UPSC EPFO APFC Exam 2023

Auditing & Insurance

By **CA Rahul Kumar** (3 UPSC Interviews)
(Commerce, Accountancy & Economy Faculty)

HIGHLIGHTS

- 100% EPFO Oriented
- Factual Focus
- As Per PYQ Pattern
- Concepts Clarity

Join our telegram channel for free updates link
t.me/epfoupscexam

DIADEMY IAS
Get Crowned with success

9811599537 / 9389802020
contact@diademy.com
www.diademy.com

A

Auditing & Insurance

(Study Material with MCQs)

For UPSC APFC Exam

By CA Rahul Kumar

(Economy & Commerce Faculty,

3 Times UPSC Interview appeared)

DIADEMY IAS

ORN, Delhi 05

Auditing & Insurance– Study Material

Cover Printer:
Cover Designer: Creative Designer
Cover Image Source: NA
Visit us at: www.diademy.com
Write to us at: contact@diademy.com
CIN: U80301UP2019PTC120109

Courses offered by DIADEMY IAS for UPSC EPFO/EO/AO

1. Full Mock tests with current affairs
2. Accounting, IR & labour laws lectures
3. Free strategy webinar
4. Comprehensive online classes
5. PYQ Analysis

Join FREE Telegram Channel at **https://t.me/epfoupscexam** for regular Current Affairs

Call at 9811599537 or email at contact@diademy.com for more details

Important Links and Q R Codes

Join EPFO dedicated telegram for updates - Scan Q R Code @EPFOUPSCEXAM Link https://t.me/epfoupscexam	**Contact us** Phone No 9811599537 , 9389802020 Email id Contact@diademy.com Any error/suggestions please e-mail to contact@diademy.com Do report any error on above email id
Delhi centre address Block 54, 70 Second Floor, Bada Bazar Rd, Old Rajinder Nagar, New Delhi, Delhi 110060	**Kolkata centre address** DIADEMY IAS 13B, Bidhan Sarani, Chandra Plaza Building, 3rd Floor, Near Vidyasagar College Bidhan Sarani Campus and Adjacent to Calcutta University Law College Hostel, Kolkata - 700006

AUDITING INDEX

INSURANCE INDEX

UPSC IAS GS COURSES

by Team Diademy IAS

- GS Foundation 2024-25
- UPSC Launchpad 2024
- GS Mains Short Notes 2023-24
- GS Mains booster classes
- GS Mains Answer Writing & Test Series

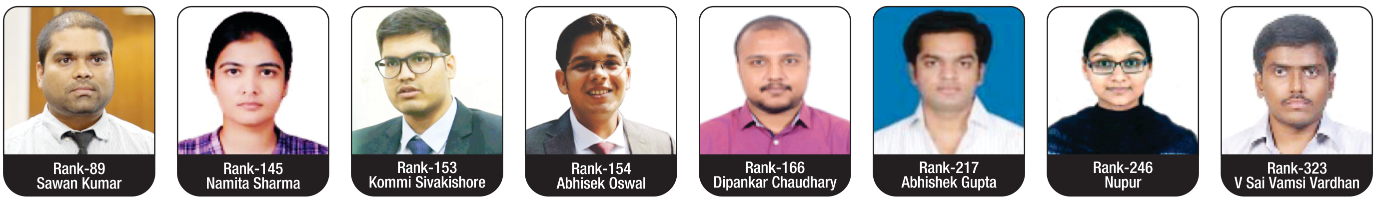
PROUD TOPPERS OF DIADEMY IAS

CSE 2019

AIR-30 Pari Bishnoi | Rank-42 Dipankar Chaudhary | AIR-51 Ananya Singh | Rank-69 Navneet Mittal | AIR-95 Rushikesh Reddy | AIR-109 Chavan Rahul Laxman | Rank-118 Malavika G Nair | Rank-150 C Chaitanya Reddy

+8 MORE

CSE 2018



Rank-89 Sawan Kumar | Rank-145 Namita Sharma | Rank-153 Kommi Sivakishore | Rank-154 Abhisek Oswal | Rank-166 Dipankar Chaudhary | Rank-217 Abhishek Gupta | Rank-246 Nupur | Rank-323 V Sai Vamsi Vardhan

+8 MORE

DIADEMY IAS

Get Crowned with success

Delhi Address: Old Rajinder Nagar, New Delhi-110005

T: 9811599537/9389802020 | **E:** contact@diademy.com

0.PRACTICE MCQs

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

2. Proving the truth means vouching of ______ ?
(A) Payment **(B) Expenses**
(C) Assets (D) Liabilities

3. An audit report is the ______ product of audit.
(A) Main **(B) Final**
(C) Semi- final (D) None of the above

4. Authorization for Government Audit.
(A) BOD (B) Audit committee
(C) CAG (D) None of the above

5. Audit is conducted to draw overall opinion on ______
(A) Financial Statement (B) Cost Statement
(C) Income Statement (D) None of the above

6. An auditor should submit a Disclaimer of Opinion when
(A) he is satisfied with the truth and fairness of financial statements.
(B) he has certain reservations as to the presentation of truth and fairness in financial statements.
(C) some material information is not available.
(D) the effect of any disagreement with the management is not so material.

7. Which of the following services cannot be rendered by an auditor as per Companies Act 2013?
(A) Vouching (B) Verification of assets and liabilities
(C) Issuing certificates on relevant matters **(D) Providing investment advisory services**

8. A Cost Auditor submits his report to
(A) Board of Directors (B) Government
(C) Shareholders (D) Statutory Auditor

9. Declaration of dividend is covered under section-
(A) Section 122 **(B) Section 123**
(C) Section 124 (D) Section 125

10. Remuneration of Auditors is covered under the following section of Companies Act, 2013:

(A) Section 142 (B) Section 148
(C) Section 139 (D) Section 143

11. Which of the following statement is true about the limitations of audit?

(A) Test nature of the audit

(B) The audit evidence available to the auditor is persuasive rather than conclusive in nature.

(C) Inherent limitations of internal control

12. What does professional scepticism mean?

(A) An approach that ensures that everything is correct

(B) An approach that ensures that if something is wrong it is detected

(C) An approach that ensures that management's representations are reliable.

13. The statement "Auditor is a watchdog, not a bloodbound " was made in which case?

(A) Kingston Cotton Mills Co. (1896)

(B) Financial Reporting Council case (2021)

(C) Securities and Exchange Board of India (2009)

14. Form for maintenance of Cost Records by the Company is________

(A) CRA-1 (B) CRA-2
(C) CRA-3 (D) CRA-4

15. SA 210 stands for-

(A) Quality control for an audit of financial Statements

(B) Agreeing the terms of Audit engagements.

(C) Audit Documentation

(D) Responsibility of Joint Auditor

16. Internal Auditor is appointed by the

(A) Board (B) Audit committee

(C) Shareholder (D) None of the above

17. Section 146 of the Companies Act, 2013 deals with

(A) Auditor not to render certain services

(B) Auditor to sign Audit Reports

(C) Auditor to attend general meeting

(D) Punishment for contravention

18. Remuneration of Auditors is covered under the following section of Companies Act, 2013:

(A) Section 142 (B) Section 148

(C) Section 139 (D) Section 143

19. Which of the following is not a component of the general approach for investigation under section 210 and 213 of the Companies Act 2013?

