of a listed company, be liable to a penalty of 5 lakh rupees; and
2. In case of any other company, be liable to a penalty of 1 lakh rupees.

Besides, auditor has also to report matters pertaining to fraud at point (xi) of paragraph 3 of CARO,2020 which is discussed subsequently.

TEST YOUR KNOWLEDGE:

1. **Mr. A is appointed as Statutory auditor of a company for the financial year ended 31st March 2018.During the course of Audit it was found that few doubtful transactions had been committed by Finance manager who retired in March 2018.The Fraud was going on Since last 2-3 years and the total amount misappropriated exceeding ₹ 100 lakhs. As a statutory auditor. What would be reporting responsibilities of Mr. A?**

Answer: Write point A from the above question

2. **The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. Here, the auditor of the company is required to report the fraudulent activity. Explain the reporting requirements of the auditor in this regard.**

Answer: Write point B from the above question

Q.NO.15 EXPLAIN THE DUTIES OF THE AUDITOR TO INQUIRE UNDER SEC 143(1)?

ANSWER:

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

a. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
b. whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

c. In case of a company other than an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

d. whether loans and advances made by the company have been shown as deposits;

e. whether personal expenses have been charged to revenue account;

f. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

Q.NO.16 EXPLAIN THE DUTIES OF THE AUDITOR TO INCLUDE CERTAIN MATTERS IN THE AUDIT REPORT AS PER SEC 143(3)?

ANSWER:

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

a. Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

b. Whether, in his opinion, proper books of account as required by the law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

c. Whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing are in agreement with the books of account and returns his report.

d. Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.

e. Whether, in his opinion, the financial statements comply with the accounting standards.

f. The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

g. Whether any director is disqualified from being appointed as a director under subsection (2) of Section 164.

h. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

i. Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

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

- **i)** whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- **ii)** whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- **iii)** whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company;

- whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities **("Intermediaries")**, with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company **("Ultimate Beneficiaries")** or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.
- whether the management has represented, that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities **("Funding Parties")**, with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party **("Ultimate Beneficiaries")** or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
- based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (1) and (2) contain any material mis-statement.

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

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

Q.NO.17 EXPLAIN THE DUTIES OF THE AUDITOR UNDER COMPANIES ACT, 2013?

ANSWER:

A. DUTY TO INQUIRE U/S 143(1): Refer Q.NO.15

B. DUTY TO REPORT ON FINANCIAL STATEMENTS OF THE COMPANY:

1. As per Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him and financial statements after taking into account
   - the provisions of this Act (Companies Act)
   - the accounting and
   - auditing standards etc.
2. Additionally, he has also to report whether in his opinion and according to the best of his information and knowledge, the said accounts, financial statements give a true and fair view

of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

C. **DUTY REGARDING INCLUSION OF CERTAIN MATTERS IN THE AUDIT REPORT AS PER U/S 143(3):** Refer Q.NO.16

D. **DUTY TO COMPLY WITH AUDITING STANDARDS:** Section 143(9) provides that it is the duty of every company auditor to comply with the applicable auditing standards in conduct of his audit.

E. **DUTY TO REPORT ANY FRAUD TO THE CENTRAL GOVERNMENT:** Refer Q.NO.14

F. **DUTY TO MAKE COMMENTS SOUGHT BY THE AUDIT COMMITTEE ON CERTAIN MATTERS:** According to Section 177(5), it is the duty of the company auditor to offer comments on internal control systems, the scope of audit, including the observations of the auditors and review of financial statement, if asked by the Audit Committee.

Q.NO.18 EXPLAIN THE PENALTY FOR NON-COMPLIANCE U/S 147 OF COMPANIES ACT, 2013.

ANSWER:

PUNISHMENT FOR NON-COMPLIANCE WITH SECTIONS 139, 144 AND 145 OF THE ACT: If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine:

A. **UN-INTENTIONAL CONTRAVENTION:** Penalty of Not be less than:
   - **a.** Rs.25,000/- but which may extend to Rs.5,00,000/- or
   - **b.** **4 times** the remuneration of the auditor, **whichever is less.**

B. **INTENTIONAL CONTRAVENTION:** If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with:
   - **a.** Imprisonment for a term which may extend to 1 YEAR and
   - **b.** With fine which:
     - **i)** Shall not be less than ₹50,000/- but which may extend to ₹25,00,000/- or
     - **ii)** **8 times** the remuneration of the auditor, **whichever is less.**

C. **REFUND REMUNERATION AND PAY DAMAGES:** Where an auditor has been convicted under sub-section (2), he shall be liable to-
   - **a.** Refund the remuneration received by him to the company;
   - **b.** Pay for damages to the company statutory bodies or authorities or to members or creditors of the company for loss arising out of incorrect or misleading statements of particulars made in his audit report.

D. LIABILITY IN CASE OF AUDIT FIRM: Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

E. CRIMINAL LIABILITY – CONCERNED PARTNER ONLY: It may be noted that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner(s), who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

Q.NO.19 WRITE ABOUT AUDIT OF BRANCH OFFICE ACCOUNTS?

ANSWER:

A. MAINTANANCE OF BRANCH ACCOUNTS:

1. Section 128(1) of the Companies Act, 2013 provides that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statements for every financial year, including that of its branch office or offices, on accrual basis and according to the double entry system of accounting.
2. The Board of Directors may, however, decide to keep all or any of the aforesaid books of account and other relevant papers at such other place in India.
3. In such circumstances, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place.
4. Where a company has a branch office in India or outside India, proper books of account relating to the transactions at the branch office can be kept at that office and proper summarised returns periodically shall be sent by the branch office to the company at its registered office

B. WHO CAN BE APPOINTED AS A BRANCH AUDITOR: Where a company has a branch office, the accounts of that office shall be audited either by:

1. The auditor appointed for the company (i.e., Principal auditor) or
2. Any chartered accountant holding certificate of practice, or
3. Where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

C. WHO CAN APPOINT BRANCH AUDITORS:

1. Usually, the branch auditors are also appointed by the members
2. However, the shareholders can delegate such power to BOD to appoint branch auditor.

D. REPORTING REQUIREMENTS OF BRANCH AUDITORS:

1. The branch auditor shall prepare a report on the accounts of the branch examined by him.

2. The branch auditor shall submit his report to the company's auditor.
3. The reporting requirements u/s 143(1), (3), (11) and (12) are equally applicable to branch auditors.

Q.NO.20 WRITE ABOUT JOINTAUDIT OF FINANCIAL STATEMENTS?

ANSWER:

A. **MEANING:** Joint audit refers to the process of conducting the audit of a single organisation by more than one auditor. Large Companies with diversified business operations often resort to this process of auditing where they employ multiple auditors to conduct statutory audit.

B. BENEFITS/ADVANTAGES OF JOINT AUDIT:

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

C. LIMITATIONS/DISADVANTAGES OF JOINT AUDIT:

1. Well experienced auditors may have a superiority complex over the less experienced one.
2. It is not suitable for a small entity due to increased costs.
3. Lack of coordination among the auditors may slow down the speed of work.
4. There may be uncertainty about the liability of any work.
5. Areas of common concern may be neglected.
6. The auditors have to share the fees.

D. DIVISION OF WORK:

1. Where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves.
2. Generally, work will be divided on the following basis:
   a. Items of assets, liabilities, incomes and expenditure
   b. Geographical areas
   c. Period of financial statements
   d. Identified units
3. The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

E. RELATIONSHIP AMONG JOINT AUDITORS AND THEIR RESPONSIBILITY:

1. In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him.
2. However, in some cases, all the joint auditors are jointly and severally responsible:
   a. In respect of audit work not divided among themselves
   b. In respect of decisions taken by all the joint auditors
   c. In respect of matters brought to the notice of all joint auditors
   d. Presentation and disclosure of the financial statements as required by the applicable financial reporting framework.
   e. For ensuring that the audit report complies with relevant statute.

F. REPORTING RESPONSIBILITIES:

1. Generally, all the joint auditors arrives common conclusions and express common opinion through a single audit report.
2. However, any joint auditor is not bound by majority's opinion.
3. If there is a difference of opinion among joint auditors, then such disagreeing auditor can express his own opinion by a separate report.
4. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit reports

G. DEPENDENCE ON OTHER JOINT AUDITORS:

1. Each joint auditor is entitled to rely upon the other joint auditors for bringing to his notice any material error noticed in the course of the audit.
2. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.

PART 2 : COST AUDIT

Q.NO.21 DEFINE COST AUDIT. WRITE ABOUT APPLICABILITY OF COST RECORDS AND COST AUDIT AS PER COMPANIES ACT 2013.

ANSWER:

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

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

B. APPLICABILTY OF COST RECORDS:

1. **APPLICABILITY:** Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides that the following conditions for companies (including foreign companies) which are required to maintain cost records,
   a. Company must be engaged in the <u>production</u> of goods or <u>providing services</u>, and
   b. It must be having an overall turnover from all its products and services of **₹** <u>35 crore or more</u> during the immediately preceding financial year.

   Exceptions: Companies classified as a Micro enterprise or a small enterprise under Micro, Small and Medium Enterprises Development Act, 2006 are not required are to maintain cost records even it satisfies the above limits.

2. **CLASSIFICATION OF COMPANIES FOR THE PURPOSE OF APPLICABILITY OF THE RULES:** The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/ industry/ sector/ product/ service prescribed under the said rule are given below:

   a. **Regulated Sector**
      - Telecommunication services
      - Petroleum products
      - Drugs and pharmaceuticals
      - Fertilisers
      - Sugar and industrial alcohol
      - Generation, transmission, distribution and supply of electricity

   b. **Unregulated Sector**
      - Machinery and mechanical appliances used in defence, space
      - Turbo jets and turbo propellers

- Arms and ammunitions and Explosives
- Iron and Steel
- Coffee and tea etc.,

3. **PRESCRIBED FORM FOR MAINTENANCE OF COST RECORDS:**
   a. As per Rule 5 of the companies (Cost Records and Audit) Rules, cost records shall be maintained in Form CRA - 1.
   b. The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

C. APPLICABILITY OF COST AUDIT u/s 148: Rule 4 of the companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of the cost audit. The applicability of Cost Audit to a company depends upon certain Turnover criteria as follows

1. **For Companies specified under "Regulated Sectors":**
   a. The overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more **and**
   b. The aggregate turnover of the individual product(s) or service(s) covered in the sector is ₹ 25 crore or more.

2. **For Companies specified under "Non-Regulated Sectors"**:
   a. The overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and
   b. The aggregate turnover of the individual product(s) or service(s) covered in the sector is ₹ 35 crore or more.

3. **Non - applicability of cost audit:** Sub - rule (3) of Rule 4 provides that the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3.
   a. Whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue (or)
   b. Which is operating from a special economic zone. (or)
   c. A company which is engaged in generation of electricity for captive consumption.

TEST YOUR KNOWLEDGE:

1. **Discuss the purpose of cost audit. What are the legal provisions regarding applicability of cost audit?**

Answer: Write point A and C from above answer

2. ***Shine Industries is an electricity generating company engaged in generation of electricity for captive consumption. Its gross turnover was ₹ 68 crores during the immediately***

preceding financial year. Management of shine industries has not maintained any cost records as they felt that there is no requirement for them to maintain any cost records or conduct any cost audit. Comment.

Answer:

Applicability for Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006. The said rule has divided the list of companies into (A) Regulated sectors and (B) Non-regulated sectors. Cost Audit Rules Not to Apply in Certain Cases:

The requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or

(ii) which is operating from a special economic zone.

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

Conclusion: Since Shine Industries is having an overall turnover of exceeding ₹ 35 crore during the immediately preceding financial year, therefore, it is required to include cost records in its books of account but is not required to get its accounts audited because Cost Audit Rules are not applicable on Companies engaged in generation of electricity for captive consumption.

Q.NO.22 WRITE ABOUT APPOINTMENT, QUALIFICATIONS AND REMOVAL OF COST AUDITOR?

ANSWER:

A. **WHO CAN BE APPOINTED AS A COST AUDITOR**: The Cost audit shall be conducted by a Cost Accountant in practice Provided that person appointed under section 139 as an auditor of the company shall not be appointed as its cost auditor.

B. **DISQUALIFICATION:** Persons disqualified u/s 141(3) shall not be appointed as the cost auditor of a company (same as company auditor).

C. **WHO CAN APPOINT COST AUDITOR:** The cost auditor shall be appointed by Board of Directors within 180 days of the commencement of every financial year. However, if there is Audit committee in the company, then the appointment can be made after considering the recommendation of audit committee.

Provided that before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate regarding the following matters shall be obtained

1. the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act,
2. the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;
3. the proposed appointment is within the limits laid down by or under the authority of the Act; and
4. the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct.

D. **COMMUNICATION WITH CG:** Every referred company shall file a notice of such appointment with the central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2.

E. **REMUNERATION OF COST AUDITOR:** The remuneration of the cost auditor shall be decided by the Board as recommended by the Audit Committee, if any, which shall be ratified by the shareholders subsequently.

F. **RIGHTS, DUTIES AND OBLIGATIONS OF COST AUDITOR:** Similar to the company auditor appointed under section 139.

G. **TENURE OF COST AUDITOR:** The cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year, or till he submits the cost audit report, for the financial year for which he has been appointed.

H. **REMOVAL OF COST AUDITOR:** The cost Auditor may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the cost auditor and recording the reasons for such removal in writing.

I. **CASUAL VACANCY IN THE OFFICE OF COST AUDITOR:** Any casual vacancy in the office of a cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the CG in Form CRA-2 within 30days of such appointment of cost auditor.

TEST YOUR KNOWLEDGE:

1. **Mr. P, the cost auditor of ABC Ltd. who was appointed for financial year 2020-21, has resigned due to some personal reasons. As per the provisions of Companies Act, 2013, the company is required to constitute an audit committee. ABC Ltd. has asked for your opinion as a legal expert regarding the process of filling up the vacancy created. Advise ABC Ltd. on the required course of action.**

Answer:

Rule 6 of the Companies (Cost Records and Audit) Rules 2014 states that any casual vacancy in the office of a cost auditor, whether due to resignation, death, or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within 30 days of such appointment of cost auditor.

In the given case the vacancy arising out of the resignation of the cost auditor is a casual vacancy. Hence, the BOD, after recommendation from the audit committee so existing, shall appoint the cost auditor within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within 30 days of such appointment of cost auditor.

Q.NO.23 WRITE RELEVEANT PROVISIONS OF THE COMPANIES ACT REGARDING COST AUDIT REPORT. / WRITE ABOUT SUBMISSION OF COST AUDIT REPORT.

ANSWER:

PROCEDURE FOR SUBMISSION OF COST AUDIT REPORT:

1. **COST AUDITOR TO BOD:** The cost auditor shall submit the cost audit report along with his reservations or qualifications, if any, in **Form CRA-3** to the BOD within a period of 180 days from the closure of the financial year.

2. **REPORTING REQUIREMENTS OF COST AUDIT AS PER CRA-3:** As per Companies (Cost Records and Audit) Rules 2014 as amended up to date, a cost auditor needs to report the following in CRA-3.
   - **a.** Whether he has obtained all the information and explanations, which to the best of his knowledge and belief were necessary for the purpose of the audit.
   - **b.** Whether in his opinion, proper cost records, as per rule 5 of the Companies (Cost Records and Audit) Rules, 2014 have been maintained by the company.
   - **c.** Whether in his opinion, proper returns adequate for the purpose of the cost audit have been received from the branches not visited by him.
   - **d.** Whether in his opinion, and to the best of his information, the said books and records give the information required by the Companies Act, 2013, in the manner so required.
   - **e.** Whether in his opinion, the company has adequate system of internal audit of cost records which to his opinion is commensurate to its nature and size of the business.
   - **f.** Whether in his opinion, information, cost records give a true and fair view of the cost of production, cost of sales, margin and other information.

3. **BOD to CG:**
   - **a.** The company shall within 30 days from the dated of receipt of a copy of the cost audit report prepared furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein in Form CRA-4.

b. If after considering the cost audit report and the information and explanation furnished by the company as above, the central Government may call for any further information or explanation as is necessary.

PART 3 : SECRETERIAL AUDIT

Q.NO.24 WRITE ABOUT SECRETARIAL AUDIT, ITS APPLICABILITY AND CONDUCT.

ANSWER:

A. APPLICABILITY:

1. As per the provision of Section 204(1) of the Companies Act, 2013, the following class of companies shall attach the Secretarial audit report with the auditor's report:
   a. Every listed company;
   b. Every public company having a
      - paid-up share capital of 50 crore rupees or more; or
      - having a turnover of 250 crore rupees or more;
   c. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more. (including private companies)
2. As per Regulation 24A of the SEBI(LODR) Regulations, 2015, every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report, with the annual report.

B. QUALIFICATION OF A SECRETARIAL AUDITOR: Only a member of the Institute of Company Secretaries of India holding a certificate of Practice (i.e., PCS) is qualified to conduct secretarial audit of the company.

C. APPOINTMENT OF SECRETARIAL AUDITOR: Secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting. The company shall report any change in the secretarial auditor during the financial year to the members through the Board's Report.

D. SECRETARIAL AUDIT REPORT:

1. The Secretarial auditor shall submit his audit report to the Board of Directors in Form MR-3
2. Further, Board of Directors, in its report, shall explain in full any qualification or observation or other remarks made by the company secretary in practice
3. In addition, Regulation 24A of the SEBI (LODR) Regulations, 2015 requires that every listed entity shall submit a Secretarial Compliance Report in such form as specified, to stock exchanges, within sixty days from end of each financial year.

TEST YOUR KNOWLEDGE:

1. **P Ltd. is an unlisted public company with an authorised capital of ₹ 100 crore. The issued and paid-up capital of the company is ₹ 45 crore. During the financial year 2020-21, the company has been able to achieve a turnover of ₹ 225 crore. The company has taken a bank loan of ₹ 110 crore in the current financial year for business expansion. The company secretary of P Ltd. has asked for your opinion as a legal expert on whether the company is required to conduct a secretarial audit. Advise the company.**

Answer:

As per the provision of Section 204(1) of the Companies Act, 2013, the following class of companies shall attach the Secretarial audit report with the auditor's report:

i. Every listed company;
ii. Every public company having a
   - paid-up share capital of 50 crore rupees or more; or
   - having a turnover of 250 crore rupees or more;
iii. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more. (Including private companies)

In the given case, the company is an unlisted public company with paid up capital of ₹ 45 crore (less than ₹ 50 crore) and its turnover of ₹ 225 crore is also lower than the threshold of ₹ 250 crore. However, the company has an outstanding bank loan of ₹ 110 crore which is higher than the threshold of ₹ 100 crore. Thus, the company will need to conduct secretarial audit.

PART 4 : NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)

Q.NO.25 WRITE ABOUT NFRA AND STATE THE FUNCTIONS OF NFRA.

ANSWER:

A. **CONSTITUTION:** In order to incorporate the quality of accounting and auditing, the National Financial Reporting Authority (NFRA) was constituted on 1st October,2018 by the Government of India under 132(1) of the Companies Act, 2013. The National Financial Reporting Authority (NFRA) is a quasi-judicial organisation that oversees accounting and auditing issues.

B. **COMPOSITION:** The body will comprise of one Chairman who will be an eminent individual with competence in accounting, auditing, finance, or law as Chairperson. In addition, there can be a maximum of 15 members.

C. **STRUCTURE:** The following committees will make up the NFRA:
   1. Accounting Standards Committee;
   2. Auditing Standards Committee
   3. Enforcement Committee

D. FUNCTIONS AND DUTIES: As per Section 132(2) of the Companies Act, 2013, the duties of the NFRA are to:

1. Recommend accounting and auditing policies and standards to be adopted by companies for approval by the Central Government;
2. Monitor and enforce compliance with accounting standards and auditing standards;
3. Oversee the quality of service of the professions and suggest measures for improvement in the quality of service;
4. Perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

Q.NO.26 DISCUSS THE ROLE OF NFRA IN MONITORING AND ENFORCING COMPLIANCE WITH AUDITING STANDARDS.

ANSWER:

1. **REVIEW WORKING PAPERS:** For the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under Rule 3, the Authority (NFRA) may:
   a. review working papers and communications related to the audit;
   b. evaluate the sufficiency and the manner of documentation of the system by the auditor; and
   c. perform such other testing of the audit as the authority may consider necessary or appropriate.

2. **REPORT ON PRACTICES FOLLOWED BY AUDITOR:** The Authority may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation etc.

3. **REQUIRE ADDITIONAL INFORMATION:** The Authority may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

4. **MONITORING THROUGH EXPERTS:** The Authority shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

5. **PUBLISH THE FINDINGS:** The Authority shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing. However, the Authority shall not publish proprietary or confidential information.

6. **REPORT TO CG:** The Authority may send a separate report containing proprietary or confidential information to the Central Government for its information.