(A) Clarity of terms of reference

(B) Determination of scope of investigation

(C) Determination of period for investigation

(D) Determination of penalties for non- compliance

20. Cost Audit is covered under

(a) Section 204 **(b) Section 148**

(c) Section 144 (d) Section 17

21.Vouching refers to the examination of accuracy, authority, and authenticity of transactions in the books of accounts with help of

(A) Audit Report (B) Balance Sheet

(C) Vouchers (D) Income Statement

23. Unpaid dividend standing at the credit of Unpaid Dividend A/C should be transferred to Investor Education and Protection Fund after _______ years of its remaining unpaid.

(A) six (B) eight

(C) seven (D) five

24. What is the purpose of SA-705?

(A) To determine the applicable financial reporting framework

(B) To express an unmodified opinion on the financial statements

(C) To provide guidance on modifying the auditor's opinion

25. What is an unmodified opinion?

(A) The auditor concludes that the financial statements are not prepared in accordance with the applicable financial reporting framework

(B) The auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

(C) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

26. What is the primary focus of forensic accounting?
    (A) Conducting financial audits for companies
    (B) Investigating fraud and analysing financial information for legal proceedings
    (C) Preparing financial statements for public companies
    (D) Providing tax advisory services to clients

27. An individual auditor who has completed his term shall not be eligible for reappointment as auditor in the same company for:
    (A) Next 3 Years **(B) Next 5 Years**
    (C) Next 7 Years (D) Next 8 Years

28. The _________ shall act as the secretary of the Audit Committee.
    (A) Employee (B) Auditor
    (C) Company Secretary (D) Chairman

29. What is the provision required for Loss Assets/
    (A) 15% (B) 25%+100%
    (C) 40%+100 **(D) 100%+100%**

30. What is Non- Performing Assets (NPA)?
    (A) An assets that generates income for the bank
    (B) An assets that is overdue for a period of less than 90 days
    (C) An assets that has ceased to generate income for the bank
    (D) An assets that is out of order for a period of less than 90 days

31. Who can conduct a tax audit?

(A) Any practicing Chartered Accountants or firm of chartered Accountants

(B) Only a Certified Public accountant (CPA)

(C) Only an auditor appointed by the government

(D) Any qualified financial professional

32. What is the ceiling for the number of tax audit assignments an auditor can accept?

(A) 60 (B) 80
(C) 50 (D) 90

33. What id Government Audit?

(A) An audit conducted by the government on private companies
(B) An audit conducted by the government on government departments and departmental undertakings
(C) An audit conducted by private firms on the government
(D) An audit conducted by the public on government departments

34. Who heads the Accounts and Audit Department of the Government of India?

(A) The President of India
(B) The Comptroller and Auditor General of India
(C) The Prime Minister of India
(D) The Finance Minister of India

35. Internal Auditor is appointed by

(A) Audit Committee
(B) Shareholders in General Meeting
(C) Extraordinary General Meeting
(D) Board of Directors

36. Which of the following is not an external audit evidence?

(A) Quotations
(B) Confirmation from debtors
(C) Goods Received Note
(D) Confirmation from bankers

37. 'Fraud' deals with ___________ but, 'error', on the other hand, refers to __________ in financial information.

(A) Unintentional mistake, misrepresentation
(B) Intentional misrepresentation, unintentional mistake
(C) Unintentional misrepresentation, intentional mistake.
(D) Misapplication, Misrepresentation.

38. Which of the following is not power of CAG

(A) To inspect any office of accounts under the control of the union or a State Government

(B) To require that any account, book, paper and other documents which deal with or are otherwise relevant to the transaction under audit, be sent to specified places

(C) To attend Parliament Session

(D) To put such questions or make such observations as he may consider necessary to the person in charge.

39. What are the various forms of receipts that a charitable institution may receive?

(A) Subscription

(B) Income from Investment

(C) Grants

(D) All of the above

40. Scope of financial audit is

(A) Financial information

(B) Non-financial information

(C) Both (a) and (b)

(D) None of these

41. Which of the following is responsibility of auditor

(A) To ensure that financial statement comply with applicable financial reporting framework

(B) To express an opinion on true and fair view of the financial statements.

(C) To ensure compliance with laws and regulations applicable on the entity

(D) To design, implement and maintain system of internal control.

42. ADT-1 is filed with ROC within

(A) Within 15 days of appointment of auditor

(B) Within 30 days of appointment of auditor

(C) Within 1 month of appointment of auditor

(D) Within 60 days of appointment of auditor

43. _____________ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

(A) Audit Techniques

(B) Audit Evidence

(C) Audit Documentation

(D) None of the above

44. CAG has a right to order conduct of supplementary audit within ____________ days from the date of receipt of audit report.

(A) 30

(B) 60

(C) 90

(D) 120

45. Dividend shall be payable----

(A) Only in cash

(B) In cash or in kind

(C) Either in cash or in electronic mode

(D) Option (c) or by issue of cheque

46. While conducting audit of financial statement auditor need to comply with

(A) Cost Audit Standards

(B) Secretarial standards

(C) Auditing Standards

(D) None of the above

47. CAATS stands for-

(A) Cornwall Air Ambulance Trust

(B) Children Air Ambulance Trust

(C) Centre for alternatives to Animal Testing

(D) Computer Assisted Auditing Technique

48. Dividend cannot be paid out of

(A) current year's profit after providing depreciation.

(B) undistributed profits for any previous financial year or years after providing for depreciation.

(C) profit on revaluation of any fixed assets

(D) money provided by the Central Government or a State Government.

49. An Audit Committee should have a minimum of_____ number of directors.

(A) 4 **(B) 3**

(C) 5 (D) 6

50. Special notice is requires when auditor is to be removed

(A) After expiry of term

(B) Before expiry of term

(C) By order of Tribunal

(D) All of the above

1. AUDITING CONCEPT

1.1 NATURE AND OBJECTIVE OF AUDIT

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

1.1.2 OBJECTIVES OF AUDITING

Primary Objective:	The main objective of an audit is to determine whether the financial statements present a '' **true & fair view''** of the financial position and financial performance of a business during the period. The Balance Sheet shows the **financial position** on a particular date (say, the last day of the financial year), and the profit & loss Accounts shows the financial performance of the business over that period (income and expenditure during the whole financial year).
Secondary Objective:	The auditor is also responsible for **detecting frauds and errors** in the books of accounts and financial records of the client's business. Such detection of frauds and errors is called the secondary objective of audit because the primary responsibility for safeguarding the business assets rests with the management. If the auditor suspects the presence of **material misstatements or defalcations** in the records of the business, he is expected to look into the matter with greater detail by applying various audit procedures to satisfy himself about their existence or non-existence.

an audit also attains certain **social objectives** as follows:

(i) To protect the shareholders' interest of shareholders.
(ii) To stop evasion of taxes
(iii) To safeguard against capital erosion
(iv) To ensure fair return on investors
(iv) To ensure reasonable price to customers
(v) To ensure fair compensation to workers
(vii) Complying with polices regarding corporate social responsibilities

As per **SA-200 "Overall Objectives of the Independent Auditor**", in conducting an audit of
financial statements, the overall objectives of the auditor are:
(a) To obtain reasonable assurance about whether the financial statements as a whole are
free from material misstatement ; and

(b) To report on the financial statements, and communicate as required by the SAs, in
accordance with the auditor's findings.

1.2 Inherent Limitation of Auditing

1.) It means unavoidable limitation which makes audit a reasonable assurance and not **absolute assurance**.
a. Test nature of the audit;
b. The audit evidence available to the auditor is persuasive rather than conclusive in nature;
c. Inherent limitations of internal control, e.g., certain levels of management may be in a position to override controls.