7. **FURTHER INVESTIGATION:** Where the Authority finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

4. AUDIT REPORT

PART 1: AUDIT REPORT AS PER SA's

SA 700 FORMING OF AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

A. CONTENTS OF AUDIT REPORT:

1. Title – Independent Auditor's Report
2. Addressee
3. Opinion Para
4. Basis for Opinion
5. Report on Going Concern Assumption (SA 570)
6. Key Audit Matters (SA 701)
7. Emphasis of Matter Paragraph (SA 706)
8. Other Matter Paragraph (SA 706)

Applicable as per the relevant standard

9. Responsibilities of management for the Financial Statements.
10. Auditor's Responsibilities for the Audit of the Financial Statements.
11. Report on Other Legal and regulatory requirements / Other Reporting Requirements
12. Signature of the Auditor.
13. Place of Signature. (Ordinarily the city where the audit report is signed)
14. Date of the Auditor's Report
15. UDIN (Unique Document Identification Number w.e.f.1st July, 2019)

B. DETAILED EXPLAINATION REGARDING CONTENTS OF AUDIT REPORT:

1. **Addressee:**
   a. The auditor's report should be appropriately addressed as per the terms of engagement or respective law or regulation.
   b. Normally, an audit report is addressed to the appointing authority.
   c. For example, in a public limited company, the audit report is addressed to the members i.e., shareholders.

2. **Opinion:**
   a. The first section of the auditor's report shall include the opinion of the auditor.
   b. This opinion section shall mention the
      i) name of the client,
      ii) the fact that financial statements have been audited,
      iii) the titles of the financial statements,
      iv) reference to the summary of significant accounting policies and other explanatory information and
      v) the date and period of the financial statements audited.

3. **Basis for Opinion:** This section shall explain the basis for holding such opinion. Accordingly, it shall –
   a. state that the audit has been conducted with applicable Standards on Auditing.
   b. refer to the section that describes auditor's responsibilities under the Standards on Auditing.
   c. Include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements.
   d. State whether the auditor believes that the audit evidences obtained by him is sufficient and appropriate to provide a basis for the auditor's opinion.

4. **Key Audit Matters:**
   a. These are matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period.
   b. For instance, valuation of goodwill and other long-term assets, valuation of financial instruments, etc.
   c. KAM are required to be reported in the following cases:
      - In case of audit of financial statements of a listed entity,
      - Law or regulation may also require communication of key audit matters for other entities as well.
      - Additionally, the auditor may also decide to communicate key audit matters for those who are of significant public interest.

5. **Responsibilities for the Financial Statements:** The report of an auditor should also include a section with heading 'Management's Responsibilities for the Financial Statements'. This section of the audit report shall describe management's responsibility for:
   a. the preparation of the financial statements according to the applicable financial reporting framework and
   b. for the design, implementation and maintenance of an appropriate internal control relevant to the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.
   c. assessing the entity's ability to continue as a going concern and whether the going concern basis of accounting is appropriate.

6. **Auditor's Responsibilities for the Audit of the Financial Statements:** This section of the auditor's report shall state that:
   a. The objectives of the auditor are to:
      i) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
      ii) Issue an auditor's report that includes the auditor's opinion.
   b. State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and

c. State that misstatements can arise from fraud or error, and describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements;
d. State that, as a part of an audit in accordance with SAs, the auditor has exercised professional judgement and maintained professional skepticism throughout the audit.
e. State that the auditor's responsibilities are:
   - to identify and assess the risk of material misstatements.
   - to obtain an understanding of internal control.
   - to evaluate the appropriateness of accounting practices followed and reasonableness of accounting estimates.

7. **Signature of the Auditor:**
   a. The report is signed by the auditor (i.e., the engagement partner) in his personal name.
   b. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.
   c. The partner/proprietor signing the audit report also needs to mention his membership number assigned by ICAI.
   d. They also include the registration number of the firm.

C. **ESSENTIAL CHARACTERISTICS OF A GOOD AUDIT REPORT:** The following are the essential characteristics of a good audit report:
   a. **Simplicity:** An audit report should be simple and easily understandable to the users. It should be written is simple language and should be self-explanatory.
   b. **Clarity:** The audit report should be clear and unambiguous. The auditor must clearly mention, in his report, the purpose of audit, sources of information, his findings and overall opinion.
   c. **Brevity:** The report should be brief and specific. While everything relevant must be disclosed, the report should avoid unnecessary detailing.
   d. **Firmness:** The report should firmly state whether, in the opinion of the auditor, the financial statements represent the true and fair view of the performance and state of affairs of the business.
   e. **Objectivity:** The audit report should always be based on objective evidences. It is very much required to reduce or eliminate biases, prejudices, or subjective evaluations by relying on verifiable data.
   f. **Disclosure:** The audit report should properly disclose all relevant facts and the truth. The relevance should be decided based on materiality of the concerned item.
   g. **Impartiality:** The report should be unbiased. The recommendations must be impartial and objective.
   h. **Information-based:** Only relevant and accurate information should be included in the audit report.
   i. **Timeliness:** The report should be prepared and presented within the stipulated time. This will help in timely decision making.

TEST YOUR KNOWLEDGE:

1. **What are the characteristics of a good audit report?**

A. Refer Point C from SA 700

2. **What are the essential features of a good audit report?**

A. Refer Point C from SA 700

3. **List out various contents of the audit report.**

A. Refer Point A from SA 700

4. **What are details which are required to be included in auditors' responsibilities paragraph of auditor's report?**

A. Refer Point B(6) from SA 700

5. **Write a short note on Key audit matter paragraph in auditor's report.**

A. Refer Point B(4) from SA 700

6. **Write a short note on management responsibilities paragraph in the auditor's report.**

A. Refer Point B(5) from SA 700

7. **Explain the matters which are required to be included in Opinion and Basis for opinion paragraph of auditor's report.**

A. Refer Point B(2) and B(3)

SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITORS REPORT

A. DIFFERENT TYPES OF OPINION: The opinions expressed in audit reports issued by statutory auditors can broadly be divided into two categories –

1. **Unmodified Opinion:** An auditor expresses an unmodified opinion when he is satisfied that the financial statements exhibit a true and fair view of the state of affairs and operations in an enterprise during the period. It is also known as 'Clean Report' or 'Unqualified Report'. an auditor issues an unmodified opinion when he finds that –
   - **a.** The Financial Statements have been prepared using the Generally Accepted Accounting Principles, which have been consistently applied;
   - **b.** The Financial Statements comply with relevant laws and regulations;
   - **c.** The Financial statements are prepared as per applicable financial reporting framework;
   - **d.** Any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the Financial Statement.

2. **Modified Opinion:** In the following circumstances the auditor shall modify the opinion in Audit report:
   - **a.** The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatements; or
   - **b.** The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

B. DIFFERENT TYPES OF MODIFIED OPINION: The following are various kinds of modified opinion:

1. **Qualified Opinion:** An auditor expresses qualified opinion on financial statements when:
   a. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, either individually or in aggregate, are material but not pervasive (i.e., not highly significant);
   b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base his opinion, but concludes that the possible effects of undetected misstatements on the financial statements could be material but not pervasive.

2. **Adverse Opinion:** An auditor expresses adverse opinion on financial statements when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, either individually or in aggregate, are both material and pervasive to the financial statements.

3. **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

   The auditor shall disclaim an opinion when, in extremely rare circumstances it is not possible to form an opinion on the financial statements.

C. FACTORS FOR DECIDING APPROPRIATE MODIFIED OPINION: The decision on an appropriate modified opinion depends on two factors –

1. the nature of matter that gives rise to the modification (availability or non-availability of audit evidence) and
2. auditor's judgement about the pervasiveness of the effects on the financial statements.

D. MEANING OF THE TERM 'PERVASIVE': The term 'pervasive' is used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements. Pervasive effects on the financial statements are those that, in the auditor's judgment:

1. Are not confined to specific elements, accounts or items of the financial statements;
2. If so confined, represent or could represent a substantial proportion of the financial statements; or
3. In relation to disclosures, are fundamental to users' understanding of the financial statements.

TEST YOUR KNOWLEDGE:

1. **Explain the differences between Unmodified opinion and Modified opinion?**

A. Refer Point 1 from SA 705

2. **What are the different kinds of modified opinion? Also explain the factors for deciding the appropriate modified opinion?**

A. Refer Point 2 and 3 from SA 705

3. Define the term Pervasive.

A. Refer Point 4 from SA 705

4. Write a short note on Unmodified opinion.

A. Refer 1(a) from SA 705

SA 706 EMPHASIS OF MATTER PARAGRAPH AND OTHER MATTER PARAGRAPH IN THE INDEPENDENT AUDITORS REPORT

A. DEFINITIONS:

1. **EMPHASIS OF MATTER PARAGRAPH:** Emphasis of Matter paragraph is a paragraph included in the auditor's report that refers to a matter **appropriately** presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

2. **OTHER MATTER PARAGRAPH:** A paragraph included in the auditor's report that refers to a matter **other than** those presented or disclosed in the financial statements that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

B. USAGE OF EMPHASIS OF MATTER PARAGRAPH: Emphasis of Matter paragraph is used to draw user's attention to a matter which is important for user's understanding of F/S' s in view of the auditor's judgment and this shall be included in auditors report provided:

1. The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter.
2. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Examples of when it is used:

1. An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
2. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
3. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
4. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.

C. MANNER OF PRESENTATION OF EMPHASIS OF MATTER:

1. Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter;"
2. Shall express the matter being emphasized (highlighted) and give the reference to such matter in the financial statements. Accordingly, this paragraph shall refer only to information presented or disclosed in the financial statements; and

3. Also state that the auditor's opinion is not modified in respect of the matter emphasized.

D. OTHER MATTER PARAGRAPHS IN THE AUDITOR'S REPORT:

The auditor shall include an Other Matter paragraph in the auditor's report, provided:

1. This is not prohibited by law or regulation and
2. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.
3. **Separate section for Other Matter paragraph:**
   When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.

E. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE:

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding their expectation and the wording of this Para.

TEST YOUR KNOWLEDGE:

1. **Explain the meaning of the term Emphasis of Matter Paragraph, its usage and manner of presentation.**

A. Refer Point A(1),B and C from SA 706

2. **Write a short note on other matter paragraph in auditor's report.**

A. Refer Point A(2) and D from SA 706

PART 2 : CARO 2020

Q.NO.1 EXPLAIN THE PROVISIONS RELATING TO REPORTING UNDER CARO 2020? WHAT ARE THE REPORTING REQUIREMENTS OF THE AUDITOR AS PER 143(11) OF COMPANIES ACT?

ANSWER:

A. APPLICABILITY OF THE ORDER: The Companies Auditor Report Order, 2016 (CARO) is an additional reporting requirement Order. The order applies to every company including a foreign company. However, it shall **not** apply to following classes of companies:

1. A banking companies
2. An insurance company
3. A company licensed to operate under section 8 of the Companies Act;
4. A One Person Company.
5. A Small company and
6. A Private Limited Company:
   a. Not being a subsidiary or holding company of a public company and

b. The Total Paid up capital and reserves & surplus shall not exceed Rs. 1 Crore as on the balance sheet date and
c. The Total Borrowings from banks and financial institutions shall not exceed Rs. 1 Crore at any point of time during the financial year and
d. Total Turnover calculated as per Schedule III (including revenue from discontinuing operations) shall not Exceed Rs. 10 crores during the financial year as per the financial statements.

B. POINTS TO BE KEPT IN MIND WHILE CALCULATING ABOVE PARAMETERS:

1. **Paid up share capital:**
   a. **Inclusions:** It includes both equity share capital as well as the preference share capital.
   b. **Exclusions:** It excludes share application money received pending allotment, calls in arrears and calls in advance.

2. **Reserves and surplus:**
   a. It includes all the reserves (whether capital or revenue reserves) as disclosed in the Schedule III of the companies act, 2013.
   b. Revaluation reserve, if any, should be taken into consideration while determining the applicability of CARO.
   c. The debit balance of the profit and loss account, if any, should be reduced from the figures of Reserves & Surplus same as per Schedule III.
   d. If there any excess debit balance of profit and loss account after adjustment to Reserves & Surplus, then such excess can be netted off against Paid up Capital also.
   e. Provisions are excluded whether they are made for depreciation or for Diminution in the value of assets or for any known liability.

3. **Borrowing:**
   a. Loans taken from banks and financial institutions are only to be considered.
   b. It includes all the loans irrespective of nature of loans:
      i) Whether term loans, demand loans, working capital loans, cash credits, and overdraft, bills purchased and discounted.
      ii) Whether loans whether secured or unsecured.
   c. The limit shall be computed with reference to the aggregate borrowings from all banks and financial institutions cumulatively but not as per each bank or financial institute basis.
   d. The limit shall be considered at any point of time during the financial year i.e., on any day during the year but need not on the date of balance sheet.
   e. Where the company has taken any overdraft facility against Fixed Deposits, the gross amount outstanding in overdraft facility (without adjusting Fixed Deposit) shall be considered for the purpose of CARO.
   f. Amounts outstanding in respect of credit Cards also would also be considered.

4. **Turnover:**
   a. Revenue means the aggregate amounts of sales affected by the company including the revenue from discontinuing operations.
   b. It includes sale of goods, services & any other operating revenues earned by the company.
   c. GST shall be deducted from the Turnover.
   d. It excludes sales returns and trade discounts, if any.

5. **Additional points:**

   a. **In the case of holding and subsidiary companies:**
      i) The limits for applicability of CARO should be computed on the basis of standalone financial statements of holding and subsidiary companies separately but not on the basis of consolidated financial statements.
      ii) CARO, 2020 reporting shall not apply to the Auditor's Report on Consolidated Financial Statements "EXCEPT Clause 21".

   b. **In the case of companies having branches:**
      i) The limits for the purpose of Applicability of CARO shall be computed from the entire company's view including the amounts form all the branches but not w.r.t each branch wise.
      ii) Once it is applicable to the company as a whole, then each and every branch of the company will be covered under CARO. Therefore, all the branch auditors of the company are also required to report on these 21 matters in their branch audit report of the concerned branches.

C. **CLAUSES TO BE REPORTED:** The following matters are required to be reported by the auditor in his audit report as per CARO 2020.

I. NON-CURRENT ASSETS:

a. **Maintenance of Records:** Whether the company is maintaining proper records showing full particulars including:
   i) Quantitative details of PPE and Intangible Assets (Fixed Assets) and
   ii) Situation of PPE.

b. **Physical verification:**
   i) Whether these fixed assets have been physically verified by the management at reasonable intervals.
   ii) Whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts.

c. **Immovable Properties:** Whether the title of immovable properties is held in the name of the company. If not, provide the details of the same:
   i) Description of the Property
   ii) Gross Carrying Value
   iii) Held in Name of (I.e., Promoter or director or employees)
   iv) Reason for Not being held in name of Company.

d. **Revaluation:** Whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so:
   i) Whether the revaluation is based on the valuation by a Registered Valuer.
   ii) Specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

e. **Benami transactions:** Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made there under, if so, whether the company has appropriately disclosed the details in its financial statements.

II. INVENTORY:

a. **physical verification:** Whether physical verification of inventory has been conducted at reasonable intervals by the management.
   i) Whether the coverage and procedure of such verification by the management is appropriate
   ii) Whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.

b. **Working capital loans:** Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets;
   i) Whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details

III. INVESTMENTS, GUARANTEE, SECURITY, LOANS OR ADVANCES:

a. **Loans to related parties:** Whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate:
   i) The aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates.

   - **ii)** The aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties OTHER THAN subsidiaries, joint ventures and associates.
- **b. Terms and conditions:** Whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest.
- **c. Repayment:** In respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular.
- **d. Overdue > 90 days:** If the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.
- **e. Rescheduling or extension of overdue loans:** Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the over dues of existing loans given to the same parties, if so,
   - **i)** Specify the aggregate amount of such dues renewed or extended or settled by fresh loans and
   - **ii)** The percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans].
- **f. Demand loans without repayment period:** Whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so,
   - **i)** Specify the aggregate amount, percentage thereof to the total loans granted,
   - **ii)** Aggregate amount of loans granted to Promoters, related parties

IV. OTHER LOANS, INVESTMENTS, GUARANTEES MADE BY COMPANY:

In respect of loans, Investments, Guarantees, and securities provided by company, whether provisions of section 185 & 186 have been complied with? If not, provide the details thereof.

V. ACCEPTANCE OF DEPOSITS: In case the company has accepted deposits from the public,

- **a.** Verify the compliance with the following:
   - **i)** The provisions of Sections 73 to 76 of the Co.'s Act, 2013 or
   - **ii)** Whether the directives issued by the RBI and
   - **iii)** An order passed by CLB or any court or any other Tribunal, if any.
- **b.** If there is any Non-compliance, the nature of contraventions should be stated.

VI. MAINTAINING COST RECORDS:

- **a.** Whether maintenance of cost records has been prescribed by the Central Government under sub section (1) of section 148 of the Co.'s Act, 2013 is applicable.
- **b.** If applicable, whether such accounts and records have made and maintained.

VII. STATUTORY DUES:

a. **Undisputed dues:**

   i) Is the company regular in depositing undisputed statutory dues e.g. provident fund, ESI, Income Tax, service tax and any other statutory dues with the appropriate authorities, and

   ii) if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date, they became payable, shall be indicated by the auditor. (Only Information and not opinion)

b. **Disputed dues:**

   In case dues have not been deposited on account of any dispute, the auditor shall indicate

   i) The amounts involved in dispute and

   ii) The forum where dispute is pending.

   Note: A mere representation to the concerned department shall not constitute a dispute.

VIII. DISCLOSURE OF UNDISCLOSED INCOME: Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

IX. REPAYMENT OF LOANS:

a. **Default in repayment:** whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported.

b. **Willful defaulter:** Whether the company is a declared willful defaulter by any bank or financial institution or other lender.

c. **Purpose of term loans:** Whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported.

d. **Usage of Short term loans:** Whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated.

e. **Loans taken to meet subsidiary company needs:** Whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case.

f. **Loan against pledge of securities of subsidiaries:** Whether the company has raised any loans during the year "on pledge of securities held in subsidiary/associate/joint venture and if so,

   i) Give details thereof

   ii) Also report whether the company has defaulted in repayment of such loans.

X. UTILISATION OF IPO/FPO:

a. **IPO / FPO:**

   i) 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.

ii) If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.

b. preferential allotment:

i) Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review &

ii) 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.

iii) If not provide the details in respect of the amount involved & nature of non-compliance

XI. REPORTING OF FRAUDS:

a. 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. Whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government.

c. Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company.

XII. NIDHI COMPANY:

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.

b. Whether Nidhi Company is maintaining 10% Unencumbered term deposits as specified in Nidhi Rules, 2014 to meet out the liability.

c. Whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.

XIII. RELATED PARTY TRANSACTION:

Whether all transaction with related parties is

a. In compliance with section 177 & 188 where applicable, &

b. Details have been disclosed in the financial statements etc., as required by applicable accounting standards.

XIV. INTERNAL AUDIT SYSTEM:

a. Whether the company has an internal audit system commensurate with the size and nature of its business.

b. Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.

XV. NON-CASH TRANSACTION: Whether Company has entered into any Non-Cash Transactions with directors & if so provisions of section 192 have been complied with.

XVI. NON-BANKING FINANCIAL INSTITUTION:

- **a. 45IA of RBI act:** Whether the company is required to be registered under section 45-IA of Reserve Bank of India Act 1934, and If so, whether the registration has been obtained.
- **b. Certificate of Registration :** Whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.
- **c. Core investment company:**
  - **i)** Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so,
  - **ii)** 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.
  - **iii)** 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.

XVII. 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.

XVIII. RESIGNATION OF AUDITORS:

- **a.** Whether there has been any resignation of the statutory auditors during the year, if so,
- **b.** Whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

XIX. INFORMATION ABOUT FINANCIAL ASSETS AND LIABILITIES ETC:

- **a.** 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,
- **b.** 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.

XX. UNSPENT CSR EXPENDITURE AMOUNT:

- **a.** Whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act.
- **b.** Whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135.

XXI. QUALIFICATION/ADVERSE REMARKS:

- **a.** Whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements,
- **b.** if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

NOTE:

- **a.** Where, in the auditor's report, the answer to any of the above matters, are unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
- **b.** Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

PART 3: AUDIT REPORT vs AUDIT CERTIFICATE

Q.NO.2 EXPLAIN THE DIFFERENCES BETWEEN AUDIT REPORT AND AUDIT CERTIFICATE?

ANSWER:

Points of Distinction	Auditor's Report	Auditor's Certificate
Definition	An audit report is a document written in a standard format through which the auditor expresses his opinion regarding the reliability and correctness of an entity's financial statements.	An auditor's certificate is a written confirmation of the accuracy of the facts stated therein.
Nature	It is an expression of opinion about the financial statements.	It is a confirmation of correctness and accuracy about some matters.
Basis of audit	The report is based on assumptions and estimations	The certificate is based on actual figures and facts.
Scope	The scope of the report is large.	Its scope is limited.
Advice	In audit report, there is a scope of giving constructive advice to the company.	No scope of constructive advice exists in the case of the certificate.
Basis	Audit report is based on facts, assumptions and estimations.	Audit certificate is based on actual figures.
Guarantee	Audit report is an opinion by the auditor and does not guarantee the accuracy of the financial statements	Audit certificate is a formal statement by the auditors which guarantee the accuracy of the facts stated therein.

Time of issue	The report is submitted to the appointing authority only after the audit is complete.	Certificates are issued as and when required.
Liability of auditor	As a report is merely an opinion, if it is not correct, the auditor may not be held responsible, unless he is found to be negligent to his duty	In case of the wrong certificate, the auditor will be held responsible.
Format	Audit report has to be presented in prescribed format.	Audit certificate is not required to be presented in any standard format.

5. AUDIT DOCUMENTATION AND EVIDENCE

Q.NO.1 DEFINE THE TERM AUDIT PROCEDURES. ALSO, EXPLAIN VARIOUS KINDS OF AUDIT PROCEDURES.

ANSWER:

MEANING OF AUDIT PROCEDURES

1. It is a broad framework of audit through which the audit is carried out to obtain sufficient appropriate evidence in order to express the opinion on financial statements.
2. The audit procedures are performed in two parts as below:
   1. Risk assessment procedures; and
   2. Further audit procedures which consist of:
      i) Compliance procedures, and
      ii) Substantive procedures which include analytical procedures and test of details.

3. DETAILED EXPLANATION OF AUDIT PROCEDURES:

RISK ASSESSMENT PROCEDUES	**a. Meaning:** The audit procedures are performed • To obtain an understanding of the entity and its environment, • Including the Internal control system, **b. Purpose:** To identify and assess the risks of material misstatements in financial statements.
COMPLIANCE PROCEDUES	**a.** It deals with examination of internal controls to determine their effectiveness to determine the nature, timing, and extent of substantive procedures to be performed. E.g.: If the auditor obtains positive confirmations in compliance procedures, generally the timing and extent of substantive procedures will reduce. **b.** These are also known as "Test of controls".
SUBSTANTIVE AUDIT PROCEDUES	It involves examination of accounting records including financial statements to determine the reliability of information therein. **a. Test of Details:** • **Test of transactions:** It deals with vouching of transactions recorded in the accounting records. • **Test of balances:** It deals with the verification of balances in the accounting records. **b. Analytical Procedures:** Analytical procedures consist of evaluation of financial information by understanding the relationships among the financial and non-financial data.

TEST YOUR KNOWLEDGE:

1. Elaborate the term audit procedures and explain its various types.
A. Write the above answer completely.

Q.NO.2 EXPLAIN THE TERM "AUDIT EVIDENCE". ALSO EXPLAIN THE MEANING OF SUFFICIENCY AND APPROPRIATENESS OF AUDIT EVIDENCE.

ANSWER:

A. AUDIT EVIDENCE:

1. The information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.
2. It includes both information contained in the accounting records that are underlying the financial statements and other information.
3. The auditor cannot express opinion unless he has examined the financial statements objectively.
4. Audit evidence is necessary to support the auditor opinion and report.
5. In SA-200, it is recognised that reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence.
6. When the client maintains the books of accounts using information systems, then the auditor will obtain audit evidence using Computer Assisted Audit Techniques (CAAT).

B. SUFFICIENCY AND APPROPRAITENESSS OF AUDIT EVIDENCE:

a. Sufficiency refers to the quantum of audit evidence obtained and appropriateness relates to its relevance and reliability.
b. The following factors influence auditor's judgement while obtaining audit evidence:
    - the nature of the item;
    - the adequacy of internal controls;
    - the nature and size of the business carried on by the entity;
    - The materiality of the item;
    - The experience gained during the previous audits;
    - The results of auditing procedures, including fraud or error which may have been found;

TEST YOUR KNOWLEDGE:

1. Explain the need for obtaining Audit evidence.
A. Write Point 1 from above answer
2. What are the various factors which influences the auditor's judgement while obtaining audit evidence?
A. Write above answer fully

Q.NO.3 WHAT ARE VARIOUS TYPES OF AUDIT EVIDENCE?

ANSWER:

A. BASED ON FORM / NATURE:

1. **Documentary:** Evidence obtained in paper or electronic form. E.g.: Registration documents, title deeds, vouchers, and Bills etc.
2. **Oral:** Evidence which is obtained through inquiry. E.g.: Response to Inquiries made by auditor.
3. **Visual:** Evidence obtained by the auditor through actual observation. E.g.: Physical inspection of Fixed Assets, Cash, etc.

B. BASED ON SOURCE:

1. **Internal evidence:** Evidence which originates within the entity being audited is called internal evidence. E.g.: Sales invoice, GRN, Debit and Credit note, internal confirmations, etc.
2. **External evidence:** Evidence, which originates outside the entity being audited, is called external evidence. E.g.: Purchase invoice, Debit notes and Credit notes, Quotations, External confirmation, etc.

Q.NO.4 EXPLAIN ABOUT RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE?

ANSWER:

1. Appropriateness means quality of audit evidence. Quality of audit evidence depends on relevance and reliability of audit evidence.
2. As per SA-500, relevance of audit evidence deals with the logical connection with the purpose of audit procedure and is therefore affected by the direction of testing.
3. On the other hand, the reliability of audit evidence depends on its source and nature.
4. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalizations may be useful in assessing the reliability of audit evidence:
   a. External evidence is generally more reliable than internal evidence;
   b. Internal evidence is more reliable when related internal control is satisfactory;
   c. Evidence in the form of documents and written representation is usually more reliable than oral representations;
   d. Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

TEST YOUR KNOWLEDGE:

1. Explain about generalisation regarding reliability of audit evidence.

A. Write above answer

2. What are the various factors which effects the reliability of audit evidence?

A. Write above answer fully

Q.NO.5 WHAT ARE VARIOUS METHODS TO OBTAIN AUDIT EVIDENCE?

ANSWER:

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

1. **INSPECTION -** It consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature, source and the effectiveness of internal controls over their processing.
2. **OBSERVATION** - It consists of witnessing a process or procedure being performed by others.
3. **INQUIRY AND CONFIRMATION -** Inquiry consists of seeking appropriate information from a knowledgeable person inside or outside the entity, Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records.
4. **COMPUTATION -** It consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.
5. **ANALYTICAL REVIEW/ PROCEDURES -** It consists of studying significant ratios and trends and investigating unusual fluctuations and items.

Q.NO.6 WHAT ARE VARIOUS AUDIT TECHNIQUES FOLLOWED BY THE AUDITOR?

ANSWER:

While conducting the audit of an organisation, an auditor resorts to various techniques. Some of these are invariably applied in all cases whereas some others are used only, if situation so demands. These are popularly known as Audit Techniques. Some of the common techniques which have wide application are discussed below:

A. ROUTINE CHECKING

1. Routine checking may be defined as the procedure to check whether the transactions are properly entered in the books of accounts and whether the posting and carry forwards are done accurately.
2. It is done to ensure that mathematical accuracy of books of accounts.
3. This is quite helpful to detect errors and frauds of very simple nature. Routine checking is normally performed by audit clerks.
4. They examine the correctness of casting and balancing of the books of primary entry, correctness of posting to ledgers, correctness of casting, correctness of the Statement of Profit and Loss and Balance Sheet.
5. It provides the base for the subsequent audit work to find out serious and organised frauds.

B. TEST CHECKING

1. In large organisations, detail examination of all accounts is very difficult because of huge number of transactions recorded in the books of accounts.
2. Also, the auditor is required to submit his report within a definite time period.
3. Thus, in such organisations, where there exists a sound internal control, the auditor selects a few transactions and conduct in-depth examination of those.

4. If no irregularities are found, then it is assumed that all the transactions have been recorded properly. This procedure is known as test checking. The rationale behind test checking lies in the 'Sampling Theory' of Statistics.
5. According to this theory, the sample selected should represent the characteristics of population.
6. Test checking, based on appropriate sampling technique, helps the auditor to form his opinion based on a limited examination of transactions.
7. It also saves time and cost of audit work. However, it also involves risk. Use of faulty sampling technique non-detection of material errors and frauds.
8. Thus, test checking is never recommended for seasonal industries, for transactions of non-recurring in nature, for transactions of legal importance, for accounting estimates, for rectification and adjustments and for presentation and disclosures.

C. AUDITING IN DEPTH

1. Auditing in depth refers to the procedure where a few selected transactions are meticulously examined from their beginning to their conclusion.
2. In other words, it is a system which reviews each and every single aspect of a transaction during its execution as well as recording.
3. It is particularly helpful in case of large organisations where detailed examination of all records at every stage of a transaction is almost impossible.
4. Hence, through this system, the auditor selects a few representative transactions of material importance conducts a detailed stage by stage examination.
5. If no irregularity is found, the auditor may come to a conclusion that the entire category of transactions is likely to be free from any material irregularity.
6. Audit in depth is a three-step process where:
   a. the auditor first reviews the effectiveness of the internal control system,
   b. then selects a few transactions of material importance from each category and finally conducts examination of each and every stage of the execution and recording of the selected transactions based on sufficient documentary evidence.

D. SURPRISE CHECKING

1. Surprise check means conducting surprise tests of some material items without any prior communication with the client's office.
2. Under traditional audit practices, an auditor generally informs the client about his routine checking plan and timing of next visit well in advance.
3. This is considered essential so that the client's staff can keep the books of accounts complete in all respects and readily available for verification.
4. Unfortunately, this also provides them ample scope for concealing any wrongdoings whatsoever.
5. Thus, surprise checks, as a part of the normal audit procedure, are likely to increase the efficiency of the audit work.

E. CUT-OFF EXAMINATION

1. For some entities, there may be a number of items especially at the end of an accounting period that may have their impact carried to the next accounting period. E.g.: Purchases, Sales, Goods in Transit, goods sent on approval basis lying with the customers etc.
2. Hence, an auditor, during the course of his audit work, should apply definite procedure to separate transactions at the end of one accounting period from those at the commencement of the next accounting period. Such a procedure is known as Cut-off Examination or Cut-off Procedure.
3. Here the audit will set a cut off date (generally balance sheet date), and then the transactions that occurred within cut-off date and post such cut-off date to identify which transactions belong current year and next year.

F. WALK THROUGH TESTS

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

Q.NO.7 EXPLAIN THE TERM "ASSERTION" AND ALSO GIVE EXAMPLES?

ANSWER:

ASSERTIONS: Representations given by the management with respect to class of transactions, account balances or disclosures in financial statements. While carrying out the audit procedures the auditor shall verify the following assertions.

The following are examples of assertions:

1. **EXISTENCE:** Assets and liabilities are existing on a given date.
2. **OCCURRENCE:** Transactions and events that have been recorded have occurred and pertain to the entity.
3. **CUT-OFF:** Transactions and events have been recorded in the correct accounting period.
4. **MEASUREMENT:** Amounts and other data relating to recorded transactions and events have been recorded appropriately.
5. **VALUATION AND ALLOCATION:** Assets and liabilities are included in the financial statements at appropriate amounts and corresponding valuations are properly accounted.
6. **COMPLETENESS:** All transactions and events that should have been recorded.
7. **CLASSIFICATION:** Transactions and events have been recorded in the proper accounts.

8. **PRESENTATION AND DISCLOSURES:** All the presentation and disclosures requirements are applied in accordance with applicable financial reporting framework.

Q.NO.8 EXPLAIN THE TERM AUDIT DOCUMENTATION. ALSO STATE ITS ADVANTAGES.

ANSWER:

A. **AUDIT DOCUMENTATION/ WORKING PAPERS/AUDIT FILE:** It refers to record of:
   1. Audit procedures performed
   2. Relevant audit evidence obtained and
   3. Conclusions reached by the auditor.

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

B. **PURPOSE OF AUDIT WORKING PAPERS:** According to SA-230, 'Audit Documentation', audit working papers or audit documentation serves a number of purposes as follows:

   1. Providing evidence of auditor's basis for a conclusion about the achievement of the overall objectives of the auditor.
   2. Providing evidence that audit was planned and performed in accordance with Standards of Audit (SAs) and applicable legal and regulatory requirements.
   3. Assisting the engagement team to plan and perform the audit.
   4. Assisting members of the engagement team responsible for the supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA220, 'Quality Control for an Audit of Financial Statements'.
   5. Enabling the engagement team to be accountable for its work.
   6. Retaining a record of matters of continuing significance to future audits.
   7. Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
   8. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

TEST YOUR KNOWLEDGE:

1. Define the term audit documentation and state its purpose.
A. Write above answer
2. What are benefits of Audit documentation/working papers?
A. Write above answer fully

Q.NO.9 WRITE A SHORT ON FORM, CONTENT AND OWNERSHIP OF DOCUMENTATION.

ANSWER:

FORM	The auditor shall prepare audit working papers that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: **a.** the nature, timing and extent of audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;

	b. the results of the audit procedures performed and the audit evidence obtained; and **c.** significant matters arising during the audit, the conclusion reached thereon and significant professional judgments made in reaching those conclusions.
TIMING	The auditor shall prepare audit working papers on a timely basis. They should be prepared while performing the task itself rather than after the audit work is performed.
CONTENTS	**a.** Audit Programmes **b.** Analyses **c.** Evidence obtained **d.** Summary of Significant matters **e.** Confirmation and representation letters **f.** Correspondence relating to significant matters. **g.** Who performed the audit work and the date such work was completed **h.** Who reviewed the audit work performed and the date and extent of such review.
OWNERSHIP	**a.** Working papers are the property of the auditor, the portions or extracts of which can be had at his discretion (Chantery Martin & Co). **b.** These working papers should be kept in safe custody and in confidential manner **c.** However, if required by some legislation, the auditor must make working papers available to the regulatory authority(s).
RETENTION PERIOD	ICAI has prescribed that the members have to retain the working papers for a period of 7 years (as per SQC 1), otherwise, the member is guilty of professional misconduct.

Q.NO.10 DISTINGUISH BETWEEN PERMANENT VS CURRENT AUDIT FILE.

ANSWER:

In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files.

1. **PERMENANT AUDIT FILE:** Contains information of continuing importance (useful for subsequent years)
2. **CURRENT AUDIT FILE:** Contains information relating to audit of a single period.

PERMANENT AUDIT FILE	CURRENT AUDIT FILE
Legal and organizational structure of the entity, e.g., Memorandum of Association and Article of Association in case of a company.	Correspondence relating to acceptance of annual reappointment.
Extracts or copies of legal documents, agreements and minutes relevant to the audit.	Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.

A record of study and evaluation of internal controls.	Copies of management letters.
Analysis of significant ratios & trends.	Analysis of transactions and balances.
Copies of the audited financial statements of previous year	Copies of communication with other auditors, experts and third parties.
Notes regarding signific ant accounting policies.	Audit programme.
Significant audit observations of the earlier years.	Conclusions reached on significant aspects of audit.

TEST YOUR KNOWLEDGE:

1. Explain various types of Working paper files.

A. Write above answer

Q.NO.11 EXPLAIN THE TERM AUDIT NOTEBOOK. ALSO STATE ITS CONTENTS.

A. AUDIT NOTE BOOK:

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

B. CONTENTS OF AUDIT NOTE BOOK

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

Q.NO.12 EXPLAIN THE TERM AUDIT PROGRAMME. ALSO STATE ITS ADVANTAGES AND DISADVANTAGES.

ANSWER:

MEANING	**a.** An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. **b.** An audit programme is written plan containing exact details with regard to the conduct of a particular audit. **c.** It is a description or memorandum of the work to be done during an audit. **d.** The audit programme should consider previous year's audit programmes and these may be modified, if necessary. **e.** It may be classified into two categories: • Programme common to all types of audits • Special programme containing the work relating to a particular audit.
ADVANTAGES	**a.** It serves as a ready check list of audit procedures to be performed. **b.** The audit work can be properly allocated to the audit assistants or the article clerks. **c.** The auditor may easily know the extent of work done at any point of time. **d.** Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as it would help him in fixing responsibilities. **e.** It is a useful basis for planning the programme for the following year **f.** It may be used as evidence by the auditor in the event when any charge is brought against him. **g.** It is useful in selection of Team members and delegation of responsibilities to them. **h.** He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.
DISADVANTAGES	**a.** The auditor's task becomes mechanical and the auditors may lose interest and initiative. **b.** Drawing up of an audit programme may be unnecessary for a small concern. **c.** Though audit programme helps in fixing responsibilities but inefficient staff may defend themselves by stating that the matter was not contained in the audit programme. **d.** Rigid programmes cannot be laid down for each type of business.

Q.NO.13 EXPLAIN THE CONCEPT OF MATERIALITY.

ANSWER:

1. The concept of "materiality" implies that trivial matters are to be disregarded, and all-important matters are to be disclosed.

2. Materiality is the cut-off point above which missing or incorrect information in financial statements is considered to have an impact on the decision-making of users.
3. As per SA 320 (Revise(d) "Materiality in Planning and Performing an Audit", misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements.
4. What is material in one circumstance may be quite immaterial in another circumstance.
5. Further, the judgements about materiality are also affected by the size or nature of a misstatement or a combination of both.
6. Both the amount (quantity) and nature (quality) of misstatements are significant in deciding what is material.

6. INTERNAL CONTROL, INTERNAL CHECK AND INTERNAL AUDIT

Q.NO.1 WHAT IS AUDIT RISK? WRITE ABOUT VARIOUS TYPES OF AUDIT RISK

ANSWER:

A. MEANING OF AUDIT RISK:

1. The risk of expressing an inappropriate opinion when the financial statements are materially misstated is termed as audit risk.
2. In other words, expression of unmodified opinion in a situation where modified opinion would be suitable.
3. However, audit risk does not include the following:
   a. Risk of expressing a modified opinion when financial statements are not materially misstated.
   b. Business risk faced by auditor. Example: Loss of clients or reputation is not considered as audit risk.

B. COMPONENTS OF AUDIT RISK: Audit risk is a function of the risks of material misstatement and detection risk.

Audit Risk = Risk of Material Misstatement x Detection Risk

1. **RISK OF MMS:** The risk that the financial statements are materially misstated prior to audit. This risk may exist at two levels:
   a. **At Overall Financial Statement Level:** It refers to the possibility that material misstatement relates pervasively to the financial statements as a whole and may potentially affect multiple assertions.
   b. **At Assertion Level:** It refers to the possibility that material misstatement may exist in a particular transaction or account balance.

   Further, the ROMM has two components:
   i. **Inherent Risk:** This refers to the possibility of material misstatement due to complex transactions or even due to organised fraud. For example, transactions such as fire damage
   ii. **Control Risk:** This refers to the possibility of material misstatement due to ineffective design, implementation and maintenance of internal control system. Thus, a sound internal control system significantly reduces this risk.

2. **DETECTION RISK:** This refers to the possibility that the audit procedures applied by the auditor to reduce the audit risk to an acceptably low level will not be able to detect a misstatement which, either individually or in aggregate, may be material.

Therefore, Audit risk = Inherent Risk (I) × Control Risk (C) × Detection Risk (D).

TEST YOUR KNOWLEDGE:

1. **J Mart Ltd. is a multi-brand retailer and operates though in multiple locations across the nation. It sells products of thousands of categories from food to consumer durables. Each individual product item has a price tag with barcode. In addition, there is another security tag which is removed only after the billing is done. Inventory records are physically verified on a fortnightly basis by the auditor of J Mart. Identify the risk associated with the audit of inventory in J Mart.**

Answer:

The auditor may perceive the following risks:

a. **Inherent Risk:** It is possible that the employees might have misappropriated the inventory by manipulating the inventory records. So, inventory records may not be accurate. This leads to a risk of material misstatement.

b. **Control Risk:** Here each item of inventory carries a price tag with bar code as well as a security code (which is removed only after the billing). Additionally, physical verification of inventory is done on a fortnightly basis. Thus, the internal control appears to be quite satisfactory. However, collusion among employees at multiple layers can evade the control implemented at any time. Hence, an element of control risk is present.

c. **Detection Risk:** It is expected that the auditor will apply appropriate procedures to judge the efficiency of the control system before deciding on the extent of test checking. However, there may still be possibilities of material misstatements and the same may not be detected due to adoption of test checking. Hence, an element of detection risk can also exist.

Q.NO.2 WRITE ABOUT ASSESSEMENT OF AUDIT RISK?

ANSWER:

As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment," the auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.

Note: Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion

The risk assessment procedures shall include the following:

A. **INQUIRIES OF MANAGEMENT AND OTHERS WITHIN THE ENTITY:** Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, through inquiries of others within the entity and other employees with different levels of authority. For example,
   1. inquiries directed towards those charged with governance may help the auditor understand the environment in which the financial statements are prepared;
   2. inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.

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

B. ANALYTICAL PROCEDURE:

1. This means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
2. Analytical procedures also involves investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.
3. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud

C. OBSERVATION AND INSPECTION: Observation and inspection may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following:

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

TEST YOUR KNOWLEDGE:

1. Explain how an auditor can assess Risk of Material Misstatement?

A. Write above answer

2. Explain what is included in Risk Assessment Procedures?

A. Write above answer

Q.NO.3 WRITE ABOUT CONCEPT OF INTERNAL CONTROL?