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

3.) **Materiality** is one of basic **fundamental concepts in process of Auditing** as well as **Accounting**. Auditor has to constantly & continuously judge whether **transaction is material or not**. It is used by him in his Audit Planning. Materiality means important cost wise, profit wise, effect wise, value wise; which influences economic decision of user. What is material in one circumstance, may not be material in another circumstances. Therefore, changes need to be done accordingly.

1.3 Qualities of an Auditor

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. **Planning:** The auditor should obtain the knowledge about client's business to determine the nature, timing and the extent of the audit procedures.

4. **Audit evidence**: The auditor should obtain sufficient appropriate audit evidence

(iv) Audited accounts are considered more reliable by different cadres of Government. For example, the tax audit report filed with the taxation authorities.

(v) It facilitates detection of wastages and losses and helps in instituting corrective actions.

(vi) Audited accounts are taken to be more reliable and useful during corporate restructuring exercises, valuations etc.

(vii) Banks, Financial Institutions and Government require audited accounts before granting any financial assistance to the enterprise.

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

through performing the compliance and substantive procedures.

1.4 Advantage of Audit

The advantages of audit are as follows:

(i) Audit is a tool, which different stakeholders can use to protect their interests in the enterprise.

(ii) Audit is not only a corrective measure but has a deterrent effect. It serves as a moral check on the employees from committing defalcations or embezzlements.

(iii) The employees of the organisation remain alert and vigilant as regards the updating of books of accounts and other records.

1.5 TYPES OF AUDITS

Audit is not mandatory for all forms of organisation. Depending on requirement s of law the audits are classified into two types:

(i) **Statutory Audit** - Audit mandatory under a law

(ii) **Non-Statutory Audit** - Voluntary Audit

I) **Statutory Audit-**

a. The organisation which **requires mandatory** audit under law is known as Statutory Audit
E.g. Company Audit u/s 139 of Companies Act 2013, Tax Audit u/s 44AB of Income Tax Act 1960

b. The Auditor shall be independent in case of statutory audits

c. The rights and duties of the auditor are determined under the law terms of engagement.

II) Non-Statutory Audit-

a. The appointment of auditor even though it is **not mandatory** under a law is known **as Non- Statutory Audit also called as voluntary audit**. E.g Audit of sole proprietary concern, audit of partnership firms.

b. The auditor need not to be independent. However, the audit process may carry out independently.

c. The right and duties are determined as per the terms of engagement by the appointing authority.

d. The audit is conducted due to various advantages associated with it.

1.6 STATUTORY v/s NON- STATUTORY AUDIT

BASIS	STATUTORY AUDIT	NON-STATUTORY AUDIT
Legal compulsion	It is compulsory.	It is voluntary
Scope	The relevant statute or law determines the scope of work	The employer or partners determine the scope of work.
Qualification of auditor	The academic or professional qualification is prescribed for the auditor	The auditor need not possess any academic or professional qualifications.
Powers, rights and duties of an auditor	The statute dictates the powers, rights and duties of an auditor.	The agreement between an auditor and firm decides these matters
Independence	The auditor has independence in status and in mental attitude	The auditor does not enjoy such independence.
Auditor's liability	The auditor is liable for negligence under the Common Law and for misfeasance under the relevant statute governing the audit.	The auditor is liable for negligence only under the Common Law.
Publication of audit report	The audit report is published for the public.	The audit report is made known to the employers or partners.

1.7 SCOPE OF AUDIT

1. The audit should be organized to cover **adequately all aspects of the enterprise** relevant to the financial statements being audited.
2. In forming his opinion, the auditor should also decide **whether the relevant information is properly disclosed in the financial statements** subject to statutory requirements, where applicable.

3. **The auditor is not expected to perform duties which fall outside the scope of his competence**. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.
4. **Constraints on the scope of the audit** of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.
5. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained **in the underlying accounting records and other source data is reliable and sufficient** as the basis for the preparation of the financial statements.

1.8 Auditor is a watchdog and not a bloodhound

Audit regulator National Financial Reporting Authority (NFRA) has urged the audit fraternity to refrain from taking shelter under the adulated description of the auditor "being only a watchdog and not a bloodhound".

- The perception of auditor's duty with regards to detection and prevention of frauds and errors was initially based on the decision given in Kingston Cotton Mills Co. (1896) case.
- The judge summed up auditor's duty by stating, "Auditor is a watchdog, not a bloodhound."
- It was noted that the auditors were to be appointed by the shareholders, and were to report to them directly, and not to or through the directors.
- The object was to ensure that the shareholders received "independent and reliable information respecting the true financial position of the company at the time of the audit."
- The duty of the auditor is to be honest i.e., he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.
- What is reasonable care in any particular case must depend upon the circumstances of that case.
- Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient.
- Where suspicion is aroused more care is obviously necessary; but still an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion, and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.
- An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong.
- He is a watchdog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company.

- He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care.

1.9 AUDITOR'S ENGAGEMENT: In case of a **statutory audit** the objective and scope of an audit is clearly described in the relevant law. However, in a non-statutory audit it has to be stated with absolute clarity so as to avoid any kind of ambiguity as to the objective and scope of audit. Although the form and content of the engagement letter differs from client to client but in general the following references should be made in audit engagement letter:

- The objective and the scope of the engagement.
- Management's responsibility for the financial statements.
- The existence of inherent limitations of audit and resulting material misstatements that may remain undiscovered,
- The need for use of services of internal auditors and/ or other experts that may arise during the course of the engagement.
- The requirement of management confirmation letter as regards representations made by them concerning audit.
- Restriction of the auditor's liability, if any.
- Basis for computation of audit fees and billing arrangements.
- The form of reports or other communication of results of the engagement.

1.10 AUDIT PROGRAMME: An audit programme is **written plan** containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

As per **SA 300,** Planning an Audit of Financial Statements, the auditor should prepare a written audit programme setting forth the procedures that are needed to be implemented while carrying out the audit plan.

An audit programme may be classified into two categories:

(i) Programme common to all types of audits - For example, checking of books of accounts; and

(ii) Special programme containing the work relating to a particular audit. For example, the audit programme for a partnership firm would be different from that of a company.

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

Disadvantages of Audit Programme	➢ The auditor's task becomes mechanical and the auditors may lose interest and initiative. ➢ Drawing up of an audit programme may be unnecessary for a small concern. ➢ 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. ➢ Rigid programmes cannot be laid down for each type of business.

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

Purpose of Audit Working Papers:

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

a. Providing evidence of auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. b. Providing evidence that audit was planned and performed in accordance with **Standards of Audit** (SAs) and applicable legal and regulatory requirements. c. Assisting the engagement team to plan and perform the audit. d. 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'**. e. Enabling the engagement team to be accountable for its work

Contents of Audit Working Papers:

(i)	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.
(ii)	The auditor shall document discussions of significant matters with management, those charged with governance and others, including the nature of the significant matters discussed and when and with whom the discussions took place.
(iii)	The auditor shall prepare audit working papers that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: ➢ the nature, timing and extent of audit procedures performed to comply with the **SAs** and **applicable legal and regulatory** requirements; ➢ the results of the audit procedures performed and the audit evidence obtained; and ➢ significant matters arising during the audit, the conclusion reached thereon and significant professional judgments made in reaching those conclusions

1.12 AUDIT EVIDENCE: As per **SA-500, 'Audit Evidence', the term 'audit evidence' includes information used by the auditor in arriving at the conclusions on which the auditor's opinion is based**. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. In short, substantive evidence collected by an auditor from various sources to base his opinion on the financial statements of the organisation is called audit evidence.