ANSWER:

A. MEANING OF INTERNAL CONTROL: SA 265 defines the system of internal control as "all the policies and procedures adopted by the management of an entity to assist in achieving management's objective.

B. OBJECTIVES OF INTERNAL CONTROLS:

1. orderly and efficient conduct of its business
2. adherence to management policies
3. the safeguarding of assets
4. the prevention and detection of fraud and error
5. the accuracy and completeness of the accounting records
6. the timely preparation of reliable financial information

C. **BASIC ELEMENTS OF INTERNAL CONTROL:** An effective system of internal control should have the following basic elements:
   1. **Financial and Other Organization Plans:** There should be a defined plan for implementing internal controls. It should specify the various duties and responsibilities of both management and staff.
   2. **Competent Personnel:** In any internal control system, personnel are the most important element. When the employees are competent and efficient in their assigned work, the internal control system can be operated efficiently and effectively.
   3. **Division of Work:** In any internal control system, each and every work of the organization should be divided in different stages and should be allocated to the employees in accordance with quality and skill.
   4. **Separation of the Custody of Assets from Accounting:** To protect assets from misuse and misappropriation, it is required that the custody of assets and their accounting should be done by separate persons.
   5. **Authorization:** In an internal control system, all the activities must be authorized(approved) by a proper authority.
   6. **Managerial Supervision and Review:** There must be regular supervision and review of the effectiveness of the internal control system of the organization by the management.

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

Q.NO.4 WHAT ARE VARIOUS TYPES OF INTERNAL CONTROL?

ANSWER:

Generally, there are two types of Internal Control in an Organization: preventive and detective controls.

A. **PREVENTIVE CONTROL:** Preventive Controls are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure achievement of departmental objectives. Examples of preventive controls are:
   a. **Segregation of Duties:** Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.

b. **Approvals, Authorizations, and Verifications:** Management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
c. **Security of Assets**: Access to equipment, inventories, securities, cash, and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

B. **DETECTIVE CONTROL:** Detective Controls are designed to find errors or irregularities after they have occurred. Examples of detective controls are:
   a. **Reviews of Performance:** Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
   b. **Reconciliations:** An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
   c. **Physical Verification of Inventories:** The auditor may conduct physical verification of inventory to detect any misappropriation.

Q.NO.5 WHAT ARE INHERENT LIMITATIONS OF INTERNAL CONTROL?

ANSWER:

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

1. **BREAKDOWNS:** Even well-designed internal controls can break down. Employees may misunderstand instructions or commit mistakes. Errors may also result from application of new technology.
2. **JUDGMENT:** The effectiveness of internal controls is highly impaired when decisions are made with human judgment under pressure.
3. **MANAGEMENT OVERRIDE:** High level personnel may be able to override prescribed policies and procedures for personal gain or advantage.
4. **COLLUSION:** Internal control systems may become ineffective due to collusion among employees. Several individuals may act collectively to alter financial data or other management information in a manner that cannot be identified by control systems.
5. **CONTROL OVER COMMON BUSINESS ACTIVITIES ONLY:** Internal control system is suitable for common and reparative business activities only.
6. **COSTLY SYSTEM:** Operating an internal control system often turns up to be very costly. If the losses incurred on account of errors and frauds exceed the benefits of internal control system, then the system becomes completely redundant for the entity.

TEST YOUR KNOWLEDGE:

1. **Explain why Internal controls can provide only a reasonable assurance that objectives have been achieved?**

A. Write above answer

Q.NO.6 WHAT ARE TECHNIQUES FOR EVALUATION OF INTERNAL CONTROL?

ANSWER:

1. **NARRATIVE RECORD:**
    - **a.** It is a complete and exhaustive description of the system.
    - **b.** It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses.
    - **c.** Weakness (Gaps) in the control system is difficult to identify using a narrative record.

2. **CHECK LIST:**
    - **a.** The Internal Control Checklist is a tool to help evaluate and improve the functioning of internal control in the organization.
    - **b.** In fact, checklist is a series of instructions and/or questions which the auditor or the audit staff must follow and answer.
    - **c.** When he completes the instructions, he initials the space against the instruction. Answers to the checklist instructions are usually 'Yes', 'No' or 'Not Applicable'.

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

4. **INTERNAL CONTROL QUESTIONNAIRE:**
    - **a.** This is the most widely used method for collecting information regarding the internal control system.
    - **b.** The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information regarding internal controls.
    - **c.** The questions are formed in a manner that would facilitate obtaining full information through answers in 'Yes' or 'No', whereby the answer 'Yes' is satisfactory, whereas the answers 'No' appear to indicate a weakness.
    - **d.** Questionnaire may also include remarks column (description regarding the comments).

Q.NO.7 WHAT ARE DIFFERENCES BETWEEN CHECKLIST AND INTERNAL CONTROL QUESTIONNAIRE?

ANSWER:

BASIS	CHECKLIST	INTERNAL CONTROL QUESTIONNAIRE
Point of Time	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
Issued To	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
Contents	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
Objective	It works as a guideline for audit staff so that no major issues remain unchecked.	This is used to collect the information to know about the internal control system and to evaluate the weaknesses therein.

Q.NO.8 EXPLAIN THE MEANING OF INTERNAL CHECK AND STATE ITS OBJECTIVES?

ANSWER:

A. MEANING:

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

B. OBJECTIVES / ADVANTAGES OF INTERNAL CHECK: The objectives of internal check are as follows:

1. Lessen the possibility of fraud and error.
2. Identify fraud and error at an early stage due to independent checking.
3. Improve the efficiency of the workforce, by implementing division of labor.
4. Allocate the duties and responsibilities of each worker in a way that they can be easily identified and held responsible for the actions performed.
5. Exercise moral pressure on the workforce with the implementation of a continuous receive process.

6. Reduce the workload of independent auditors by adopting an internal check system.

TEST YOUR KNOWLEDGE:

1. **Explain the meaning of Internal check and state its advantages?**

A. Write above answer

Q.NO.9 WHAT ARE THE ESSENTIAL CHARECTERISTICS OF INTERNAL CHECK SYSTEM?

ANSWER:

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

1. **DIVISION OF WORK:** The entire task should be divided among the staff in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end.
2. **PROVISION OF CHECK:** There must be clear instruction that the work performed by any staff must be checked by the next staff.
3. **RESPONSIBILITY:** Responsibility of each individual must be properly defined and fixed.
4. **USE OF TECHNOLOGY:** As far as possible, various technology enabled devices should be used to minimize human error.
5. **ROTATION OF EMPLOYEES:** A system of transfer or rotation of employees from one responsibility to another must be followed by the business.
6. **CONTROL OVER EMPLOYEES:** Generally, chances of frauds are high in case there is direct contact between staff and the customers. So, a manager can keep eyes in those areas to make internal check system more effective.
7. **PERIODICAL REVIEW:** The system of internal check is reviewed from time to time to introduce improvements.

TEST YOUR KNOWLEDGE:

1. **The cashier of a trading firm has also control of all the financial books. He also opens all incoming mails comprising cash and cheques. Under these circumstances, what malpractices are open to the cashier in respect of both receipts and payments and what checks would you, as an auditor, suggest to the company?**

   Answer:

   In the given case there is no proper segregation of duties as the cashier is having the control over the financial records. Hence in the given case, the management of the company should implement proper internal check system containing the below characteristics:

   Now write the above answer fully.

Q.NO.10 WRITE ABOUT THE PROVISIONS OF COMPANIES ACT 2013 RELATING TO INTERNAL AUDIT?

ANSWER:

A. **MEANING:** An independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggesting improvements thereto and add value to and strengthen overall governance mechanism of the entity, including the entity's risk management and internal control system.

B. APPLICABILITY: As per section 138 of the Companies Act, 2013, the following class of companies are required to appoint internal auditors:

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

C. WHO CAN BE APPOINTED AS AN INTERNAL AUDITOR:

1. Chartered Accountant, whether in practice or not or
2. Cost Accountant, whether in practice or not or
3. such other professional as may be decided by the Board

The internal auditor may be or may not be an employee of the company.

D. OBJECTIVE AND SCOPE: The scope, functioning, periodicity and methodology for conducting the internal audit shall be finalized by the Audit Committee of the company or the Board in consultation with the Internal Auditor.

TEST YOUR KNOWLEDGE:

1. During the financial year 2021-22, ABC Private Ltd. had a paid-up share capital of ₹ 52 Crore and a turnover of ₹ 198 Crore. The company didn't have outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during 2021-22 financial year. Explain whether the company would be required to appoint an internal audit, keeping in view of the provisions of Companies Act, 2013. Will your answer change if the company is an unlisted public company?

Answer:

As per section 138 of Companies Act, 2013, every private company having-

- **i.** turnover of two hundred crore rupees or more during the preceding financial year; or
- **ii.** outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

is required to appoint an internal auditor.

In the given scenario, ABC Private Ltd. did not have outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during 2021-22 financial year and its turnover during the year also did not exceed the threshold ₹ 200 Crore limit. Hence, it would not be required to appoint an internal auditor. In case of an unlisted public company, a paid-up share capital of at least ₹ 50 Crore will require the company to appoint an internal auditor, though the turnover is still below ₹ 200 Crore. Hence, in that case the company will need to appoint an internal auditor.

Q.NO.11 WRITE ABOUT SCOPE AND OBJECTIVES OF INTERNAL AUDIT FUNCTION?

ANSWER:

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

1. **MONITORING OF INTERNAL CONTROL:** The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
2. **EXAMINATION OF FINANCIAL AND OPERATING INFORMATION:** The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
3. **REVIEW OF OPERATING ACTIVITIES:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.
4. **REVIEW OF COMPLIANCE WITH LAWS AND REGULATIONS:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
5. **RISK MANAGEMENT:** The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

Q.NO.12 WRITE ABOUT ADVANTAGES OF INTERNAL AUDIT FUNCTION?

ANSWER:

Internal audit offers a number of advantages as follows:

1. **ASSISTANCE TO MANAGEMENT:** Internal audit helps management in executing various plans and policies effectively and efficiently.
2. **DETECTION ERRORS AND FRAUDS:** Through internal audit, frauds and errors can be detected easily.

3. **PREVENTION OF ERRORS AND FRAUDS:** By ensuring continuous evaluation, it contributes a lot in preventing the errors and frauds.
4. **REDUCTION IN WASTAGE:** Internal audit identifies the weaknesses and deficiencies of the organization and thereby helps in reducing wastages.
5. **SAFEGUARDING ASSETS:** Internal audit ensures that proper measures are in place to safeguard the assets.
6. **INCREASED EFFICIENCY:** It helps in improving the effectiveness of the internal control system and thereby improves the overall efficiency of the entity.

Q.NO.13 WHAT ARE THE FACTORS WHICH ARE REQUIRED TO BE CONSIDERED BY EXTERNAL AUDITOR WHILE MAKING USE OF INTERNAL AUDITORS WORK?

ANSWER:

As per SA 610, Using the Work of Internal Auditor, the external auditor can use the work of an internal auditor after conducting an evaluation of internal audit functions. Accordingly, the external auditor shall consider the following factors to determine the extent to which he can rely on the work of an internal auditor:

1. whether internal audit is undertaken by an outside agency or by a separate audit department within the entity.
2. The scope of internal audit, management action and the internal audit report.
3. Experience and qualification of internal auditor.
4. The technical compliance by internal auditor.
5. Authority vested on internal auditor and level of management to whom he is accountable.
6. Whether professional care has been taken by the internal auditor in conducting audit work.

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

TEST YOUR KNOWLEDGE:

1. **XYZ Ltd., an unlisted public company, is required to appoint an internal auditor as per the provisions of Companies Act, 2013. Accordingly, it has appointed Mr. A as the internal auditor who is a qualified Chartered Accountant. The statutory auditor of XYZ Ltd., M/S PQR and Associates is of the view that as the company has an internal auditor, they can rely on the direct assistance of the internal auditor and it can sufficiently reduce their audit work and liability. Give your opinion citing the guidance from relevant Standard.**

Answer: Write above answer

Q.NO.14 INTERNAL CONTROL Vs. INTERNAL CHECK Vs. INTERNAL AUDIT

ANSWER:

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

Q.NO.15 WRITE ABOUT RISK BASED INTERNAL AUDIT (RBIA).

ANSWER:

1. Institute of Internal Auditors (IIA) defines risk based internal auditing (RBIA) as a methodology that links internal auditing to an organisation's overall risk management framework.
2. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively.
3. Traditional internal audit only provides control assurance based on routine audit, RBIA provides Assurance on the effectiveness of risk management in addition to control assurance.
4. To put it differently, RBIAs give auditors a larger role in your risk reduction program.
5. By following RBIA internal audit should be able to conclude that:
   a. Management has identified, assessed and responded to risks above and below the risk appetite.
   b. The responses to risks are effective.
   c. Where residual risks are not in line with the risk appetite, action is being taken to remedy the same.
   d. Risk management processes, including the effectiveness of responses and the completion of actions, are being monitored by management to ensure they continue to operate effectively.
   e. Risks, responses, and actions are being properly classified and reported.

Q.NO.16 WHAT ARE ADVANTAGES OF RISK BASED INTERNAL AUDIT (RBIA).

ANSWER:

Risk-based internal auditing has a number of benefits over a more traditional audit approach.

1. **CONSISTENCY:** Developing a consistent and comprehensive approach to risk management makes it easier for an organization to adapt to changing conditions. Adjusting audit schedule to risk management framework will improve the overall organisation.
2. **TRANSPARENCY:** A risk-based approach to audit enables the internal auditors to identify risks correctly and allows management to put the right internal controls in place for the best performance. This provides a better understanding of the risks and enables organization to better manage them.
3. **SPECIFICITY:** Ranking and mapping risks with RBIA will allow allocate activity and funds to the areas that need the most attention, creating a unique risk management program rather than relying on external frameworks and recommendations.

Q.NO.17 EXPLAIN THE DIFFERENCES BETWEEN TRADITIONAL INTERNAL AUDIT VS. RISK BASED INTERNAL AUDIT.

ANSWER:

TRADITIONAL IA APPROACH	RISK BASED IA APPROACH
Audit plan is based on the audit cycle	Audit plan is based on the results of the business risk evaluation. Risky areas are covered first and more frequently.

Important risks might not be covered during the audit plan	Provides assurance that important risks are being managed properly
Focuses on deficiencies in controls and cases of non-compliance with policies and procedures	Focuses on risks that are not properly controlled.
IA resources are spread over all business activities	More efficient use of IA resources by concentrating on risk areas
Disagreement with the business management over the action plans leading to delays in implementation	Facilitates consensus with management on the needed action plans thus improving timely the implementation of corrective measures

Q.NO.18 WRITE ABOUT INTERNAL FINANCIAL CONTROLS (IFC) AND INTERNAL FINANCIAL CONTROL OVER FINANCIAL REPORTING (IFC-FR).

ANSWER:

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

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

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

C. **IFC vs. IFC-FR:**
   1. Internal Financial Control over Financial Reporting (IFC-FR) covers those controls which are elements of Financial Reporting i.e., of balance sheet, profit and loss accounts. They cover those risks which are having a direct or indirect reporting on financial statements.
   2. Internal Financial Control (IFC), in addition to ICFR, covers controls which ensure efficient and effective functions of business, controls which safeguard assets and ensure compliance of policies.
   3. To put it differently, IFC as a concept is much wider in scope when compared to IFC-FR.
   4. In fact, **IFC = IFC-FR + Operational Controls + Anti-fraud Controls**

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

<u>7. AUDIT IN AN AUTOMATED ENVIRONMNET</u>

Q.NO.1 EXPLAIN THE MEANING OF AUTOMATED ENVIRONMENT AND STATE ITS ADVANTAGES.

<u>ANSWER:</u>

1. **MEANING OF AUTOATED ENVIRONMENT:** The business environment in which, the processes, operations, accounting and even decisions are carried out by <u>using computer systems</u> – also known as <u>Information Systems</u> (IS) or <u>Information Technology</u> (IT) systems which makes the environment automated.

2. **ADVANTAGES:** Automated environment offers a lot of advantages:
   - **a.** It enables <u>accurate</u> data processing.
   - **b.** Computation becomes more <u>reliable</u>.
   - **c.** It can process <u>high volume</u> of transactions easily.
   - **d.** It makes business processes <u>faster</u>.
   - **e.** It improves <u>control efficacy</u> and security.
   - **f.** It minimizes the <u>human errors</u>.
   - **g.** It offers better <u>integration</u> among business processes.

<u>TEST YOUR KNOWLEDGE:</u>

1. Define the term automated environment and what are its benefits?

A. Write above answer

Q.NO.2 WHAT ARE THE COMPONENTS OF AUTOMATED ENVIRONMENT?

<u>ANSWER:</u>

Following are the general components of an automated environment.

1. Databases - Oracle 19C, MS-SQL Server;
2. Operating systems - Windows, Unix, Linux;
3. Hardware and Storage devices – servers, disks, tapes, network storage;
4. Network devices - switches, routers and firewalls;
5. Networks - local area networks, wide area networks, virtual private networks, etc.;
6. Physical and environmental landscape –IT facilities like Data center, physical access control mechanisms like biometric based access system, CCTVs, adequate HVAC system, fire suppression system etc.
7. Application software such as Package Software (e.g., Tally, QuickBooks), Small ERPs (e.g., Tally ERP, SAP, Business One, Focus ERP) and ERP applications for medium to large enterprises (e.g., SAP ECC, Oracle Enterprise Business Suite).

Q.NO.3 WHAT ARE THE AREAS OF USE OF COMPUTER IN AUDITING?

ANSWER:

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

1. Preparation of detailed audit programming.
2. Preparation of audit planning, scheduling and assignment of available manpower to different assignments in hand.
3. Checking of validity, consistency and reasonableness of entries.
4. Reviewing the internal control of the system.
5. Retrieving requires key information from the files for making comparison with the set of standard information.
6. Doing arithmetical computations and checking the arithmetical computations.
7. Doing analytical review of the data by way of comparison, ratio analysis, trend analysis, tests of reasonableness and so on.
8. Selecting representatives for vouching (Sampling).
9. Preparation of flow- charts.
10. Preparation of audit reports, documenting working papers and writing other communication, etc.

TEST YOUR KNOWLEDGE:

1. **What role does the technology play in audit?**

A. Write above answer

2. **How technology can be used in Audit?**

A. Write above answer

Q.NO.4 WHAT ARE THE VARIOUS TYPES OF CONTROLS IN AUTOMATED ENVIRONMENT?

ANSWER:

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

A. **APPLICATION CONTROLS:** Application controls are those controls (manual and computerised) that relate to the transaction and standing data pertaining to a computer-based accounting system. Application controls need to be ascertained, recorded and evaluated by the auditor.

B. **INPUT CONTROLS:** Control activities designed to ensure that input is authorised, complete, accurate and timely are referred to as input controls.
   a. **Range checks:** These ensure that information input is reasonable in line with expectations.
   b. **Compatibility checks:** These ensure that data input from two or more fields is compatible. For example, a sales invoice value should be compatible with the amount of sales tax charged on the invoice.

c. **Validity checks:** These ensure that the data input is valid.
d. **Exception checks:** These ensure that an exception report is produced highlighting unusual situations that have arisen following the input of a specific item.
e. **Sequence checks:** These facilitate completeness of processing by ensuring that documents processed out of sequence are rejected.
f. **Control totals:** These also facilitate completeness of processing by ensuring that pre-input, manually prepared control totals are compared to control totals input.
g. **Check digit verification:** This process uses algorithms to ensure that data input is accurate.

C. **PROCESSING CONTROLS:** Processing controls exist to ensure that all data input is processed correctly and that data files are appropriately updated accurately in a timely manner.

D. **OUTPUT CONTROLS:** Output controls exist to ensure that all data is processed and that output is distributed only to prescribed authorised users. The auditor must ensure that output is kept confidential and available to authorized users only.

E. **MASTER FILE CONTROLS:** The purpose of master file controls is to ensure the ongoing integrity of the standing data contained in the master files. It is vitally important that stringent 'security' controls should be exercised over all master files.

Q.NO.5 WHAT ARE THE VARIOUS TESTING METHODS IN AUTOMATED ENVIRONMENT?

ANSWER:

1. An auditor applies four types of tests to identify the reliability of controls and associated risks. These are
   a. Inquiry
   b. Observation
   c. Inspection and
   d. Reperformance.
2. Though inquiry is the most efficient, it must always be used with any of the three other methods to produce better results.
3. Reperformance, though the most effective method, is time consuming and less efficient.
4. Thus, keeping in mind the risk assessment, internal controls in place, desired level of evidence required the auditor needs to decide the appropriate method of testing.
5. Some of the common testing in an automated environment include the following:
   a. Obtain an understanding of the processing of an automated transaction by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
   b. Observe how a transaction is recorded by a user in different scenarios.
   c. Inspect the configuration of an application control.

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

Q.NO.6 DEFINE THE TERM AUDIT TRAIL AND STATE ITS BENIFITS?

ANSWER:

A. MEANING:

1. Audit trail may be defined as the documents, records relating to transactions that enables an auditor to trace the transactions from the source documents to the summarised total in accounting reports.
2. It is an orderly, step-by-step record of transactions that serves as a proof of a transaction's history, right from recording to tracking all changes that may take place.
3. For example, a sequentially numbered sales invoice copies would normally be listed in a Register and subsequently filed either in numerical or chronological order. Thus, it would be possible to trace a particular invoice from the daybook to the original file by reference to the number or date of the invoice.
4. In an automated environment accounting software provides the ideal example of audit trails. For example,
   a. when a transaction is entered in the software, the software will maintain a record of it
   b. Any further edits made to the details, such as a change in the name or amount will also be tracked by the software along with the user who made the changes and the time of change
   c. Even if some transactions were to be deleted, the software will track that as well and keep the record of everything since the original entry was made.

B. BENEFITS OF AUDIT TRAIL: A well-functioning audit trail offers the following benefits:

a. **User Accountability:** In an automated environment, a well-functioning audit trail system records the activities of every user. This promotes appropriate user behaviour because everyone is held accountable for their doings. Thus, introduction of virus to the system or unauthorised alteration of data can be prevented. Additionally, it helps to identify the intruders.
b. **Promotes Organization's Data Security:** A well-functioning audit trail system ensures data security as it protects data from unauthorized access and fraudulent activities by staff and external parties.
c. **Allows Reconstruction of Events:** An excellent audit log system allows organizations to understand the operations of users, including cyber attackers. Data retrieval is also possible in some cases.
d. **Detection of System Interference and Errors:** A functioning audit trails system indicates upcoming system interference, failures, and errors. Such detections allow an organization to respond accordingly to allow a smooth continuation of its operations.

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

Q.NO.7 WRITE A SHORT NOTE ON INFORMATION SYSTEMS AUDIT.

ANSWER:

INFORMATION SYSTEMS AUDIT:

1. Information systems auditing is an organizational function that evaluates asset safeguarding, data integrity, system effectiveness, and system efficiency in computer-based information systems.
2. The effectiveness of an information system's controls is evaluated through an information systems audit.
3. Information systems audit aims to establish whether information systems are safeguarding corporate assets, maintaining the integrity of stored and communicated data, supporting corporate objectives effectively, and operating efficiently.
4. It is a part of a more general financial audit that verifies an organization's accounting records and financial statements. The factors that led to the development of Information System Audit are:
    a. The consequences of losing the data resource;
    b. The possibility of misallocating resources because of decision based on incorrect data or decision rules;
    c. The possibility of computer abuse if computer systems are not controlled;
    d. The high value of computer hardware, software, and personnel;
    e. The high costs of computer error;
    f. The need to maintain the privacy of individual persons; and
    g. The need to control the evolutionary use of computers.

8. AUDIT SAMPLING AND ANALYTICAL PROCEDURES

Q.NO.1 EXPLAIN THE MEANING OF AUDIT SAMPLING AND STATE ITS BENIFITS.

ANSWER:

A. **MEANING:** According to SA-530, Audit Sampling is the application of audit procedures to less than 100% of the items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis to draw a conclusion about the entire population.

B. **BENEFITS OF AUDIT SAMPLING:** Audit sampling offers a number of benefits as follows:
   1. It reduces the workload of the auditor.
   2. It saves time and cost.
   3. As it substantially reduces the time for audit work, the auditor may devote more time for critical issues.
   4. Since the auditor verifies the transactions on sampling basis, he can devote more time on evaluating the operating effectiveness of internal controls. In this process, any weakness of the internal control system, if identified, can immediately be brought to the notice of the management.
   5. The auditor can form better conclusions by following audit sampling.

TEST YOUR KNOWLEDGE:

1. **Explain the advantages of audit sampling.**

A. Write above answer

Q.NO.2 WHAT ARE VARIOUS APPROACHES OR METHODS OF SAMPLING.

ANSWER:

The approaches or methods can be classified as follows:

A. **NON-STATISTICAL SAMPLING OR JUDGEMENTAL SAMPLING:**
   1. Under this technique, the sample size and its composition are determined based on auditor's own experience and knowledge.
   2. No statistical tool is applied to select the sample.
   3. The method is easy but subject to personal judgement.

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

1. **Random Sampling:** In this method of sampling each item of the population or within a given group (popularly known as stratum) has a known chance of selection. Random sampling can again be of two types:
   a. **Simple Random Sampling:**
      i) Under this method of sampling, each unit of the population has an equal chance of being selected in the sample.
      ii) Here selection is normally done either by choosing a random number manually from a random number table or allowing the computer programme to select a random number.
      iii) However, this method essentially requires the population units to be reasonably homogeneous or similar in nature.
   b. **Stratified Sampling:**
      - This method requires a given heterogeneous population to be first divided into a number of sub-populations (known as stratum) with homogeneous items.
      - Then selecting equal or unequal proportion of items from each group to form a representative sample of reasonable size.
      - Example: Trade receivable balances may be divided in five groups with specified ranges and then selection of trade receivables of a certain percentage can be done from each group.

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

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

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

Q.NO.3 WHAT ARE VARIOUS STAGES OR STEPS INVOLVED IN AUDIT SAMPLING.

ANSWER:

Audit sampling requires the following steps:

1. **SAMPLE DESIGN:** Here, the auditor selects the appropriate method based on the consideration of objectives of audit and nature of population.
2. **SAMPLE SIZE DETERMINATION:** Auditor decides the sample size to minimise the sampling risk. He generally applies statistical techniques to avoid subjectivity.
3. **SAMPLE SELECTION:** At this stage, using the selected methods, sample units are drawn from the population.
4. **PERFORMANCE OF AUDIT PROCEDURE:** Audit procedure is then performed on the selected sample units. Based on the results of the audit procedure, the auditor forms his opinion.

Q.NO.4 WRITE ABOUT THE RISK ASSOCIATED WITH SAMPLING.

ANSWER:

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

A. **SAMPLING RISK:** Since sample is only a selected part of the population, it can never reflect all the characteristics of the population. Thus, there will always be some amount of risk unavoidable in this process. This sampling risk can again be of two types as follows:
    1. **Sampling Risk associated with Compliance Procedure (i.e., Test of Control):** Here, the auditor, based on sampling procedure, may come to the conclusion that that the controls are more effective (or less effective) while they are not.
    2. **Sampling Risk associated with Substantive Procedure (i.e., Test of Details):** Here, the auditor, based on sampling procedure, may come to the conclusion that that the financial statements are free from any material misstatements while they are not.

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

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

Q.NO.5 WHAT ARE THE FACTORS TO BE CONSIDERED FOR AUDIT SAMPLING.

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

1. **OBJECTIVES OF AUDIT:** Audit sampling has to be done keeping in mind the objective of the audit procedure.
2. **NATURE OF POPULATION:** Audit sampling technique must be selected based on the degree of heterogeneity in the population.
3. **INTERNAL CONTROL SYSTEM:** Adequate internal control helps the auditor to reduce his sample size.
4. **MATERIALITY OF ITEMS:** For material items the auditor must increase the sample size to reduce the risk.
5. **SAMPLING RISK:** Audit sample must be so designed as to keep the sampling risk within the acceptable limit.
6. **NON-SAMPLING RISK:** This is the risk factor emanating from human error. The auditor must take due care to avoid non-sampling risk.
7. **TOLERABLE ERROR:** It is the limit of error which does not significantly impact auditor's opinion. For material items, the limit should be kept low.

Q.NO.6 EXPLAIN THE MEANING AND NATURE OF ANALYTICAL PROCEDURES.

ANSWER:

A. MEANING:

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

B. NATURE OF ANALYTICAL PROCEDURES: As per SA520, the nature of analytical procedures includes the following:

1. Analytical procedures consider comparison of entity's financial information with
   a. Comparable information of prior periods
   b. Any anticipated results of the organisation like budget or forecast or any estimation by the auditor like estimation of depreciation.
   c. Similar information of any other comparable entity belonging to the same industry or the industry averages.

2. Analytical procedures may also include consideration of relationships:
   a. Among different items of financial data that is expected to follow a predictable pattern like the operating profit margin.

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

3. Analytical procedures consider application of diverse analytical tools that may range from a simple comparison to complex analysis involving advanced statistical techniques.
4. Analytical procedures may be applied either on standalone or on consolidated financial statements. Moreover, they can be applied on any component or individual information of the statements.

Q.NO.7 WRITE ABOUT APPLICATION OF ANALYTICAL PROCEDURES.

ANSWER:

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

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

Q.NO.8 WHAT ARE VARIOUS TOOLS/TECHNIQUES FOR PERFORMING ANALYTICAL PROCEDURES?

ANSWER:

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

1. **TREND ANALYSIS:** Under this method, analysis is done for to assess fluctuation of the amount of any item over the year or years.
2. **TESTING OF REASONABLENESS:** This is done by comparing certain items or account balances with other accounts or balances. Some examples are as follows;
   a. Raw material consumption to production (quantity)
   b. Percentage of wastage and scrap against production and raw material consumption
   c. Work-in-progress based on material issued
3. **RATIO ANALYSIS:** This technique calculates different ratios between various items of financial statements in order to study their relationships. Some common ratios include:
   a. Gross Profit Ratio

b. Receivable Turnover Ratio
c. Inventory Turnover Ratio

4. **ANALYSING VARIOUS SOURCES OF INFORMATION:** Analytical procedures also require analysing the following sources of information.
   - **a.** Interim financial information
   - **b.** Budgets
   - **c.** Management Accounts
   - **d.** Non-financial information etc.

9. TYPES OF AUDITS

Q.NO.1 WHAT IS PERIODICAL OR FINAL AUDIT?

ANSWER:

A. MEANING:

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

B. ADVANTAGES:

1. Final audit is cost effective and ensures continued focus
2. The possibility of tampering with the books of accounts during the audit is considerably reduced as the audit work starts only after the books are closed
3. Non-interference with client's accounting work

C. LIMITATIONS / DISADVANTAGES:

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

Q.NO.2 WHAT IS CONTINUOS AUDIT?

ANSWER:

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

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

B. NECESSITY OF CONTINUOS AUDIT: Continuous audit is necessary where:

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

C. ADVANTAGES:

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

D. DEMERITS / DISADVANATGES / LIMITATIONS:

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

Q.NO.3 WHAT ARE THE DIFFERENCES BETWEEN PERIODICAL/FINAL AUDIT AND CONTINUOS AUDIT?

ANSWER:

POINTS OF DISTINCTION	CONTINUOUS AUDIT	PERIODICAL/FINAL AUDIT
Timing	It is conducted throughout the year.	It is conducted after preparation of final accounts.
Cost	It is more expensive.	It is less expensive.
Detection of errors and frauds	Errors and frauds are detected early.	Errors and frauds are detected late.
Scope	Detailed checking is possible.	Detailed checking is not possible.
Interim dividend	It helps in finalization of interim accounts and thus facilitates in declaration of interim dividend.	It does not facilitate in declaration of interim dividend.

Monotony of the audit staff	It leads to monotony of the audit staff as they are engaged in the same work throughout the year.	It does not lead to monotony of the audit staff as they are engaged in different organisations.
Efficiency of the client's staff	It improves the efficiency of the client's accounting staff.	Here the accounting staff may become lazy and inefficient and keep works pending.
Collusion	There is a possibility of collusion between audit staff and employees of the organisation.	There is hardly any possibility of collusion between audit staff and employees of the organisation.
Moral Pressure	As the audit staff are continuously engaged in the organisation, it maintains a moral pressure on the client's staff.	There will be less moral pressure on the client's staff as the auditor visits only after the finalization of accounts.
Applicability	It is applicable for large organisations.	It is applicable for small organisations.
Report	It facilitates timely submission of audit report.	It takes time to prepare and submit the audit report under periodical audit.

Q.NO.4 WRITE A SHORT NOTE ON INTERIM AUDIT.

ANSWER:

1. Interim audit is the audit conducted between two annual audits.
2. It may be conducted for a specific period, such as a quarter or half year, with an interim object of declaration of interim dividend or valuation of shares on a certain date, in case of mergers.
3. It is carried out by professionals, but has no legal status as the figures may be altered subsequently.
4. It is useful for:
   a. Ascertainment of interim profit and loss and declaration of interim dividend.
   b. Change in the structure of a partnership firm.
   c. Determining goodwill and net worth of any business for acquisition purpose.
   d. Investigation of any suspected fraud.
   e. Obtaining loans from financial institutions.

Q.NO.5 WRITE A SHORT NOTE ON LIMITED REVIEW.

ANSWER:

1. As per Clause 33 of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, a company shall submit its quarterly, year-to-date and annual financial results to the stock exchange in the manner prescribed in this clause.

2. Accordingly, a company has an option to submit audited or unaudited quarterly and year to date financial results to the stock exchange within forty-five days from the end of each quarter (other than the last quarter).
3. Under most of these circumstances the auditor finds little time to conduct thorough examination of books and other supporting documents.
4. Moreover, it may also not be possible for the client to balance books and provide all documentary evidences.
5. So instead of conducting a full-fledged audit, the auditor has to make restricted study of books and other documents. This system of review is called Limited Review.
6. It is to be noted that in case of Limited Review, generally accepted auditing standards are not followed. So, the scope of Limited Review is substantially narrower as compared to an audit.

Q.NO.6 WRITE ABOUT SCOPEWISE CLASSIFICATION Of AUDIT.

ANSWER:

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

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

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

Q.NO.7 WRITE ABOUT MANAGEMENT AUDIT.

ANSWER:

1. Management audit is a forward-looking, independent and systematic evaluation of the activities of the management for
   a. the improvement of the organizational profitability and
   b. attainment of other predefined objectives of the organization

   through well directed management function.
2. Management audit is a comprehensive and critical review of each and every aspect of the management process.
3. It is basically a tool of management control.
4. It covers all areas of management like planning, organizing, co-ordination and control. It assists managers at all levels in the effective discharge of managerial functions.
5. It acts as a guide, which helps in improving the efficiency of the management.

Q.NO.8 WRITE ABOUT OPERATIONAL AUDIT.

ANSWER:

1. Operational Audit involves examination of all the operations and activities of the entity under audit.
2. It provides an appraisal of whether the department is operating in conformity with prescribed standards and procedures laid down by the management.
3. Operational audit, in its initial stages, was developed as a branch of internal auditing.
4. Internal audit focuses on accounting operations of the entity but operational audit has a wider scope of working and covers all other operations, such as production and marketing too.
5. Operational audit is one of the management tools to get first-hand information.
6. It is more useful in an entity where the management is at a distance from actual operations.
7. It is very useful in large organizations where management cannot control the actual operations due to layers of delegation of responsibility.
8. The operational audit is also one of the tools used in large or geographically vast entities to control the operation and to fill up the gaps of information provided by department heads through periodic reports.

Q.NO.9 WRITE A SHORT NOTE ON TAX AUDIT.

ANSWER:

1. Tax audit can be defined as ‘an examination of financial records to assess correctness of calculation of taxable profit, to ensure compliance with provisions of the Income Tax Act and also ensure fulfilment of conditions for claiming deductions under Income Tax Act.’

2. Tax audit is required in addition to the financial audit since taxable income largely differs from accounting profit because of various allowances, disallowances, deductions and exemptions suggested under tax laws.
3. In India, the Income Tax Act, 1961 contains a number of provisions requiring tax audit of an entity.
4. Section 44AB gives the provisions relating to the class of taxpayers who are required to get their accounts audited from a chartered accountant.
5. The prime objective of tax audit is to stop tax evasion.

Q.NO.10 WRITE A SHORT NOTE ON SOCIAL AUDIT.

ANSWER:

1. Social audit is defined as the system of independent evaluation of operations of an organisation, examination of records relating to social responsibility accounting and critical appraisal of the impact of organisations on the society.
2. Business is a social institution and evolves out of social environment.
3. In course of earning profit business takes resources from society, so in return they should discharge certain duties to society also for long term sustainability.
4. In order to measure and examine how far the business concerns have been able to discharge their social responsibility, that is, how much contribution has been made by the concern towards social welfare, the concept of 'social audit' was introduced in business arena.
5. Social audit is not mandatory in most of the countries including India. This exercise is often undertaken by business houses voluntarily.

Q.NO.11 WRITE A SHORT NOTE ON PROPRIETY AUDIT.

ANSWER:

1. Propriety audit is the independent and systematic evaluation of the appropriateness of management decisions on the basis of public interest, financial discipline and behavioural standards.
2. In other words, it is an evaluation as to whether decisions have been undertaken in tune with the accepted rules, standards, policy and delegated power.
3. The objective of propriety audit is to ensure safeguard of assets, check misappropriation of funds, misutilisation of delegated authority and increase the productivity of management etc.
4. In India, propriety audit is not separately practiced. However, the Companies Act, CARO and other legislations contain sufficient provisions that require performance of propriety audit in the context of conventional statutory audit.

Q.NO.12 WRITE A SHORT NOTE ON PERFORMANCE AUDIT.

ANSWER:

1. A performance audit is an independent assessment of an entity's operations to determine if specific programs or functions are working as intended to achieve stated goals.
2. Performance audits are typically associated with government agencies at all levels as most government bodies receive federal funding.
3. Performance audits serve a fundamental purpose of government accountability.
4. Through performance audits government entities are held to objective standards of executing the responsibilities that they are legally authorized and charged to carry out.

Q.NO.13 WRITE A SHORT NOTE ON FORENSIC AUDIT.

ANSWER:

1. Forensic audit involves examination of legalities by blending the techniques of propriety audit, regularity, investigative and financial audits.
2. The objective is to find out whether or not true business value has been reflected in the Financial Statements and in the course of examination to find whether any fraud has taken place.
3. Major accounting scandals involving Enron, World Tel, Parmalat and Satyam have been widely reported. In all these cases, the methods and purpose of manipulations in the Financial Statements were very sophisticated.
4. The Companies (Auditors' Report) Order, 2020, requires auditors to report, amongst others, "whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved are to be indicated". In this background, the techniques of forensic auditing have gained importance.

Q.NO.14 WRITE A SHORT NOTE ON ENVIRONMNETAL AUDIT.

ANSWER:

1. Environmental audit is an excellent management tool for relating productivity to pollution.
2. Environmental audit is the examination of the correctness of environmental accounts. In broader sense, environmental auditing is the examination of accounts of revenues and costs of environmental and natural resources, their estimate, depreciation and values recorded in the books of accounts.
3. Under Environment (Protection) Act, 1986, every person carrying operations of an industry, operation or process requiring consent under Section 25 of the Water (Prevention & Control of Pollution) Act, 1974 or under Section 21 of the Air (Prevention & Control of Pollution) Act, 1981 or both or authorisation under the Hazardous Wastes (Management and Handling) Rule of 1989 issued under the Hazardous (Protection) Act, 1986 is required to submit an environmental audit report.

Q.NO.15 WRITE A SHORT NOTE ON HUMAN RESOURCE AUDIT.

ANSWER:

1. Human Resource Audit is a comprehensive method of objective and systematic verification of current practices, documentation, policies and procedures prevalent in the HR system of the organization.
2. An effective HR audit helps in identifying the need for improvement and enhancement of the HR function.
3. It also guides the organization in maintaining compliance with ever-changing rules and regulations. HR audit, thus, helps in analysing the gap between 'what is the current HR function' and 'what should be/could be the best possible HR function' in the organization.
4. Though HR auditing is not mandatory like financial auditing, yet, organizations these days are opting for regular HR audits in order to examine the existing HR system in line with the organizations policies, strategies and objectives, and legal requirements. HR auditor can be internal or external to the organization.

10. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

Q.NO.1 WHAT IS VOUCHING? ALSO STATE WHAT IT INCLUES?

ANSWER:

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

1. All transactions undertaken by the entity have been recorded and nothing has been left out.
2. transactions recorded in the books of accounts are supported by documentary evidence.
3. No fraudulent transaction has been recorded in the books of accounts.
4. Transactions that have been recorded belong to the current accounting year.
5. Necessary vouchers relating to entries recorded in books are with the client.
6. All transactions are properly authorized by the person responsible to do so.
7. Transactions have been recorded at the correct value.

Q.NO.2 EXPLAIN THE MEANING OF VERIFICATION AND WHAT DOES IT INCLUDE?

ANSWER:

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

1. Examination of existence of the assets or liabilities on the reporting date.
2. Examination of ownership and control of the asset or liabilities on the reporting date.
3. Examination of possession of the assets on the reporting date.
4. Examination of charges, if any, against the assets.
5. Examination of accounting of assets or liabilities.
6. Examination of correctness of valuation of assets or liabilities.
7. Examination of adequacy of disclosures as required by the relevant regulation

PROFIT AND LOSS ITEMS

Q.NO.3 HOW TO CONDUCT AUDIT OF REVENUE FROM OPERATIONS?

ANSWER:

Revenue from operation comprises sale of goods, sale of services and other operating revenues. Other operating revenue includes any for example, Discount Received, Bad Debt Recovery etc.