Auditor's Judgement while Obtaining Audit Evidence:

The auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn therefrom. It is to be noted that sufficiency and appropriateness are interrelated and apply to evidence obtained from both substantive and compliance procedures. 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;
- Situations which may exert an unusual influence on the management;
- The financial position of 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;
- The type of information available;
- The trend indicated by accounting ratios and analysis.

Methods of Obtaining Audit Evidence

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.
Observation	It consists of witnessing a process or procedure being performed by others.
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.
Computation -	It consists of checking the **arithmetical accuracy of source** documents and accounting records or performing independent calculations.
Analytical Review	It consists of studying significant ratios and trends and investigating unusual fluctuations and items

1.13 AUDIT NOTE BOOK: 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.**

Contents of Audit Note Book	a. Name of the business enterprise. b. Organisation structure. c. Important provisions of Memorandum of Association **(MOA)** and Articles of Association **(AOA).** d. Communication with the previous auditor, if any.

	e. <u>Management representations</u> and <u>instructions</u>. f. List of <u>books of accounts</u> maintained by the enterprise. g. Accounting methods, <u>internal control</u> systems followed by the enterprise, applicable laws etc. h. <u>Key managerial personnel</u>. i. <u>Errors and fraud discovered</u>. j. <u>Matters requiring explanations or clarifications</u>. k. Special points that need attention in the <u>audit report</u>

<u>1.14 VOUCHING:</u> 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 –

- all transactions undertaken by the entity have been recorded and nothing has been purposefully left out.
- transactions recorded in the books of accounts are supported by documentary evidence.
- no fraudulent transaction has been recorded in the books of accounts.
- transactions that have been recorded belong to the current accounting year (in case of accrual basis of accounting).
- necessary vouchers relating to entries recorded in books are with the client.
- all transactions are properly authorised by the person responsible to do so.
- transactions have been recorded at the correct value and such values have been calculated correctly.
- transactions recorded in the books of accounts are related to the organisation.
- proper accounting entries have been made against the transactions.

<u>1.15 VERIFICATION:</u> On the other hand, can be defined as a process of substantiation of assets and liabilities recorded in the books of account, by means of physical inspection and examination of legal and official documents, and then forming expert opinion as to the existence, ownership, possession, classification and valuation of assets and liabilities of an entity.

verification includes –	➢ Examination of existence ➢ of the assets or liabilities on the reporting date. ➢ Examination of ownership and control of the asset or liabilities on the reporting date. ➢ Examination of possession of the assets on the reporting date. ➢ Examination of charges, if any, against the assets. ➢ Examination of accounting of assets or liabilities. ➢ Examination of correctness of valuation of assets or liabilities. ➢ Examination of adequacy of disclosures as required by the relevant regulation.

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

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

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

1.17AUDIT SAMPLING

Definition: According to SA- 530 Audit sampling is the application of audit procedures to less than 100% of the total population and all the items in the population have the same chance to be selected.

Audit sampling is really important because it doesn't only help auditors to gather sufficient and appropriate audit evidence to draw the audit's opinion, but also plays a very important part in the audit's works' efficiency and effectiveness. That mean auditor is not required to check 100% of object or items to let them express their opinion.

To ensure that the selected items could represent the total population, the selection process and methods should not involve too much from human judgments and should be avoiding bias from auditors.

They only perform their review and verification on the selected items and then express their opinion on the entire population. In general, audit sampling can be performed in two different types.

Approaches to sampling

1. Non-Statistical Sampling or Judgemental Sampling	Under this technique, the sample size and its composition are determined based on auditor's own experience and knowledge and no statistical tool is applied to select the sample. The method is easy but subject to personal judgement
2. Statistical Sampling	This approach is more scientific and does not depend on auditor's personal judgement. The approach includes the following methods: **a. Random Sampling :** In this method of sampling each item of the population or within a given group (popularly known as **stratum**) has a known chance of selection. **(i) Simple Random Sampling:** Simple random sampling (SRS) is a probability sampling method where researchers randomly choose participants from a population. All population members have an equal probability of being selected. This method tends to produce representative, unbiased samples. Simple random sampling helps ensure that the sample mirrors the population. The process proportionately samples from larger subpopulations more frequently than smaller subpopulations. **(ii) Stratified Sampling:** In a **stratified sample**, researchers divide a population into homogeneous subpopulations called *strata* (the plural of *stratum)* based on specific characteristics (e.g., race, gender identity, location, etc.). Every member of the population studied should be in exactly one stratum. Researchers rely on stratified sampling when a population's characteristics are diverse and they want to ensure that every characteristic is properly represented in the sample. This helps with the generalizability and validity of the study, as well as avoiding research biases like under coverage bias.

	.
3. **Systematic/ Interval Sampling**	This method requires selecting items using a constant interval between selections with the first selection being random.
4. **Monetary Unit Sampling**	This method uses the monetary value of the transaction rather than the items as the basis for sample size determination and item selection. It is also known as valued- based sampling or value weighted sampling.

Risk Associated with Sampling:

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

1. **Sampling Risk**	Since sample is only a selected part of population, it can never reflect all characteristic of the population. Thus, there will always be some amount of risk unavoidable in this process. This sampling risk can again be two types as follows: a. **Sampling Risk associated with Compliance Procedure (Test of control):** Here, the auditor, based on sampling procedure, may come to the conclusion that controls are more effective while they are not. b. **Sampling Risk associated with Substantive Procedure (Test of details):** Here, the auditor, based on sampling procedure, may come to the conclusion that the financial statements are free from any material misstatements while they are not.
2. **Non-Sampling Risk**	Non-sampling risk arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the sampling risk. For example,

	most audit evidence is persuasive rather than conclusive, the auditor might use inappropriate procedures, or the auditor might misinterpret evidence and fail to recognize an error.

Stages in Audit Sampling

Audit sampling requires the following steps:

1. **Sample Design**	Here, the auditor selects the appropriate method based on the consideration of objectives of audit 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. If the procedure cannot be applied on the selected unit, the same is replaced. Based on the results of the audit procedure, the auditor forms his opinion.

1.18ANALYTICAL PROCEDURE

Definition: Analytical procedures are the processes of evaluating financial information through trend, ratio or reasonableness of data in relation to other financial and non-financial data. In this case, auditors perform data analysis to examine whether it is consistent with other relevant information and whether the fluctuation is within their expectation.

If the auditors identify any irregular fluctuation or find that data relationship is inconsistent with their expectations or other information, they will investigate further on the discrepancy that exists. In this case, the investigation might require them to perform further substantive tests, such as inquiry management about the course of variance and inspecting the supporting document on management's explanation.

It is also useful to note that analytical procedures are also used in many other non-audit and assurance engagements. For example, cost accountant usually uses analytical procedures to identify the fluctuation of different types of costs or expenses and the reasons behind those fluctuations.

Types of Analytical Procedures

1. **Trend Analysis**	Trend analysis is the process of comparing the data from one period to one or more comparable periods including both

	comparing to prior period data and comparing to the projections based on the changing patterns in the history data. Trend analysis may include comparing ratios from one period to another or evaluate the relationship between data, both financial and non-financial, from one period to another.
2. Ratio Analysis	Ratio analysis is the process of examination of various ratios of the company by comparing them to one or more comparable periods or to other companies in the same industry. Ratios are usually formed from two or more accounts or balances in the financial statements. In this case, using ratios with trend analysis can help auditors to identify unusual or unexpected changes in relationships between accounts or balances. Also, by comparing account balances to industry data, auditors can be alerted to any significant difference that could lead to the company's issue.