AUDIT PROCEDURES TO BE FOLLOWED:

A. OCCURRENCE:

1. The auditor should ensure that all revenue items recognized are genuine and no sale transactions have been recorded twice.
2. He may test check a few invoices with accounting entries.
3. Check the sequence of sales invoices, review the recording of unusual transactions, verify the return transactions with sales invoice, challan, credit note and stock records.
4. He should also obtain confirmation from few customers to check whether the transactions are genuine.
5. He should ensure that no fake sale transactions have been recorded.

B. COMPLETENESS

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

C. MEASUREMENT:

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

Q.NO.4 HOW TO CONDUCT AUDIT OF OTHER INCOME?

ANSWER:

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

AUDIT PROCEDURES TO BE FOLLOWED:

A. OCCURRENCE

1. The auditor shall obtain a list of new fixed deposits opened during the year along with the information on rate, tenure and date of investment.
2. He shall obtain a confirmation of interest income from bank. Also obtain a copy of Form 26AS of Income Tax to confirm the interest income and related TDS.
3. He should investigate the investment ledger further to see the new investments made.
4. He should trace a sample of dividend/interest received from the cash book through dividend/interest warrants to investment certificates and their deposit into the bank.

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

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

C. **MEASUREMENT:**
   1. The auditor must check the accuracy of interest calculation on new fixed deposits and fixed deposits existing on the opening date of the year.
   2. He should also see that dividend income received is accurate.
   3. In certain cases, dividends and interest are received by the client after deduction of tax at source. The auditor should ensure that dividends and interests are recorded at gross amounts.

Q.NO.5 HOW TO CONDUCT AUDIT OF PURCHASES?

ANSWER:

As a part of an audit exercise, the auditor examines the purchase transactions and related internal control to ensure that there is no material misstatement in the amount of purchase and accounts payable reported in the financial statements.

AUDIT PROCEDURES TO BE FOLLOWED:

A. **OCCURRENCE**
   1. The auditor must ensure that only genuine purchases have been recorded in the books of accounts. He may examine the purchase orders, goods received notes and purchase invoices to satisfy himself.
   2. Photocopy of purchase invoices should not be allowed.
   3. Moreover, purchase invoices must be in the name of the entity.
   4. He shall see whether all the purchases are approved by the relevant authority, especially in the case of purchases from related parties.

B. **COMPLETENESS**
   1. He should apply the cut-off procedure to ensure that purchases effected during the year are only recognised in the current accounting period.
   2. The auditor should see that purchase invoice should be booked only once the risk and reward incidental to the ownership has been transferred.
   3. The auditor must check the return transactions carefully based on relevant documents.
   4. He shall ensure correct accounting for goods-in-transit.

C. **MEASUREMENT**
   1. The auditor shall see that purchase transaction values have been correctly calculated considering the trade discount applied.
   2. Information relating to input tax credit shall be verified.

Q.NO.6 HOW TO CONDUCT AUDIT OF EMPLOYEE BENEFIT EXPENSES?

ANSWER:

Employee benefit expenses represents the total amount payable by the organisation to its employees and essentially includes, apart from the wages and salaries in cash, all types of perquisites, post-employment benefits including gratuity, superannuation, leave encashment, provident fund contribution, ESI contribution as well as employee welfare expenses etc.

AUDIT PROCEDURES TO BE FOLLOWED:

A. **UNDERSTANDING OF POLICIES:** The auditor shall obtain understanding of:
   1. company's recruitment, promotion and retirement policies, remuneration schemes
   2. evaluate the internal control associated with these expenses

B. **OCCURRENCE**:
   1. The auditor should ensure that all expenses included in the 'employee benefit expenses' are genuine.
   2. For a sample of newly appointed employees, he may conduct a complete examination of their appointment and remuneration paid as per terms.
   3. Similarly, he may collect a list of employees resigned or terminated during the year and see that their payments have been appropriately decided and settled.
   4. He should obtain the pay roll register and conduct and examination of reasonability of remuneration and investigate irregularities, if any.
   5. He should also see that all adjustments such as outstanding salary, PF contribution, deposit of TDS, PF and ESI premium have been appropriately recorded.

C. **COMPLETENESS:**
   1. The auditor shall see that all the employee benefit expenses have been appropriately recorded in the books of accounts.
   2. He should also check whether all the amount of money deducted from salary have been duly deposited and if not, the same have been shown as a current liability.

D. **MEASUREMENT:**
   1. The auditor must see that the total amount of remuneration is correctly determined. He may conduct a test on a sample to check the same.
   2. He should check whether statutory deductions have been accurate and post-employment benefits have been determined as per the policy adopted.

Q.NO.7 HOW TO CONDUCT AUDIT OF DEPRECIATION AND AMORTISATION EXPENSES?

ANSWER:

Depreciation is the charge representing the cost of a tangible asset allocated over its effective life. The similar charge for an intangible asset is known as amortization.

AUDIT PROCEDURES TO BE FOLLOWED:

A. OCCURRENCE

1. The auditor shall obtain the fixed asset register and identify the items of assets acquired, sold and discarded during the year.
2. He may select a sample of assets on materiality considerations and verify the rates and amount of depreciation and amortisation calculated.

B. CUT-OFF

1. The auditor needs to ensure that depreciation is charged on the assets purchased from its date of put to use and not form purchase date.
2. Moreover, he shall also see that, in case the company has a policy of charging depreciation on time basis
3. Deprecation on items acquired during the year is calculated from the date of put to use to year end and for items sold, from the beginning of the year up to the date of sale.

C. COMPLETENESS

1. He must ensure that depreciation and amortization have been charged on all eligible tangible and intangible assets respectively and no fake assets have been considered for this purpose.
2. He shall also ensure that depreciation on revalued amount has been properly accounted from revaluation reserve.

D. MEASUREMENT

1. The auditor shall see that the rate of depreciation is consistent with the rates suggested in Schedule II and the amount of depreciation and amortisation has been calculated accurately based on the rates and time involved.
2. He shall ensure that the rates have been decided in conformity with the effective life of assets.
3. He should also see that residual value has been properly determined.
4. The auditor shall also see that in case of change in estimation of useful life the amount of depreciation has been calculated appropriately.

Q.NO.8 HOW TO CONDUCT AUDIT OF FINANCE COST?

ANSWER:

Generally, Finance Cost comprises of interest cost on structured debt instruments such as Debentures as well as traditional institutional finance such as Bank Loan, secured or unsecured.

AUDIT PROCEDURES TO BE FOLLOWED:

A. OCCURRENCE:

1. The auditor shall see whether interest has been provided on all debt instruments and loans.
2. He shall verify the amount of interest payment form bank statement and shall check the same with accounting entries in the cash book and general ledger.
3. He shall see that interest was paid and provided only in respect of loans outstanding either for a part of the year or for entire year.

B. CUT-OFF: The auditor shall ensure that interest has been provided only for the period the loan was outstanding during the year.

C. COMPLETENESS: The auditor shall ensure that interest due but not paid has also been considered as Accrued Interest and the same is appropriately accounted and shown in the financial statement.

D. MEASUREMENT:

1. The auditor must verify the calculation of interest payable based on the rate, loan amount outstanding and the period for which the loan remains outstanding during the year.
2. He shall be extra careful with loan items repaid during the year and debentures redeemed during the year.

Q.NO.9 HOW TO CONDUCT AUDIT OF OTHER EXPENSES?

ANSWER:

Other Expenses in the Statement of Profit and Loss include Power and Fuel, Rent, Repairs, Insurance, Travelling and Miscellaneous Expenses. These are some essential and incidental expenses to run the organisation.

AUDIT PROCEDURES TO BE FOLLOWED:

A. OCCURRENCE:

1. The auditor needs to ensure that all expenditure charged against the revenue are genuine. For this purpose, he should vouch the expenditure based on relevant documents.
2. With respect to rent he should obtain a monthly expense schedule along with the rent agreements and verify whether the agreement is in the name of the company and whether the rent for all the months has been recorded.
3. With respect to power and fuel expenses, the auditor should collect a monthly expense schedule and see that the expense for all the months has been recorded.
4. With respect to insurance expenses, the auditor should obtain a summary of insurance policies taken along with their validity period and see that the expense shown is genuine.
5. With respect to legal and professional expenses, the auditor should collect a consultation-wise summary and see that the expense is genuine.
   a. For monthly retainership agreements, he shall verify that expense for all 12 months has been recorded.
   b. For non-recurring expenses a test on selected sample may be preferable.
6. For all other expenses, the auditor shall conduct examination on selected sample of transaction to ensure their validity.

B. CUT-OFF: The auditor should ensure that expenses charged against the revenue are related to current year only. He should be extra cautious with rent and insurance expenses as the often involve advance payments.

C. **COMPLETENESS:** The auditor should ensure that the transactions are properly authenticated as per the policy of the company, appropriately classified and proper accounting entry has been done for their payment and adjustments (e.g., outstanding and prepaid expenses).

D. **MEASUREMENT:**
   1. In case of monthly expenses as per agreement, the auditor should verify the calculation of the expense and adjustment for outstanding and prepaid expense, if any.
   2. He should be extra careful with escalation clause and rent agreements terminated during the year.
   3. For other expenses he shall evaluate whether the same is reasonable based on the data available for past years.
   4. He may perform analytical procedures such as expenditure per unit of production analysis to assess overall reasonableness of expenditure.

BALANCE SHEET ITEMS

Q.NO.10 HOW TO CONDUCT AUDIT OF PROPERTY, PLANT AND EQUIPMENT?

ANSWER:

Property, Plant and Equipment constitute a significant portion of total assets of an entity. According to the Guidance Note on Audit of Property, Plant and Equipment issued by ICAI, the term 'Property, Plant and Equipment' refers to such tangible items that

- are held for use in the production or supply of goods or services, for rental to others or for administration purposes; and
- are expected to be used during more than one period.

AUDIT PROCEDURES TO BE FOLLOWED:

A. **EXISTENCE:**
   1. The auditor must ensure physical verification of the assets to confirm that they exist and are under the possession of the client.
   2. He must tally the physical verification report with the asset register maintained by the company as at the reporting date. He shall demand explanations for any discrepancies found in this process.
   3. He shall specifically ensure that assets that are not in the working condition have been accounted for as deletions.

B. **RIGHTS AND OBLIGATIONS:**
   1. The auditor should verify that PPE additions have been approved by the responsible official and such additions are as per the capital expenditure budget approved by the board.

2. He shall also verify whether appropriate internal controls like inviting competitive quotations or floating tenders were done before finalising the vendor.
3. The auditor shall check that PPE purchase invoices are in the name of the client that entails the legal ownership. For land and building, the auditor shall verify the title deed of the property.
4. In case any charge is created on any immovable property due to any loan taken from a bank or financial institution and hence the original title deed is with the lender, the auditor shall ask the management to obtain a written confirmation from the lender in this respect.
5. In relation to all deletions, he shall verify management's rationale for deletion and also check managements authorization for the same.

C. COMPLETENESS:

1. He shall also verify the PPE schedule (asset class wise) maintained by the management and tally the closing balances to the entity's books of accounts.
2. He should check the arithmetical accuracy of the movement in PPE schedule and reconcile the opening balance with the closing balance of each class of asset by considering the additions and disposals during the year.

D. VALUATION:

1. The auditor shall see that all items of PPE have been carried at cost less accumulated depreciation less accumulated impairment loss.
2. The cost, for this purpose, includes all costs incurred to acquire or construct the PPE and all subsequent costs to replace part of it.
3. He shall also verify the installation certificate to know the date of installation of the asset.
4. The auditor shall verify whether depreciation has been charged on all items except the freehold land.
5. He shall also see that the depreciation method reflects the pattern in which the future economic benefits are expected to be derived from the assets and also comply with Schedule II of the Companies Act 2013.

Q.NO.11 HOW TO CONDUCT AUDIT OF PATENT AND COPYRIGHT?

ANSWER:

PATENT: A patent is an exclusive right granted by the Government to the manufacturer to dispose of or otherwise benefit from the result of the invention of a production process. It is an official document, which secures to an investor exclusive right to make, use and sell his invention.

COPYRIGHT: A copyright is an exclusive right granted by the Government to publish or republish a book, report, or any other literary work, music composition or other work of art etc. The right is primarily granted to the author of the literature or creator of the art work. In India, copyright is valid for the lifetime of the author/creator and even fifty years after his death

AUDIT PROCEDURES TO BE FOLLOWED:

A. EXISTENCE:

1. A schedule of patents and copyright held by the company should be procured from the management.
2. The document of each patent and contract paper of each copyright should be physically verified by the auditor to ensure that it has been duly registered.
3. The auditor shall ensure that the patent is in active use in production of goods or rendering services.

B. RIGHTS AND OBLIGATIONS:

1. The ownership of patents and copyrights should be verified by inspection of the certificate of patent issued in the name of the client and the contract paper of copyright.
2. If it has been purchased, the agreement surrendering it in favour of the client should be examined.
3. The last renewal receipt should be examined to ascertain that the patent has not lapsed.
4. The auditor has to verify that renewal fees have been paid on due dates.
5. The auditor must ensure that the copyrights shown in the financial statement are yet to expire.

C. COMPLETENESS:

1. The auditor should check the patent and copyright register carefully in order to verify that all the items have been properly included therein.
2. He must ensure that patents and copyrights acquired during the year has been entered in the register and items lapsed during the year has been removed properly.
3. He shall verify the arithmetical accuracy of the above movements in asset schedule.

D. VALUATION:

1. The auditor should ensure that patents and copyrights are being shown at cost less amortisation charges.
2. He shall also see that the amortisation rate follows the pattern in which the benefits are expected to be consumed.
3. In case it is purchased from a third party, the cost of the patent and copyright is the acquisition cost. Also, the cost of registration of the same in the client's name should be included in the valuation, while the renewal fees for patents should be charged off to revenue.
4. If the patent has been developed by the client in house, all development expenses, legal charges, including registration fees and other direct costs incurred in creating it, should be capitalized (as per Ind AS 38 or AS 26).
5. The cost of patent should be written off over the legal term of its validity or over its useful commercial life, whichever is shorter.
6. The cost of the copyright should be written off over the legal term of its validity.

Q.NO.12 HOW TO CONDUCT AUDIT OF INVESTMENTS?

ANSWER:

Investments are the assets held by an enterprise for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits to the investing enterprise.

AUDIT PROCEDURE TO BE FOLLOWED

A. EXISTENCE:

1. The auditor shall collect a schedule of all short and long-term investments from the management with all possible details including their name, nature, purchase price etc.
2. He shall tally the aggregate figure of the schedule with the figure shown in the balance sheet.
3. He shall physically verify all the certificates, and de-mat statement details to check that they are in the name of the client on the reporting date. Verification of certificates should be done in a single sitting to avoid producing same certificates more than once.
4. In case the certificate of investment is yet to be received, purchase of the same should be verified based on allotment advice, broker's note and receipt, etc.
5. For sale of shares or other listed securities, trading account statement may be verified.
6. In case investments are not held by the entity in its own custody, then a certificate should be obtained from the relevant authority.

B. RIGHTS AND OBLIGATIONS:

1. The auditor shall verify the Memorandum and Article of the company to determine the power of the company to invest the surplus funds outside.
2. By verifying all the certificates, he shall determine the rights of the company in respect of the investments made, especially, the interest and dividend.
3. The auditor shall also see that all interest has been duly received and included in income. Outstanding interest if any should be recalculated and verified with the figure shown.

C. COMPLETENESS:

1. The auditor shall ensure that the schedule of investment is exhaustive (complete).
2. He shall also ensure that all movements in the investment ledger have been appropriately recorded.

D. VALUATION:

1. The auditor shall see that all costs incurred in connection with purchase of investments have been capitalised. However, in case the investment is purchased at cum-interest price, he shall see that cost doesn't include the interest component.
2. He shall also see that bonus shares received by the company are recorded in the investment ledger without attributing any cost to it.
3. In case of right shares purchased by purchasing the right also, the cost of right entitlement must also be capitalised.

4. He shall see that any pre-acquisition dividend is credited to the investment account itself and not considered in the Statement of Profit and Loss.
5. The auditor shall also verify that the value of the investment has been determined following the relevant accounting standards keeping in mind the nature of investments.

Q.NO.13 HOW TO CONDUCT AUDIT OF INVENTORIES/STOCK IN TRADE?

ANSWER:

A. EXISTENCE

1. The auditor should review the client's plan to verify inventory physically. He shall see that the process is properly supervised.
2. Where the client follows periodic system stock count should be done at the end of the period. On the other hand, where the client follows perpetual system, stock count should be done at interim dates.
3. The auditor must satisfy himself about any inventory lying at public warehouses or with third party.

B. RIGHTS AND OBLIGATIONS

1. The auditor shall also vouch recorded purchases to underlying documentation such as purchase invoice, purchase order, Goods Received Notes etc to determine that client is the owner of such goods.
2. He shall evaluate consignment agreement and examine the terms and conditions binding on the client.
3. He shall also obtain confirmation from the third parties for inventories lying with them.

C. COMPLETENESS

1. The auditor should perform analytical procedure to identify any abnormality.
2. He should collect non-financial information such as weights and measures and check the same with physical verification reports.
3. He shall reconcile physical inventory amounts with perpetual records including stores ledger. The value of the inventory should also be tallied with the amount recorded in the books as adjustment entry of closing stock.

D. VALUATION

1. The auditor must determine the appropriateness of the method of issuing inventory (LIFO, FIFO, Weighted Average, etc.) for valuation purpose.
2. Value of raw materials must be examined based on the cost of purchase, carriage inwards etc. The auditor shall see that lower of cost and NRV has been considered as the value.
3. He shall also ensure that work-in-progress has been valued considering the completed stage of production and all direct and relevant indirect costs (up to works cost).
4. He shall ensure that cost of finished goods includes all direct and relevant indirect costs.

Q.NO.14 HOW TO CONDUCT AUDIT OF LOANS?

ANSWER:

A. EXISTENCE:

1. At first, the auditor must obtain separate schedules of long-term and short-term loans and advances.
2. He should verify whether the balances shown in the schedule agree with the respective ledger accounts.
3. He should also attempt to obtain written confirmation from those who have been granted the loans and advances.

B. RIGHTS AND OBLIGATIONS

1. The auditor should see that loans and advances have been authorised by the Memorandum and Articles of Association.
2. He shall be extra cautious in verifying the authorisation for related party loans and advances.
3. In case loans and advances have been granted against any security, the auditor shall verify the mortgage deed for the terms and conditions. For unsecured loans, he shall judge the possibility of its recovery.
4. In case advances granted to the employees, the auditor shall examine whether the instalments have been deducted from their salary regularly.

C. COMPLETENESS

1. The auditor should see that all the loans and advances that are outstanding on the reporting date have been recorded.
2. He should also see that all the money recovered against the advances have been appropriately recorded against the respective advances.

D. VALUATION

1. He shall obtain an aging schedule of different loans and a list of loans under litigations.
2. He should also verify the provision for bad and doubtful debts.
3. He shall see that write-offs are properly authorised by a responsible official.

Q.NO.15 HOW TO VERIFY TRADE RECEIVABLES?

ANSWER:

A. EXISTENCE:

1. The auditor should obtain a schedule of debtors duly signed by a responsible officer and examine it with reference to individual debtors' accounts.
2. The auditor should carry out an examination of the relevant records himself about the validity, accuracy and recoverability of the trade receivables balances.
3. The auditor should check the agreement of balances as shown in the schedules of trade receivable with those in the ledger accounts.

B. RIGHTS AND OBLIGATIONS:

1. The auditor must ensure that the company has valid claims in respect to the amount shown as debtors.
2. He shall examine the bills and notes receivables to see whether those are legally held by the company
   .

C. COMPLETENESS

1. The auditor should ensure that all debtors and receivables have been included in Trade Receivables. In case of dispute, he must obtain confirmation from debtors in this respect.
2. Inspect relevant correspondence such as court order declaring insolvency of a debtor.
3. Verification of subsequent realisations is a widely used procedure.

D. VALUATION:

1. The provision for bad and doubtful debts is to be recomputed and compared it with past period for assessing its reasonableness.
2. The calculation of discount on bills must be verified.
3. Rebates and discount allowed in excess of normal terms should be investigated.
4. Bad debt written off should be examined.

Q.NO.16 HOW TO VERIFY CASH AND CASH EQUIVALENTS?

ANSWER:

Cash and Cash equivalent includes cash in hand, stamps in hand, balances held with bank in current accounts/ margin money accounts, cash credit accounts (debit balance), fixed deposits, and cheques in hand, etc.

AUDIT PROCEDURE TO BE FOLLOWED

A. EXISTENCE:

1. The auditor shall exercise special care to verify cash balances. They shall be preferably checked by surprise.
2. If the company maintains any rough Cash Book or details of daily balances, the auditor shall perform test check to see that entries in the Cash Book are accurate.
3. The auditor shall also perform a cash sensitivity analysis (by calculating total receipts and payments month wise) to determine if there is any abnormal variation in the same in a month.
4. In such a case the auditor shall enquire into the same and demand explanation from the management.
5. He shall also obtain the Bank reconciliation Statements for every bank account as at the reporting date to rule out possibility of any error in the cash book.
6. The BRSs must be signed by the accountant and approved by responsible official. He shall also ask the management to reconcile all discrepancies.