In summary, analytical procedures may be used in the following forms:

- Comparing account balances in the current period to one or more comparable periods
- Comparing account balances to the company's budget and forecasts
- Comparing account balances of the company to other companies in the same industry or comparing to the industry average.
- Evaluating the relationship of one account balances to other account balances with the predictable pattern
- Evaluating the relationship of account balances to non-financial data

Purpose of Analytical Procedures

Auditors perform analytical procedures in various stages of the audit for three main purposes:

- To use as risk assessment procedures to obtain an understanding of the client and the risks that the client exposes to

- To assess the risks of material misstatements that could occur on the financial statements at the planning stage of the audit
- To obtain audit evidence as substantive analytical procedures at the evidence-gathering stage of the audit
- To form an overall conclusion whether the financial statements are consistent with auditors' understanding of the client at the end of the audit

1.18.1 Analytical Procedures in Audit Process

Auditors are required to perform analytical procedures at the planning stage of audit and at the completion stage of audit to perform an overall review of the **financial statements** before issuing the audit report.

Analytical Procedures in Audit Process	
1. Analytical Procedures at planning stage	Auditors need to use analytical procedures as **risk assessment** procedures at the planning stage to obtain an understanding of the client and its business environment. As a result, they may identify the high-risk areas which they are not aware of and assist them in determining the nature, timing, and extent of the audit procedures to address the risks of material misstatements. Auditors may also evaluate the relationship between financial information and non-financial information, such as the relationship between sale amount and square footage of selling space.
2. Analytical Procedures at Evidence Gathering Stage	Auditors have responsibilities to design and perform substantive procedures to gather sufficient appropriate audit evidence in order to form a basis of opinion on financial statements. In this case, substantive procedures may include both the test of details and analytical procedures. Analytical procedures in this stage of audit are usually referred to as substantive analytical procedures. Likewise, in performing substantive analytical procedures, auditors need to consider a number of factors below: • **Suitability of analytical procedures,** e.g. is performing analytical procedures on sale amount can assure the assertion of completeness, accuracy, or cut-off? Also, analytical procedures may not be suitable if the client's internal controls are weak.

	• **Reliability of data used in developing the ratio or expectation,** e.g. is the data used from an internal source or external source? Is data comparable, e.g. with industry average? Is the data used relevant? • **Whether the expectation can identify material misstatements,** e.g. the expected gross margin from one period to another give better assurance than the fluctuation of the research and development expenses • **Whether the difference between the recorded amount and expected value is acceptable,** e.g. how much difference in percentage can be acceptable, 3%, 5%, or 10%? Usually, auditors will reduce the acceptable level of difference in order to increase the desired level of assurance if the risk of material misstatement is high.
3. Analytical Procedures at Completion Stage	Auditors need to perform analytical procedures at the end of the audit after obtaining sufficient appropriate audit evidence to form an overall conclusion whether the client's financial statements are reasonable and consistent with their understanding. As a result, auditors may identify the risk of material misstatements that they overlooked. In this case, they may need to revise their risk assessment at the planning stage and re-evaluate the planned audit procedures.

1.19 AUDITOR'S LIABILITIES

Over the last two decades, the auditing profession has suffered from various scandals such as **Enron** and other **high-profile audit scam settlements**. The involvement of PwC in the Satyam scandal has brought it to its knees in an operational environment in the World. Audit liability has increased many folds since the scam of Enron.

The liabilities have also enhanced the audit quality and reputation of the profession. This has also created barriers to new entries within the core audit market in itself.

Auditors are required to show two major skills while carrying out activities as independence and competence.

Auditors should have the required skills to carry out their job with due care and fairly. An auditor is also expected to complete tasks in good faith and integrity.

The auditor's liability represents the legal liability that is assumed when the auditor is performing professional duties.

- The auditor is liable for client accounting misstatements in the financial statements. There is always the risk of fraud and material misstatement in financial statements.
- This forces auditors to be professionally competent and employ all the auditing and accounting standards carefully.
- The auditor who performs his duties negligibly can face suit from the company, its shareholders, or even creditors who rely on auditors' work.
- The auditor can be held responsible for financial disadvantage to the firm caused by incorrect representation of the company's books. This leads the auditors to take out professional liability insurance.

Types Of Auditors' Liability

Auditors are potentially liable for both criminal and civil offenses. Criminal liabilities occur when the organization breaches the law or regulation.

On the other hand, disputes between individuals and/or organizations are tantamount to civil liability

Criminal offenses	Auditors are bound by the laws and regulations of the state or countries they operate in. They have also bound the ethics applicable to them as issued by the auditing boards. Auditors under criminal law can be prosecuted for acts such as fraud and insider trading. The audit is subject to legislation as per the Companies Act of the country. This Act includes the sections on auditors' qualifications, how they can be appointed, and what would be their functions. As per general law, the auditors can be prosecuted in criminal court for either knowingly or recklessly issuing an inappropriate audit opinion.
Civil offenses	This relates to issues related to contract law and the law of tort. The contract law seeks parties for breach of contractual obligations. That would mean the company can seek remedy from auditors only in terms of the engagement letter. Therefore, the shareholders can sue the auditors directly in terms of the letter of engagement for failing to handle work with due care.

Disclaimers of liability: Auditors can be exposed to litigation from third-person parties for whom they have not disclaimed liability. Hence, it is necessary to include a disclaimer of liability in the workings of the audit reports. Disclaimers cannot be entirely reduced. Further, the laws do not protect from threats from litigations under contract law

1.20 INTERNAL AUDIT

The term Internal Audit can be defined as "the independent appraisal activity within an organization for the review of operations as a service to the organization**".** The scope of internal audit will vary from business to business as it will be decided by the directors of each company. The function of Internal Audit can be carried out either by the employees of the organization or an outside agency. The Internal audit is an integral part of internal control.

Scope of Internal Audit

With regard to management	The following are the duties of the Internal Auditor ➢ Review & Appraisal of the system of internal check and internal control. ➢ Review of the accounting systems and records. ➢ Ensuring that the information generated by the accounting system is reliable To prevent and detect frauds and errors. ➢ To protect the assets against losses of any kind through Physical verification. ➢ To ensure that acquisition of assets and their disposal are under proper authority ➢ To take up an investigation at the special request of the management
With regard to statutory Auditor	➢ Review of Internal Control System. ➢ Verification of repetitive transactions. ➢ Ensuring maintenance of proper accounting records. ➢ Ensuring that information generated from such accounting records is reliable. ➢ Physical Verification of inventory and Fixed Assets. ➢ Preparation of schedules of debtors, creditors etc. ➢ Confirmation of balances of customers and suppliers

Scope and Objective of the Internal Audit

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

To Evaluate The Risk Management Ability	Internal auditing is primarily focused on assessing how well a company manages its risks. To evaluate that, the internal auditor will assess the quality of internal control systems, risk management processes, and corporate governance. The risks assessed include health and safety risks, market failure risks, supply chain risks, cybersecurity risks and financial risks, to mention a few. The ability to manage risks effectively or more effectively than rivals and as effectively as stakeholders expect is critical to a company's success.

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

Advantages of Internal Audit

Internal audit offers a number of advantages as follows:

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

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

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

d. **Reduction in Wastage**: Internal audit identifies the weaknesses and deficiencies of the organisation and thereby helps in reducing wastages.

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

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

Applicability of Internal Audit

<table>
<tr><td>

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

- every listed company;
- every unlisted public company having-
  - (i) paid up share capital of **50 crore rupees** or more during the preceding financial year; or
  - (ii) turnover of **200 crore** rupees or more during the preceding financial year; or
  - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding **100crore** rupees or more at any point of time during the preceding financial year; or
  - (iv) outstanding deposits of 20 crore rupees or more at any point of time during the precedingfinancial year; and
- every private company having-
  - (i) turnover of two hundred crore rupees or more during the preceding financial year; or

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

</td></tr>
</table>

Internal Control vs. Internal Check vs. Internal Audit

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	Its objective is to ensure that no one employee has exclusivecontrol over any transaction or group of transactions

		completeness of accounting records	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 asit 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 avoidduplication.

Traditional Internal Audit vs. Risk Based Internal Audit

Traditional Internal Audit	**Risk Based Internal Audit**
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 duringthe 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 andoverly-controlled
IA resources are spread over all business activities	More efficient use of IA resources by concentrating on risk areas
Disagreement with the business managementover the action plans leading to delays in implementation	Facilitates consensus with line management on the needed action plans thus improving timely the implementation of corrective measures

1.21 SPECIAL AUDIT

A special audit is **a tightly-defined audit that only looks at a specific area of an organization's activities**. This type of audit may be initiated by a government agency, but could be authorized by any entity, or even internally.

Types of special audit

1. Compensation audit	Compensation audit allows for the yearly examination or audit of employee salary, bonus, incentive, and stock option programs in order to assess their efficiency, competitiveness, and legal compliance.
2. Compliance audit	A compliance audit is a type of audit in which the purpose is to evaluate whether or not an organization is following the terms of a contract or certain rules and regulations. Compliance audits may be used by regulatory agencies to determine if a business is in compliance with the requirements of its operating license. The basic objective of a compliance audit is to evaluate an organization's conformity to laws, norms, internal bylaws, and codes of conduct. As far as Indian laws are concerned, an audit that checks compliance with the Companies Act is termed a secretarial audit.
3. Construction audit	A construction audit, as the name implies, is performed to assess the costs of any given construction project. It deals with keeping track of various construction costs such as payments made to suppliers, contractors, and so on. To determine the authenticity of construction expenses, the costs as recorded in the books are compared to the actual papers.
4. Internal audit	An internal audit can be used to evaluate an organization's performance or the execution of a process against a set of standards, policies, metrics, or guidelines. These audits may include an examination of a company's internal controls in the areas of corporate governance, accounting, financial reporting, and IT general controls.
5. Cost audit	A cost audit is an audit of cost records on the utilization of materials, labor, overheads, and other items of cost applicable to the production of goods. It checks whether the cost accounting system followed in the company serves as a correct basis for ascertaining the cost of production.
6. Fraud audit	It is a special form of investigation to identify whether or not there is any fraudulent activity in any particular area of financial statements. Fraud can be done in a variety of ways, including falsifying accounting records, misusing assets, and passing fictional journal entries to conceal fraudulent activities. As a result, if the entity finds that management or officials are involved in fraud, a special audit to investigate such fraud can be undertaken. A fraud audit involves checking any specific area of finance that is likely to be affected. For example, if a cashier steals cash and escapes, a fraud audit will be conducted to determine how much money was taken away by theft, to carry out a detailed analysis of cash records handled by

	the cashier, and to investigate the tasks previously performed by the cashier, etc.
7. Information systems audit	An information systems audit is required to ensure that the information systems are running properly and that there are no errors or malfunctions in the system. This particular audit is important for determining whether general controls connected to software development are functioning properly or not. An information systems audit is also performed to assess various controls such as data processing, software applications, IT infrastructure, access to information systems, and so on.
8. Royalty audit	A royalty audit is a financial verification that determines whether a licensee (user of a patent, license, or franchise) is paying the licensor (owner of the patent, license, or franchise) the correct amount of fees that have been agreed upon in the agreement they have in place for use of the patent, license, or franchise.
9. Income Tax audit	The verification of the books of accounts maintained by a taxpayer is referred to as a tax audit. The goal of a tax audit is to validate the taxpayer's income tax computation in the income tax return and to ensure compliance with the relevant laws of Income Tax. The books of accounts must be audited by a professional Chartered Accountant.
10. GST audit	In terms of indirect tax regulations in India, the Assistant Commissioner of CGST/SGST can initiate a Special Audit under GST [Section 66 of the CGST Act 2017], taking into account the nature and complexity of the case as well as the interest of revenue. If the Assistant Commissioner believes that the value of the taxable supplies disclosed by the registered person is erroneous or that the input tax credit has been improperly claimed, a special audit can be undertaken at any stage of scrutiny/inquiry/investigation.

2 COMPANY AUDIT

SECTIONS COVERED UNDER THIS CHAPTER

- **SECTION 139: APPOINTMENT OF AUDITORS**
- **SECTION140: REMOVAL, RESIGNATION OF AUDITOR & GIVING OF SPECIAL NOTICE**
- **SECTION 141: ELIGIBLITY QUALIFICATION AND DISQUALIFICATION OF AUDITORS**
- **SECTION 142: REMUNERATION OF AUDITORS**
- **SECTION 143: POWERS/ RIGHTS AND DUTIESSS OF AUDITORS**
- **SECTION 144: AUDITOR NOT TO RENDER CERTAIN SERVICES**
- **SECTION 145: SIGNING OF AUDIT REPORT**
- **SECTION 146: AUDITOR TO ATTEND GENERAL MEETING**
- **SECTION 147: PUNISHMENT FOR CONTRAVENTION**
- **SECTION 148: COST AUDIT**

2.1 ELIGIBILITY, QUALIFICATION AND DISQUALIFICATION OF AUDITOR [SECTION141]

2.1.1 Qualification of a Company Auditor [Section 141(1)]

The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by **Section 141** of the Companies Act, 2013

1. Only a Chartered Accountant (CA) shall be appointed as auditor of a company.
2. In case of a firm where 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.
3. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.**[Section 141(2)]**

2.1.2 Disqualifications of Company Auditor[Section 141(3)]

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

I) Is holding security or interest in CASSH **(Company/Associate/Subsidiary/Holding/Subsidiary of such Holding i.e. CASSH)** ➢ Relative may hold security in the Co. of Face value **1 Lakh** ➢ If relative (not auditor or partner) acquires interest > **1 lakh** è then corrective action to maintain limit within **60 Days of acquisition** II) Person/Relative/Partner indebted to **CASSH > 5Lakh** **III)** Person/Relative/Partner given guarantee or security for indebtedness of 3rd person to **CASSH >1 Lakh** 5. Person or firm has business relation with CASSH or associate Co. (Business relation excludes services permitted under CA Act 1949 by auditor & commercial transactions by Co. in ordinary course of business at Arm's length price) 6. A person whose relative is a director or is in the employment of the company as a director or key managerial personnel 7. <u>Convicted for Fraud</u> by a Court & period of **10 years not elapsed** from date of conviction. 8. Full time employed OR person or partner of firm auditing **> 20 companies** excluding OPC/Dormant/Small Cos./Pvt Cos. with **paid up capital < 100 Cr** (with no default in filing F.S. or Annual Return) ❖ No. of partners on date on date of acceptance of audit assignment shall be taken into account ❖ **CA in full time** employment elsewhere shall not be taken into account. 9. Renders service under **<u>Section 144</u>** to Company or its holding or Subsidiary.