7. He shall also communicate with the respective banks and obtain written confirmation regarding the balances held in different bank accounts and deposits.

B. **RIGHTS AND OBLIGATIONS:** The auditor shall verify that all the deposits are in the name of the client. For this purpose, the confirmation of the banker and certificate of such deposits shall be examined.

C. **COMPLETENESS:** The auditor shall ensure confirmation of 100% of the bank accounts. He shall also be careful to include all items of cash in hand in the total balance.

D. **VALUATION:** In addition to performing the above steps, the auditor shall also see that all bank balances representing holding of foreign currencies have been appropriately restated at the exchange rate prevailing on the date of reporting.

Q.NO.17 HOW TO VERIFY SHARE CAPITAL?

ANSWER:

A. **EXISTENCE:**
1. The auditor must conduct a reconciliation between the opening and closing balance of share capital to know whether there was any new issue, capitalisation or buyback of equity shares or redemption of preference share.
2. In case of change he must ensure that the revised capital is within the limit of authorised capital of the company.
3. He must examine that the transactions effecting the change in share capital are genuine and properly authorised. He should examine the resolutions of meetings of the BOD and shareholders for this purpose.

B. **RIGHTS AND OBLIGATIONS:**
1. He should ensure that the new issue satisfies all the regulatory requirements of Companies Act, 2013, SEBI regulations and guidelines.
2. In specific, he shall see that no shares have been issued at discount.
3. In case shares have been issued at premium, he shall see that the balance of Share Premium has been utilised only for the purposes permitted.
4. With respect to issue of sweat equity shares, right shares, bonus shares etc. he shall ensure that the rules have been duly complied with.

C. **COMPLETENESS:** The auditor must ensure that all changes made in share capital have been duly given effect and accounting entries are adequate.

D. VALUATION: The auditor must verify that the proceeds collected are correct. For this purpose, he shall verify the calculation of total proceeds received, its allocation to various heads and also underwriter's commission payable and settlement of their accounts with liability.

Q.NO.18 HOW TO VERIFY OTHER EQUITY / RESERVES AND SURPLUSES?

ANSWER:

A. EXISTENCE:

1. The auditor must trace and tally the opening balance of reserves with their closing balances and needs to identify the changes, if any.
2. In case there is addition during the year, such as issue of new shares at premium, transfer to General Reserve from current year's profit, revaluation profit etc., the auditor needs to ensure that such additions are genuine, properly authorised by appropriate resolutions in the meetings of BOD and members.
3. Similarly, for any reduction in balances, the auditor needs to find out the resultant transaction and its validity.

B. RIGHTS AND OBLIGATIONS: The auditor must ensure that addition and utilisation of balances of various items have been in compliance with the relevant Act and Regulations and only for specified purposes.

C. COMPLETENESS: The auditor must ensure that all changes made in Other Equity items have been duly given effect and accounting entries are adequate.

D. VALUATION: The auditor must ensure that the additions and utilisations from various balances of Other Equity have been calculated appropriately. For example, in case of utilization of accumulated profits for dividend payment, the amount so utilised must satisfy the conditions laid down in Companies (Declaration and Payment of Dividend) Rules, 2014.

Q.NO.19 HOW TO VERIFY BORROWINGS?

ANSWER:

A. EXISTENCE:

1. The auditor should collect a schedule of all borrowings with details regarding the date of procurement of the loan, period of loan, rate of interest, amount of loan and assets pledged against the loan, if any.
2. He shall examine the loan agreements to ensure that the loans have been taken in name of the client. He shall tally the loan recorded with the loan agreement.
3. In case of bank loan, he shall obtain a confirmation from the bank regarding the amount of loan outstanding and shall tally the same with the balance of loan shown in the books.

B. RIGHTS AND OBLIGATIONS:

1. The auditor shall ensure that the loan agreement adheres to all such rules in MOA and AOA.
2. He shall verify that the procurement of loan has been properly authorised in the form of a resolution of the Board.
3. The auditor should collect a certificate from the lender regarding the asset pledged with the lender and shall verify the information from the register of mortgage maintained by the client.
4. He shall also enquire about the nature of the charge - fixed or floating.

C. COMPLETENESS:

1. The auditor shall ensure that information regarding all loans has been produced before him and no loan that was paid earlier in full has been shown as outstanding.
2. Also, he must ensure that information about the assets pledged and the nature of charge is complete.
3. He shall verify all new loans taken during the year and check the minutes of the meetings of the Board for authorisation of the same.

D. VALUATION:

1. The auditor shall check whether the accounting policies and methods of recording the loan are appropriate and applied consistently.
2. He shall also examine whether the interest payable on such loan has been paid in due time and the same has been accounted for accordingly.
3. In case of amortizing loan (i.e., loans of which principal amount is repayable in instalments) taken by a company, the auditor shall determine the current maturities of the loan.

Q.NO.20 HOW TO VERIFY TRADE PAYABLES?

ANSWER:

A. EXISTENCE

1. At first, the auditor shall examine whether an effective internal control system exists in the organisation relating to the transactions with creditors.
2. He shall collect a schedule of trade creditors from the management with all possible details including the name of the creditor and amount payable. He shall verify the same with the balance of individual creditor’s account in the ledger.
3. With prior permission from the client, he shall collect confirmation from some selected creditors regarding the amount payable to them.

B. RIGHTS AND OBLIGATIONS: The auditor shall also examine that all the terms and conditions of the contract with the supplier have been duly complied. He shall ensure that the goods purchased have actually been received and/or services have been provided in due course. For this purpose, Goods Inward Book may be examined.

C. COMPLETENESS:

- **a.** The auditor shall ensure that no trade creditor is excluded from the schedule. He may collect a confirmation from the management in this respect.
- **b.** He shall be extra cautious while verifying the transactions near the end of the year.

D. VALUATION:

- **a.** The auditor shall see that the total of balances as per the schedule of creditors tallies with the total of balances of all creditors' account.
- **b.** He may select a few sample credit sale transactions and shall verify the correctness of recording the same based on invoice, Goods Received Note, Purchase Day Book and respective ledger heads.
- **c.** The auditor shall also verify the transactions relating to return of goods from Return Outward Book and see that the same has been correctly posted to creditors' accounts.
- **d.** In case any discount is received from the supplier, the same shall be examined from the correspondence with creditors. Its accounting treatment shall also be verified.

SPECIAL ITEMS

Q.NO.21 HOW TO VERIFY ALTERATION OF SHARE CAPITAL?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor must confirm that alteration was authorised by articles.
2. He shall verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He shall verify that alteration had been effected in copies of Memorandum, Articles, etc.
4. He shall check whether there is any change in the voting percentage of shareholders due to consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.
5. He has to confirm that the alter share capital's denomination should be more than rupee one.
6. He has to verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alterations have been effected therein.

Q.NO.22 HOW TO VERIFY ISSUE OF BONUS SHARES?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor must confirm that issue of Bonus Share was authorized by articles.
2. He shall verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He shall check that the company has issue fully paid-up bonus shares to its members only.

4. He shall confirm that the issue of bonus shares shall not be made by capitalising reserves created by the revaluation of assets.
5. He shall check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
6. He must check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
7. He shall check whether the partly paid-up shares are made fully paid-up.
8. He must check whether the bonus shares shall not be issued in lieu of dividend.

Q.NO.23 HOW TO VERIFY SPLITTING OF SHARES?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor shall confirm that alteration was authorised by articles.
2. He should verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He should verify that alteration had been effected in copies of Memorandum, Articles, etc.
4. He should verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alterations have been effected therein.

Q.NO.24 HOW TO VERIFY REISSUE OF FORFEITED SHARES?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor should ascertain that the board of directors has the authority under the Articles of Association of the company to reissue forfeited shares. Check the relevant resolution of the Board of Directors.
2. He should vouch the amounts collected from persons to whom the shares have been allotted and verify the entries recorded from re-allotment. The auditor should check the total amount received on the shares including received prior to forfeiture, is not less than the par value of shares.
3. He should verify that computation of surplus amount arising on the reissue of shares credited to Capital Reserve Account and
4. Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 is essential. The auditor needs to ensure the same.

Q.NO.25 HOW TO VERIFY ISSUE OF DEBENTURES?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.

2. He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.
3. He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.
4. If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.
5. Compliance with SEBI guidelines should also be ensured.
6. Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.

Q.NO.26 HOW TO VERIFY REDEMPTION OF DEBENTURES?

ANSWER:

The audit procedure to be applied in this context are:

1. The auditor should inspect the debentures or trust deed for the terms and conditions regarding redemption of debentures.
2. He should see the Director's minute book authorizing the redemption of debentures.
3. He should also vouch the redemption with the help of debenture bonds cancelled and the cash book.
4. He should also examine the accounting treatment thoroughly.

Q.NO.27 WHAT ARE THE AUDIT PROCEDURES TO BE PERFORMED FOR FINAL DIVIDEND?

ANSWER:

1. The auditor should examine the minute book of directors' and shareholders' meetings to verify the dividend was properly recommended by the directors and whether it was passed by a resolution in the shareholders' meeting.
2. The auditor should verify whether the amount of dividend paid was calculated accurately.
3. He should ensure that the provisions of Companies Act, 2013 and Companies (Declaration and Payment of Dividend) Rules, 2014 have been complied with.
4. Based on the bank statements, the auditor must verify whether the total amount of dividend was transferred to a separate bank account in a scheduled bank within five days from the declaration of such dividend and whether dividend was paid to shareholders only out that account.
5. The auditor must ensure that dividend has been paid to the rightful owner. He should verify the Dividend Register and bank statements for this purpose. The auditor shall also reconcile the amount of dividend warrants outstanding with the Dividend Register and the balance in the Bank Account.
6. The auditor shall also verify whether sufficient effort was made by the management to distribute the dividend within 30 days from its declaration and shall enquire into all the cases where the dividend could not be paid within such time.

Q.NO.28 WHAT ARE THE AUDIT PROCEDURES TO BE PERFORMED FOR INTERIM DIVIDEND?

ANSWER:

1. The auditor should examine the Articles of Association of the company to ascertain whether payment of interim dividend is permitted by the articles or not.
2. The auditor should also examine the minutes of book of directors' meeting to verify resolution approving the payment of interim dividend.
3. The auditor must critically appraise the justification in paying interim dividend based on interim accounts.
4. The amount of interim dividend shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
5. The auditor must ensure that dividend has been paid to the rightful owner. He should verify the Dividend Register and bank statements for this purpose.
6. The auditor shall also reconcile the amount of dividend warrants outstanding with the Dividend Register and the balance in the Bank Account.

Q.NO.29 WHAT ARE THE AUDIT PROCEDURES TO BE PERFORMED FOR UNPAID DIVIDEND?

ANSWER:

1. The auditor should collect a statement or list containing every detail regarding the unpaid dividend such as the names of the shareholders, dividend payable to them, dividend warrant number, reason for the dividend remaining unpaid etc.
2. The auditor shall conduct an enquiry to identify whether there was any fault on the part of the company and if so, what action has been taken against the company.
3. The auditor shall verify the statement provided by the management in this respect with other supporting documents like Dividend Register, Returned Warrants, bank statement, etc.
4. The auditor shall also verify whether the unpaid dividend has been transferred to a separate account namely Unpaid Dividend Account within seven days from the expiry of 30 days allowed for declaration and payment of dividend.
5. The auditor must verify whether there is any fault on the part of the company and if so whether they have deposited the interest and the penalty.
6. The auditor shall also verify whether the company has published the details of unpaid dividend in its own website and also in other website(s) approved by the government for this purpose.
7. Any payment of previously unpaid dividend must be verified by the auditor to see that the same has been paid to the rightful owner.
8. In case any amount of dividend is remaining unpaid for more than seven years, the auditor shall verify whether the same along with the interest accrued thereon has been transferred by the company to IEPF.
9. The auditor shall also verify whether all the shares in respect of which unpaid dividend has been transferred to IEPF, have also been transferred to such fund.

11. AUDIT OF VARIOUS ENTITIES

Q.NO.1 WHAT ARE THE ADVANTAGES OF AUDIT OF SOLE PROPRIETORS?

ANSWER:

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

Q.NO.2 WHAT ARE THE ADVANTAGES OF AUDIT OF PARTNERSHIP FIRMS?

ANSWER:

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

EDUCATIONAL INSTITUTIONS

Q.NO.3 WRITE ABOUT AUDIT OF EDUCATIONAL INSTITUTION?

ANSWER:

Educational institutions of any state in India are generally established and run under the Societies Registration Act 1960 or Public Trust Act of the state concerned. In some cases, large educational institutions like universities are established by Central or State governments by enacting special legislation.

The audit procedure for these institutions must consider the following aspects:

A. **UNDERSTAND THE CONSTITUTION:** Study the Trust deed, Regulation or Act under which the institution has been established and should take note of the provisions regarding the maintenance of accounts. In case of State or Central University, established under the Special Act, study the regulations framed under the Act.

B. **ASSESS THE INTERNAL CONTROL SYSTEM:** Normally, these institutions have a well-organised internal control system. So, evaluate the internal control system associated with acquisition and maintenance of assets, authorization of transactions, etc.

C. **CONSULT THE MINUTE BOOK:** Carefully examine all notices and minutes of the meeting of Governing Body (in case of colleges) and Council (in case of universities) and other committees which affect the accounts and finance of the institute. Confirm that the decisions taken for operation of bank accounts, approval of expenditure etc. have been duly complied with.

D. **VERIFY THE RECEIPTS:**

1. **Tuition Fees:**
   - **a.** Tally the counterfoils of fee receipt with fee register to see whether they have been duly recorded or not.
   - **b.** Check the register to identify whether all the students have paid their fees in due time.
   - **c.** If any student has deposited the fees beyond the due date, check whether late fine has been charged or not and whether the same has been properly recorded.
   - **d.** See whether all collections are deposited in the bank account at the end of the day.
   - **e.** The fee paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

2. **Admission Fees:** Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

3. **Other Fees:** Verify the collection of other fees such as library fees, session fees or development fees, fees for hostel etc. based on the counterfoils and fee registered and ensure that the fees have been accounted for in appropriate heads.

4. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
5. Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
6. Verify grants received from Government or other organisations based on the sanction letter and bank statement.
7. Check income from letting out institutional properties based on the counterfoil of receipts issued to parties.
8. Vouch income from legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

E. **VERIFY THE PAYMENTS:**

1. Verify the salary and wages paid to the employees have been properly prepared and authorized by responsible officials.

2. Check the calculation and accounting of arrear salary and see whether the deductibles from salary, such as Provident Fund Contribution and Income Tax deducted at source, have been deposited with the authority concerned in due date.
3. Examine whether all the expenditure associated with special events like seminar or symposium etc. has been accounted properly.
4. Vouch all the regular expenses such as electricity, telephone or broadband bills, travelling expenses, etc. based on available vouchers and accounting records.
5. Vouch the refund of Caution Deposit from the students based on receipts and accounting records.
6. Examine the payments on account of hostel facilities including repairs and maintenance of hostel building, electricity charges, purchase of food items etc.

F. VERIFICATION OF ASSETS AND LIABILITIES:

a. Conduct physical verification of tangible fixed assets as shown in the Fixed Asset Register. Verify investments based on Investment Register.
b. Check whether depreciation and amortization has been provided as per the policy adopted.
c. Carefully examine all outstanding liabilities such as electricity and telephone bills outstanding, TDS and PF not yet deposited.
d. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc.
e. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

G. VERIFICATION OF FINANCIAL STATEMENTS: Verify that the financial statements (i.e., Income and Expenditure Account and Balance Sheet) have been prepared in the form and manner as specified by the regulatory authority complying with the accounting standards and applicable legal requirements.

TEST YOUR KNOWLEDGE:

1. **You have been appointed as the auditor of Imperial University for the financial year 2021-22. The University has 3 campuses located in Mumbai, Ahmedabad and Kolkata. It conducts 5 Year integrated courses in different subjects and also offer Ph.D. programme. There are both domestic and foreign students. The university offers hostel facilities to all its students for which separate fees are collected. All the fees are collected up-front on semester basis and students need to pay fine if the fees are not paid within 15th of the first month of the concerned semester. The caution deposit for the course is payable only if a student completes his/her course. The University regularly conducts symposiums, conferences and workshops in which faculty members and students of other institutions also participate. Prepare a detail audit programme with respect to the receipt related transactions for this audit engagement.**

Answer: Write Point D from above answer.

HEALTH CARE ORGANISATIONS

Q.NO.4 WRITE ABOUT AUDIT OF HOSPITAL/NURSING HOME?

ANSWER:

There may be hospitals run and funded by the Government or local authorities or by any charitable trust. These are generally non-profit seeking organisations. However, hospitals may also be established by private sector organisations.

The audit procedure must highlight the following steps:

A. **UNDERSTAND THE CONSTITUTION:** Study all the relevant documents to determine its nature and ownership structure (i.e., trust, partnership or company). Study the trust deed (in case of trust), partnership agreement (in case of partnership business) and articles and memorandum of association (in case of a company) and accordingly identify the rules and regulation relating to its management and process of preparation of accounts.

B. **ASSESS THE INTERNAL CONTROL SYSTEM:** Evaluate the internal control system associated with acquisition and maintenance of assets, authorisation of transactions, etc. and determine the scope of the audit work.

C. **CONSULT THE MINUTE BOOK:** Carefully examine the notices and minutes of the meeting of Board of Directors, Managing Committee and other committees (such as purchase committee) and identify the decisions which may affect the accounting. Confirm that the decisions undertaken with respect to operation of bank accounts, approval of expenditure, etc. have been duly complied with.

D. **VERIFY THE RECEIPTS:**
   1. In case of a hospital run by state government or any local authority, vouch the grants received from the state or the local authority based on Govt. Orders, sanction letters, counterfoil of receipts.
   2. Vouch collection from patients admitted to the paying beds based on the Patient Admission Registrar and counterfoil of receipts/ copies of bills.
   3. Vouch collection from various pathological tests based on the counterfoils of receipts/ copies of bills.
   4. In case hospitals having guest houses, assess the collections based on the register, counterfoils of receipts and accounting entries.
   5. Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
   6. In case of legacies and donations which are received for specific purposes, it should be ensured that any income therefrom is not utilized for any other purposes.

E. VERIFY THE PAYMENTS:

1. Verify that all capital expenditure associated with machineries, furniture, vehicle, etc. is approved and supported by documentary evidences such as counterfoils cheque, invoices, tenders, etc.
2. Vouch the salary paid to staff based on attendance register, payroll, etc. Examine that the appointment of casual staff and payment of their salaries are duly authorized.
3. Verify doctor's remuneration should be verified based on the list of visits and operations performed.
4. Verify the purchases of pathological test kits, X-ray plate and other consumables based on tenders, orders placed and invoices received.
5. Vouch all other overhead expenses like telephone bills, electricity bills, fuel bills, etc. based on appropriate documentary evidences.

F. VERIFICATION OF ASSETS AND LIABILITIES:

1. Verify the stock registers of medicines, food items and other equipment and check their valuations.
2. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.
3. Check the adequacy of depreciation and its accounting.
4. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

G. VERIFICATION OF FINANCIAL STATEMENTS: Verify that the financial statements have been prepared in the manner and format appropriate to the nature (profit seeking or non-profit seeking) and ownership structure of the organisation.

ORGANISATIONS IN HOSPITALITY SECTOR

Hospitality sector covers a wide range of organisations which can broadly be divided into four categories, viz.

A. Food and Beverages i.e., Restaurants,
B. Travel and Tourism,
C. Lodging i.e., Hotels and Guest Houses and
D. Recreation such as Cinema Halls, Theme Parks etc.

Q.NO.5 WHAT ARE THE COMMON POINTS OF AUDIT FOR ALL FROMS OF HOSPITALITY ORGANISATIONS?

ANSWER:

Steps common for all Hospitality Sector Organisations

1. **CONSTITUTION:** Understand the ownership structure of the organisation (such as sole proprietorship, partnership, private limited companies or public limited companies) and determine the regulatory requirements to be examined relating to management as well as accounting.
2. **INTERNAL CONTROL:** Evaluate the internal control system and determine the nature, timing and the extent of the audit procedures.
3. **LICENSE:** Check that the organisation has a valid licence from an appropriate authority to run the business.

Q.NO.6 WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE CONDUCTING AUDIT OF RESTAURANTS?

ANSWER:

1. Verify the total revenue recognised based on the daily and monthly sales report.
2. Check that the revenue has been realised in cash based on bank statements. Check whether arrears written off, if any, has been duly approved by the person responsible.
3. Vouch all payments made to suppliers based on documentary evidences such as orders placed, invoices and bank records.
4. Carefully examine the petty cash book. Any irregularity should be examined further.
5. Vouch payments on account of rent, electricity and other overhead expenses.
6. Vouch the payment of salary based on payroll, attendance register and bank records.
7. Carefully examine the valuation of stock. Large writing off of any perishable item should be carefully examined.
8. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.
9. Check the adequacy of depreciation and its accounting.
10. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

Q.NO.7 WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE CONDUCTING AUDIT OF TRAVELS AND TOURISM BUSINESSES?