<u>CEILING ON NUMBER OF AUDIT SECTION 141(3) (g)</u>	• As per this section that a Chartered Accountant in practice cannot be appointed as an auditor of more than **20 companies** other than **One Person Company, Dormant Companies, Small Companies and Private Companies having paid-up share capital less than ₹100 crore.** • Ceiling on Tax Audit Assignments: 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**. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB

SUBSIQUENT DISQUALIFICATION AFTER APPOINTMENT: [SECTION 141(4)]	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

2.2 APPOINTMENT OF AUDITOR [SECTION 139]

A) APPOINTMENT IN NORMAL CASE

(I) PROVIOIN RELATING APPOINTMENT OF FIRST AUDITOR

(a) **In case of a company other than a Government Company [Section 139(6)]**	❖ The first auditor of a company, other than a Government company, shall be appointed by the **Board of Directors** within **30 days** from the date of registration of the company. ❖ In the case of **failure** of the **Board** to appoint such auditor, it shall inform the members of the company, who shall appoint such auditor within **90 days** at an extraordinary general meeting **(EGM)** ❖ The auditor, so appointed, shall hold office till the conclusion of the 1st annual general meeting **(AGM)**
(b) **In case of a Government Company [Section 139(7)]**	❖ In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by **the Comptroller and Auditor-General of India (C&AG)** within **60 days** from the date of registration of the company. ❖ In case the **Comptroller and Auditor-General of India** does not appoint such auditor within the aforesaid period, the **Board of Directors** of the company shall appoint such auditor within the next **30 days**. ❖ Further, in the case of failure of the **Board** to appoint such auditor within the next **30 days**, it shall inform the **members of the company** who shall appoint such auditor within **60 days** at an extraordinary general meeting **(EGM)**. ❖ The auditor, so appointed, shall hold office till the conclusion of the 1st annual general meeting **(AGM)**

(II) PROVISION RELATING APPOINTMENT OF SUBSEQUENT AUDITOR

(a) **In case of a company other than a Government**	❖ Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every **6th meeting**.

Company [Section 139(1), read with Rule 3 and 4 of Company (Audit and Auditors) Rule 2014]	❖ Before such appointment is made, the **written consent** of the auditor to such appointment and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as prescribed, shall be obtained from the auditor. ❖ The certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141. ❖ The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed in **Form ADT-1 [Rule 4(2)].**
(b) **In case of a Government Company [Section 139(5)]**	❖ In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the **Comptroller and Auditor General of India** shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of **180 days** from the commencement of the financial year. ❖ The auditor, so appointed, shall hold office till the conclusion of the annual general meeting **(AGM)**

B) <u>APPOINTMENT IN CASE OF FILLING A CASUAL VACANCY[SECTION 139(8)]</u>

(a) In case of a company other than a company whose accounts are subject to audit by an auditor appointed by the CAG [Section 139(8)]	❖ Any casual vacancy will be filled by **<u>the Board of Directors within 30 days.</u>** ❖ If such casual vacancy is as a result of the <u>resignation of an auditor</u>, such appointment shall also be approved by the company at a **general meeting** convened within **3 months** of the recommendation of the **Board.** ❖ The auditor, so appointed, shall hold the office till the conclusion of the next annual general meeting**(AGM)**
(b) In case of a company whose accounts are subject to audit by an auditor appointed by the CAG	❖ Any casual vacancy will be filled by the **<u>Comptroller and Auditor-General of India</u>** within **30 days.** ❖ In case the Comptroller and Auditor-General of India does not fill the vacancy within the aforesaid period, the **Board of Directors** shall fill the vacancy within next **30 days**.

[Section 139(8)]	

Re-appointment of a Company Auditor [section 139(9)	As per Section 139(9), a retiring auditor may be re-appointed at an annual general meeting, if: ❖ he is not disqualified for re-appointment; ❖ he has not given the company a notice in writing of his unwillingness to be re-appointed; and ❖ a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
Automatic Re-appointment of a Company Auditor [section 139(10)]	According to Section 139(10), where at any **annual general meeting**, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

<u>NOTES : Role of Audit Committee's Recommendation in Appointment of Auditors:</u> Where a company is required to constitute **an Audit Committee** under **section 177**, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee

<u>ROTATION OF AUDTIOR</u>

<u>Section 139(2)</u>	**A. Eligible Companies** The provisions for rotation of auditors shall be applicable to – ❖ Every <u>listed company</u> excluding <u>one person companies and small companies.</u> ❖ Every <u>unlisted public</u> company having paid up share capital of **₹10crore or more**; ❖ Every private limited company having paid up share capital of **₹50 crore or more**; ❖ All other companies having public borrowings from financial institutions, banks or public deposits of **₹50crore or more**.
	B. Maximum Term ❖ No **individual** shall be appointed or reappointed as auditor for more than **one** term of **five consecutive years.** ❖ No **audit firm** shall be appointed or reappointed as auditor for more than **two terms** of **five consecutive years.**
	C. Additional Conditions for Rotation ❖ An individual auditor or an audit firm who/which has completed his/its term **<u>shall not be eligible for re-</u>**

	appointment as auditor in the same company for five years from the completion of such term. ❖ On the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years: ❖ Every company, existing on or before the commencement of this Act, which is required to comply with provisions of Section 139(2), shall comply with requirements of this sub-section within a period which not be later than the date of the first AGM of the company held within the period specified in Section 96(1), after 3 years from the date of commencement of Companies Act. ❖ The above provisions shall not prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company

Rotation of Partners in the Audit Firm [Section 139(3)]	According to Section 139(3), the members of a company may resolve to provide that – ❖ in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or ❖ the audit shall be conducted by more than one auditor
Section 139(4)	**Firm** shall include a **Limited Liability Partnership** incorporated under the **Limited Liability Partnership Act, 2008**
Section 139(5)	In the case Government Company, **CAG** in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of the company within a period of **180 days** from the commencement of the **financial year** who shall hold the office till the conclusion of the **AGM.**

2.3 REMOVAL, RESIGNATION OF AUDITOR AND GIVING SPECIAL NOTICES [SECTION 140]

2.3.1 REMOVAL OF AUDITOR

- **According to Section 140(1),Removal of auditor before expiry term,** the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014-

- ❖ The application to CG for removal of auditor shall be made in **Form ADT-2** and accompanied with fees provided under Companies (Registration Offices and Fees) Rules, 2014.
- ❖ The application shall be made to CG within 30 days of Board Resolution.
- ❖ The Co. shall hold general meeting within 60 days of receipt of approval of CG for passing special resolution.