ANSWER:

1. Vouch the collections from customers based on their booking details, counterfoil of receipts etc. Determine arrears, if any, at the end of the year.
2. Vouch revenue out of commissions from various companies and tour partners.
3. Vouch the payment made on account of tour bookings (divided into Air Travel, Rail, Road, Sea etc.), hotel accommodations.
4. Vouch transactions related with cancellation of bookings.
5. Check that discounts offered to individual customers are approved by the competent authority.
6. All overhead expenses including electricity bills, telephone and broadband bills, taxes to local authorities, etc. should be vouched based on the respective bills.

7. Verify the salary paid to permanent staff based on their payroll, attendance records and leave applications. Payment of incentives should be checked carefully.
8. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.
9. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

Q.NO.8 WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE CONDUCTING AUDIT OF HOTELS AND GUEST HOUSES?

ANSWER:

1. Vouch the collections from boarders based on their check-in and check-out information recorded in the register, counterfoils of bills and cash book.
2. Verify the room rent receipts and daily occupancy reports.
3. Be careful while verifying the adjustment of unrealised room rent, cancellation charges of booking accommodation at the time of closing of accounts.
4. Vouch collections on account of special events such as conferences, wedding ceremony etc. separately based on counterfoil of receipts and cash book.
5. Income from bar, casino, health centre, etc. associated with the hotel should be vouched based on counterfoils of bills and cash book.
6. Vouch the rent from shops situated in the premises of the hotel, if any.
7. Vouch transactions relating to purchase of food materials, drinks and other materials. Check whether the payments have been made based on purchase orders or contracts, invoice, etc.
8. Verify the salary paid to permanent staff based on their payroll. Salary paid to casual and contractual employees should be verified based on documentary evidences like authorisation by management.
9. All overhead expenses including electricity bills, telephone and broadband bills, taxes to local authorities, etc. should be vouched based on the respective bills.
10. Carefully examine the valuation of stock. If possible, remain physically present at the time of stock taking.
11. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively. Check the adequacy of depreciation and its proper accounting.
12. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

Q.NO.9 WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE CONDUCTING AUDIT OF CINEMA HALL / AMUSEMNT PARK?

ANSWER:

1. Check whether appropriate control is in force over tickets of different denominations. Verify whether unsold tickets are kept under lock and key under the responsibility of any official.
2. Vouch the collections based on daily sales report of tickets and entries in the cash book.
3. Check whether collections from advance bookings have been duly adjusted.

4. Vouch collections on account of rental income due to hiring of the hall for special events based on the respective contract and counterfoil of receipt.
5. Vouch collection from sale of drinks, refreshments etc based on their daily sales report and entries in the cash book.
6. Check whether the entertainment tax collected as a part of the ticket value has been appropriately accounted and deposited within due dates.
7. Vouch payments relating to hiring of films based on relevant contract with the distributor and receipts. ***(Don't write this point for amusement park)***
8. Vouch payment on account of advertisement with the advertising agencies based on the agreements and receipts.
9. Payment to suppliers of refreshments should be vouched based on orders placed, invoices and entries in the cash book.
10. Vouch salary paid to staff based on payroll, attendance register and leave applications. Appointment of casual staff must be verified based on appointment letter issued by the responsible authority only.
11. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively. Check the adequacy of depreciation and its proper accounting.

LOCAL SELF GOVERNMENT

Q.NO.10 WRITE ABOUT VARIOUS ASPECTS TO BE COVERED IN AN AUDIT OF LOCAL SELF GOVERNMENT?

ANSWER:

A. MEANING:

1. In India, local self-government refers to governmental jurisdictions below the level of the state.
2. The urban local self-governance bodies are further divided into
   - **a.** Municipal Corporation / Nagar Nigam
   - **b.** Municipality / Nagar Palika
   - **c.** Notified Area Council / Town Panchayat / Nagar Panchayat.
3. Similarly, the rural self-governance in India is structured in three layers,
   - **a.** Gram Panchayat (at village level)
   - **b.** Panchayat Samiti (at block level)
   - **c.** Zilla Parishad (at district level).
4. The local bodies derive a part of income from local taxes and spends the same on following activities:
   - general administration and revenue collection
   - public health
   - public safety
   - education

- public works
- others such as interest payments

B. OBJECTIVES OF AUDIT: Since these organisations deal with public money, audit or the accounts of these bodies are of immense importance to ensure transparency and accountability. The major objective of audit of Municipalities and Panchayats are enumerated below:

1. To ensure on the fairness and correctness of contents in the Financial Statement
2. To report on adequacy of Internal control
3. To ensure value of money is fully received on amount spent.
4. To detect the frauds and errors

C. POINTS TO BE CONSIDERED BY AUDITOR: The auditor is supposed to consider the following general points in conducting the audit of local bodies:

1. Ensure that his appointment is in line with the respective regulation of the local body and approved by the appropriate authority.
2. Obtain a detail understanding of the rules and regulations that governs the operations, especially the financial control and accounting of the organisation.
3. Consult the relevant documents, minutes and resolutions of various meetings of different committees.
4. With regards to various government schemes which are implemented through local bodies, check the utilization of grant, appropriate authorization being maintained throughout and adequacy of accounting.
5. Apply in depth investigation in areas with potential fraud such as revenue collection, various waiver schemes, use of casual labour etc.
6. Whenever there is a provision of funds, ensure that the expenditure is incurred from the provision and the same has been authorized by the competent authority.
7. Ensure that where huge financial expenditure is involved, the schemes are running economically and is expected to generate the targeted outcome.

AUDIT OF BANKS

Q.NO.11 WRITE ABOUT AUDIT OF BANKS.

ANSWER:

A. MEANING: A bank is a financial institution that accepts deposits from the public and lends loans.

B. DIFFERENT TYPES OF BANKS IN INDIA: Banks are generally classified into the following broad categories:

1. Commercial Banks
2. Regional Rural Banks
3. Co-operative Banks
4. Development Banks

5. Payment Banks
6. Small Finance Banks

C. REGULATORY FRAMEWORK OF BANKS IN INDIA: In India, banks are guided by a whole host of Acts and associated Rules. However, not all are applicable to each and every banking institution. These are as follows:

1. Banking Regulation Act, 1949
2. Companies Act, 2013
3. State Bank of India Act, 1955
4. State Bank of India Act (Subsidiary Banks) Act, 1959
5. Regional Rural Banks Act, 1976
6. Information Technology Act, 2000
7. Prevention of Money Laundering Act, 2002
8. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
9. Credit Information Companies Regulation Act, 2005
10. Payment and Settlement Act, 2007

D. APPOINTMENT OF AUDITORS OF BANKS: The authority to appoint auditors are as follows:

1. **State Bank of India:** Appointed by the CAG of India.
2. **Nationalised Banks:** Appointed by Board of Directors subject to approval of RBI.
3. **Regional Rural Banks:** Appointed by the Board of directors with the approval of the Central government.
4. **Banking Company:** Appointed at AGM of the shareholders.

E. REMUNERATION OF AUDITORS:

1. **In case of SBI, nationalized banks and RRB** fixed by RBI in consultation with the Central government.
2. **In case of banking companies** fixed by shareholders at AGM as per Sec 142 of Companies act, 2013

F. REPORTING REQUIREMENTS OF BANK AUDITORS:

1. The auditor of a nationalised bank is primarily required to comment on the following aspects in its report to the Central Government:
   a. whether the financial statements present a true and fair view of the affairs of the bank and whether all necessary explanation and information has been made available to him;
   b. whether or not the transactions of the bank, which have come to his notice, have been within the powers of that bank;
   c. whether or not the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit; and
   d. any other matter which he considers should be brought to the notice of the Central Government.

2. Auditors of Public Sector Banks, Private Sector Banks & Foreign Banks (as well as their Branches), are required to submit Long Form Audit Report (LFAR) on various matters specified by RBI.

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G. AUDITING ASPECTS OF BANKS' FINANCIAL STATEMENTS:

1. GENERAL ISSUES:

a. **Understand the Bank and its Environment:** Obtain an understanding of the bank and the control environment to identify and assess risk and develop an audit plan to determine the effectiveness of controls and address specific risk issues.
b. **Understand the Accounting Process:** Obtain an understanding of the accounting process – computerised or manual – of the bank.
c. **Understand the Risk Management Process:** Obtain a clear understanding of the process adopted by the bank for managing financial as well as operational risks.
d. Develop a **detail audit plan**.
e. Determine **audit materiality**
f. Obtain a detail understanding of the **relevant framework** applicable for the bank.
g. Determine the extent of **reliance on reports** of previous auditor, RBI reports, internal audit report etc.

2. SPECIFIC ISSUES:

ADVANCES	The auditor needs to review the following: **a.** Ensure that the internal control is in place in relation to advances made. **b.** Scrutinise the subsidiary, ledger, & control accounts **c.** Ensure the proper documentation of account. **d.** Scrutinise the overdue account and scheme for recovery of such amount.
CASH IN HAND	The auditor should: **a.** Ensure that the internal control is in place. **b.** Visit the bank branch and inspect physical cash and ensure that it tallies with the bank's cash book balance. **c.** Verify the amount of foreign currency held by bank and its translation at market rate on the date at which financial statement is prepared.
BALANCE WITH RBI	The auditor should Inspect the ledger balance in each account with **a.** bank confirmation certificates from Reserve Bank of India and **b.** Reconciliation Statement.
BALANCE WITH OTHER BANKS	The auditor should **a.** Inspect the reconciliation statement. **b.** Examine the large transition and balances with banks outside India. **c.** Ensure that they are converted at market rate as on financial statement preparation date.

MONEY AT CALL & SHORT NOTICE	He should: **a.** Examine the system of authorisation for money at call and short notice. **b.** Ensure that call loan made by bank are not netted off against call loan received by it. **c.** Ensure that money market lending for more than 6 days are not classified under this head but as a deposit or advance based on their nature of lending.
FIXED AND OTHER ASSETS	The auditor has to ensure the following: **a.** Ensure that accounting method of bank is appropriate and ownership document is adequate. **b.** Examine with reference to schedule of fixed assets to find new assets acquired. **c.** Examine sale deed in relation to sale of assets by bank. **d.** Ensure appropriateness of basis of revaluation of fixed assets.
BORROWINGS	He should: **a.** Ensure that the amount has been properly disclosed for borrowing in India from RBI and barrowing from outside India. **b.** Ensure that the rate of interest is commensurate with the duration of borrowing. **c.** Verify whether the borrowings of money at call and short notice are property authorized.
DEPOSITS	He should: **a.** Ensure that the interest accrued but not due on deposits has not been taken under other liabilities and provision **b.** See whether there is any instance of window dressing.
CAPITAL	He should: **a.** Examine the opening balance of capital. **b.** Examine the special resolution of shareholders' meeting or MOA about increase in authorized capital during the year. (iii) **c.** Examine the prospectus regarding increase in subscribed/ paid up capital. **d.** Examine the Government notification for any fresh contribution from them.
RESERVE AND SURPLUS	He should: **a.** Examine the opening balance of different type of reserve, addition/ deduction from reserves, reason for appropriation from such account and dividend paid by bank. **b.** In respect of foreign branch ensure compliance with foreign laws.
BILLS PAYABLE	He should: **a.** Evaluate the existence and effectiveness and continuity of internal controls over bills payables such as:

	➢ Drafts, mail transfers, traveller's cheques, etc., should be made out in standard printed forms. ➢ Unused forms should be kept under the custody of a responsible officer. **b.** The bank should have a reliable private code known only to the responsible officers of its branches. **c.** Coding and decoding of the telegrams should be done only by such officers. **d.** The signatures on a demand draft should be checked by an officer with the specimen signature book. **e.** On payment of these instruments, the paying branch should send a debit advice to the originating branch. **f.** If the paying branch does not receive proper confirmation of any telegraphic transfers or demand draft from the issuing branch, it should take immediate steps to ascertain the reasons. **g.** In case an instrument prepared on a security paper, e.g., draft, has to be cancelled (say, due to error in preparation), it should be examined whether the manner of cancellation is such that the instrument cannot be misused. **h.** Cases of frequent cancellation and reissuance of drafts, pay orders, etc., should be carefully looked into by a responsible official.
CONTINGENT LIABILITIES	**a.** The auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. **b.** The auditor should verify whether there exists a system whereby the non-fund-based facilities to parties are extended only to their regular constituents, etc. **c.** Ascertain whether there are adequate internal controls like transaction done under authorisation and following procedures **d.** The auditor should also examine whether in case of LCs (Letter of Credits) for import of goods, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs. **e.** He should also ascertain whether the accounting system relating to contingent liabilities is appropriate **f.** He must perform substantive audit tests like getting confirmations etc.
BILLS FOR COLLECTION	**a.** The auditor should examine whether the bills drawn on other branches of the bank are not included in bills for collection. **b.** Inward bills are generally available with the bank on the closing day and the auditor may inspect them at that time. **c.** The bank dispatches outward bills for collection soon after they are received. They are, therefore, not likely to be in hand at the date of the balance sheet.

	d. In regard to bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. **e.** The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc.

AUDIT OF CO-OPERATIVE SOCIETIES

Q.NO.12 WRITE ABOUT AUDIT OF COOPERATIVE SOCIETIES.

ANSWER:

A. MEANING: A Co-operative society may broadly be defined as an association of persons who have voluntarily joined together to achieve a common economic objective through the formation of a democratically-controlled business organization, making equitable contributions to the capital as required, and accepting a fair share of risks and benefits of the undertaking.

A co-operative society may be formed for different purposes. Accordingly, there may be

1. Consumers' co-operative societies
2. Housing co-operative societies
3. Industrial co-operative societies
4. Urban and rural co-operative banks, etc.

B. BOOKS OF ACCOUNTS TO BE MAINTAINED BY COOPERATIVE SOCIETIES: Under section 43(h) of the Co-operative Societies Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society. Generally, the following records are maintained by co-operative societies –

1. **Cash book:** It may be maintained to record particulars regarding cash receipts and expenses under suitable heads, with clear distinction between capital and revenue items of receipts and expenses.
2. **Stock register:** It may contain detailed information as regards receipts, issues and balances of stock-in-trade, date-wise.
3. **Register of assets and investments:** It will contain detailed particulars regarding the various immovable and movable assets belonging to the society, such as, types of assets, location, date of acquisition, cost, depreciation provided, and so on.
4. **Register of fixed deposits:** In the case of a co-operative credit society, or a co-operative bank, a register of fixed deposits may be maintained giving details as regards the dates of acceptance, maturity, interest accrual, repayment, etc.
5. **Register of sureties:** In the case of a co-operative credit society, loans are given against personal security of members as also surety (guarantee) provided by two other members. The Register of Sureties will give particulars about the number of borrowers in respect of which a

member has stood surety, and show whether it is within the overall limit of surety-ship that may.

C. SPECIAL FEAUTURES OF COPERATIVE SOCIETIES:

1. **Restriction on shareholding:** No member of the society, other than a registered society, can hold more than twenty per cent of the total number of shares of the society, or such number of shares which in value exceeds Rs. 1,000.

2. **Restriction on Loan:** A registered co-operative society can only grant loans to its members, though, with prior approval of the Registrar, it may grant loans to other registered co-operative societies.

3. **Restriction on Borrowing:** Subject to the restrictions imposed by its bye-laws, a co-operative society may accept loans and deposits from its members as well as non-members.

4. **Investment of Funds:** A society may invest its funds in any of the following (Sec.32 of the Central Co-operative Societies Act):
   - **a.** Central or State Co-operative Bank,
   - **b.** Any securities specified in Section 20 of the Indian Trusts Act, 1882.
   - **c.** Any shares, securities, bonds or debentures of any other Co-operative society with limited liability.
   - **d.** Any bank, or person carrying on banking business or a Co- operative bank, other than a Central or State co-operative bank, as duly approved by the Registrar;
   - **e.** In any other manners as duly permitted by the requisite authority.

5. **Appropriation of profits:** According to the Central Co-operatives Societies Act, 25% of the profits of a co-operative society should be transferred to a Reserve Fund before distribution of dividend or payment of bonus to its members. However, the Registrar may, having regard to the financial position of the society, reduce the percentage of profits to be transferred to the Reserve Fund. But in any case, he cannot reduce it to less than 10% of the profits of the society.

6. **Contributions to charitable Purposes:** According to Section 34 of Co-operative Societies Act, 1912, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose.

D. QUALIFICATIONS OF AUDITOR:

1. Generally, only a chartered accountant within the meaning of the Chartered Accountants Act 1949, can be appointed as the auditor of a co-operative society.

2. However, in certain State Co-operative Societies Act, a person holding a government diploma in co-operative accounts, or in co-operation and accounts, or a person who has served as an auditor in the Co-operative Department of Government, may also be appointed as the auditor.

E. APPOINTMENT OF THE AUDITOR:

1. An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society.
2. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited. For example, the audit fees of co-operative credit society and Urban Co-operative Banks are to be calculated with reference to working

F. STEPS TO BE TAKEN BY AN AUDITOR OF A CO-OPERATIVE SOCIETY:

1. **General Points:** In general, while conducting audit of Co-operative society, the auditor needs to look into the following: -
    - The auditor should carefully go through the bye-laws of the society and see that they are being observed both in letter and spirit.
    - He should examine the Register of Members of the society and individual shareholdings.
    - He should test-check the internal check and control system operated by the society and model his audit examination based on its strengths and weaknesses.

2. **Audit of income:**
    - He should carefully vouch the receipt of cash.
    - Cash receipts on account of share capital should be vouched with the Register of Members.
    - Cash received against sales should be vouched with the cash memos and invoices issued to customers as also Sales Account.
    - Receipt of cash in respect of payment of interest and repayment of loans advanced by the society should be vouched with the loan agreements.

3. **Audit of Expenditure:**
    - He should vouch all expenditure with reference to authorisation from the Managing Committee, particularly in the case of large capital expenditure.
    - He should vouch the payment of loans from the loan agreements entered into with borrower members.
    - He should vouch establishment expenses with reference to the resolutions of the Managing Committee, agreements with the persons concerned, and money receipts obtained from them.

12. MISCALLANEOUS CONCEPTS

Q.NO.1 WRITE ABOUT THE CONCEPT OF GROUPING SCHEDULE AND STATE ITS OBJECTIVES.

ANSWER:

A. CONCEPT OF GROUPING SCHEDULE:

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

B. OBJECTIVES OF GROUPING SCHEDULE: The objectives of preparing Grouping Schedule are as follows:

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

C. EXAMPLE:

GL ACCOUNT CODE	PRIMARY GROUP	SECONDARY GROUP
Non-Current Assets	Property, Plant & Equipment	Land Building Plant & Machinery Furniture & Fixture Motor Vehicles, etc.
	Intangible Assets	Intellectual Property Rights ICT Software, etc.
	Investments	Shares of Companies Government Bonds Other Bonds Mutual Funds, etc
Current Assets	Receivables	Government Entities MSMEs Others
	Inventory	Raw Materials Finished Goods

		Work-in-Progress Stores and Spare Parts
	Cash and Cash Equivalents	Short term Deposits Cash Balances

Q.NO.2 WHAT IS THE AUDITOR'S ROLE WITH RESPECT TO GROUPING SCHGEDULE?

ANSWER:

Under a mechanized accounting system with a descent and reliable software, accounts are finalized and financial statements are prepared automatically based on organization's policy for Grouping Schedules. The auditor, in this respect, should ensure that –

1. The composition of Grouping Schedules for various line items of the financial statements has adhered to the prescription of the relevant regulations.
2. The composition of the Grouping Schedule for various line items has been decided only by the person(s) authorized for this purpose.
3. Appropriate customization of the accounting software has been done to meet organization's accounting and reporting requirements.
4. The composition of the Grouping Schedule has not been altered without appropriate authorization triggered by any legal and/ or regulatory authority.

Q.NO.3 WRITE ABOUT SCRUTINY OF TRAIL BALANCE BY AUDITOR?

ANSWER:

An auditor can use Trial Balance to reap important benefits. He can reasonably be assured about the arithmetical accuracy of the accounts when the trial balance has tallied. However, while undertaking the scrutiny of Trial Balance to reap the above benefits, the auditor should ensure that:

1. It has been prepared after a declared cut-off date for considering primary accounting entries for business transactions and other journal entries.
2. The codification logic has been adhered to while preparing the trial balance.
3. It has been prepared strictly based on 'As the Books written' without any adjustments inserted from any sources other than Financial Ledgers on a given date/or period end.
4. Before the grouping schedule is prepared ledger accounts are corrected based on adverse observations emerging from Trial Balance scrutiny.

Q.NO.4 WRITE A SHORT NOTE ON TEEMING AND LADING?

ANSWER:

1. Teeming and lading is one of the techniques of committing fraud related to cash receipts.
2. It involves the following:
   a. Amount received from the first customer being misappropriated

b. In the above case to prevent its detection the money received from second customer subsequently being credited to the account of the first customer.
c. Similarly, moneys received from the third customer who has paid thereafter being credited to the account of the second customer so that no one account is outstanding for send out a statement of account to him or communicate with him.

THE END