It is important to note that before taking any action for removal before expiry of terms, auditor shall be given reasonable opportunity of being heard

2.3.2 RESIGNATION BY AUDITOR

Section 140(2)	❖ The auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed **Form ADT–3** (as per Rule 8 of CAAR) with the company and the Registrar. ❖ In case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the CAG along with the company and the Registrar. The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation. **Note:** ***In case of failure, the auditor shall be liable to a penalty of ₹50000 or the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of ₹500 for each day after the first during which such failure continues, subject to a maximum of lakh rupees as per section 140(3)***

REMOVAL OF AUDITOR BY THE TRIBUNAL

As per Section 140(5), an auditor can be removed from his office by the Tribunal in the following manner:	❖ The Tribunal either **suo motu** or on an application made to it by the Central Government or by any person concerned, may, by order, direct the company to change its auditor, if it is satisfied that the auditor has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers. ❖ If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within **15 days** of receipt of such application, make an order to the removal of the auditor from his office. ❖ The **Central Government** may appoint another auditor in his place. ❖ An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this Section shall not be eligible to be appointed as an auditor of any company for a period of **5 years** from the date of passing of

	the order and the auditor shall also be liable for action under **Section 447.**

Note: For this purpose, the word **'auditor'** shall include a **firm of auditors**. Moreover, in case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

APPOINTMENT OF AUDITOR OTHER RETIRING AUDITOR

According to Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed	• **Special notice** required for resolution at AGM for appointing auditor ➢ Person other than **retiring auditor** or ➢ Providing expressly that retiring auditor will not be reappointed (except where **rotation timeline completed**) • On receipt of notice - Company shall forward to retiring auditor • On receipt of notice if retiring auditor makes representation to Company in writing & request notification to members, then Company shall: ➢ In notice of meeting to members state fact that representation has been made & ➢ Send copy of representation to every member to whom notice is sent ➢ If copy of representation couldn't be sent - then Auditor may require it to be **read out at meeting + copy to be filed with ROC** If Tribunal satisfied on application of Co. or any other aggrieved person, rights conferred by Sec 140(4) are being abused by Auditor, then, copy of representation may not be sent and representation need not be read out at the meeting

2.4 REMUNERATION OF AUDITOR [SECTION 142]

Section 142	The remuneration of the auditor of a company shall be fixed in its general meeting or in such a manner as may be determined therein. Provided that the board may fix remuneration of the **first auditor** appointed by it.

Remuneration includes fees+ expenses reimbursed+ facility extended to him

2.5 POWERS/RIGHT AND DUTIES OF AUDITOR [SECTION 143]

RIGHT OF AUDITOR SECTION 143(1)	**A. RIGHT TO ACCESS TO BOOKS** ❖ Right of access at all times to the **books and accounts and vouchers of the company**, whether kept at the registered offices of the company or at any other place. ❖ Right to access to other records **namely minutes board meeting** . MIS report and any other books as may required by the auditor. ❖ Further this right can be exercised during **working days and business hours** ❖ Right to access to books of accounts of **subsidiary company and associate company** in so far as they related to **consolidated financial statement**. **B. RIGHT TO OBTAIN INFORMATION AND EXPLAINATION** ❖ The auditor has right to obtain from the officers of the company such **information and explanation** as he may think necessary for the performance of his duties as auditor. ❖ The information and explanation can be obtained from either **officer or employee** of the company. ❖ The auditor can also obtain any additional information if needed,. The management of the company has duty to explain the auditor. **C. RIGHT TO RECEIVE NOTICES AND DUTY TO ATTEND GENERAL MEETING [SECTION 146]** ❖ The auditor of company are entitled to attend any general meeting of the company; also to receive all the notices to the general meeting which members are entitled to receive.

DUTIES OF AUDITOR SECTION 143(1)	**A. Duty to Inquire:** ❖ 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; ❖ whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; ❖ 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; ❖ whether loans and advances made by the company have been shown as deposits; ❖ whether personal expenses have been charged to revenue account; ❖ 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.
<u>SECTION 143(2)</u>	**B. Duty to Report on Financial Statements of the Company** The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act after taking into account the provisions of this Act, the **accounting and auditing standards** etc. and matters which required under this Act or rules made thereunder and under any order made u/s 143(11).
<u>Rule 11 of Cos. (Audit and Auditors) Rules, 2014 other matters to be included in auditor's report namely:-</u>	a) whether Company has disclosed impact, of pending litigations on its financial position in its financial statement; b) whether Company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts; c) whether there has been delay in transferring amt, to Investor Education and Protection Fund by Company d) i) Whether management has represented to best of knowledge & belief, other than disclosed in notes, no funds advanced, loaned or invested by Co. in any person or entity including foreign entity with understanding that Intermediary will lend or invest in another entity or provide guarantee or security on behalf of Co. (Ultimate Beneficiary) ii) Whether management has represented to best of knowledge & belief, other than disclosed in notes, no funds received by Co. from any person or entity including foreign entity(Funding Parties) with understanding that Co. will lend or invest in another entity or provide guarantee or security on behalf of Funding Party (Ultimate Beneficiary iii) Auditor has found no material misstatement in above representations

	e.) Whether company has complied **section 123** of Companies Act, 2013 declaration and payment of dividend f.) In respect of FY commencing after 1.4.22 à Co. used accounting software to maintain books of a/c having audit trail & same operated throughout year & audit trail hasn’t been tampered & preserved by Company for retention.
<u>SECTION 143(3)</u>	**C. <u>Duty of auditor to report on following matters</u>:-** ❖ Whether all the information & explanation which according to his knowledge were required for the purpose of audit has been **sought & obtained** by him (auditor) or not ❖ Whether the **books of accounts** as required by the law have been **properly** made by company or not. ❖ Whether **Branch Audit** report has been received for those branches whose audit was conducted u/s **143(8)** by person other than co-auditor. ❖ 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; ❖ whether, in his opinion, the financial statements **comply with the accounting standards;** ❖ the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company; ❖ whether any director is disqualified from being appointed as a director u/s 164(2) ❖ any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith; ❖ whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls; ❖ such other matters as may be prescribed
<u>SECTION 143(4)</u>	**D. Duty to Provide Reasons for any Negative Remarks/Qualification:** According to Section 143(4), where any of the above-mentioned matters required to be included in the audit report is answered in the **negative or with a qualification**, the report shall state the reasons therefor.
<u>SECTION 143(5)</u>	**E. Duty to Comply with the Directions of CAG** As per section 143(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the auditor shall, in his report, include

	❖ The directions, if any, issued by the **Comptroller and Auditor-General of India** regarding the manner of audit of accounts; and ❖ The action taken on such directions and its impact on the accounts and **financial statement** of the company.
SECTION 143(6)	**F. C&AG** right to conduct supplementary audit , comment upon or supplement such audit report.
SECTION 143(7)	**G. C&AG** may, by an order, cause test audit.
SECTION 143(8)& RULE 12	**H. Branch Auditor**: Accounts of Branch office can be audited by- 1. The company's auditor or, 2. Any other person, qualified to be and appointed as an auditor as per the provision of the Act as branch auditor: or In case of foreign branch, by the company's auditor or by an accountant or a competent person appointed in accordance with the prevailing laws of the foreign country.
Section 143(9) & (10)	**I. AUDITING STANDARDS:** Every auditor must comply with **the auditing standards**. While the Central Government prescribes the Auditing Standards or addendums thereto, is shall consult with and take recommendation of **the Institute of Chartered Accountants of India (ICAI) AND THE National Financial Reporting Authority (NFRA**). Till such time the auditing standards are notified by the Central Government, the auditing standards specified by the ICAI are deemed to be the auditing standards
Section 143(12) {Read with rule 13 of CAAR, 2014	**J. REPORTING OF FRAUDA BY AUDITOR:** In case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but **not later than 60 days** of his knowledge and after following the procedure indicated herein below: ❖ Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observation within 45 days; ❖ On receipt of such reply or observations the auditor shall forward his report and the reply or observation of the Board or the Audit Committee along with his comment to the Central Government within 15 days or receipt of such reply or observation; ❖ The report shall be in the form of a statement as specified in **Form ADT-4.** ❖ The report shall be sent to the Secretary, Ministry of Corporate Affairs(MCA) in sealed cover by Registered Post

	with Acknowledgement Due(RPAD) or by Speed Post followed by E-mail in confirmation of the same. ❖ The repot shall be on the letter head of the Auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number ❖ The provision of this rule shall also, Mutatis Mutandis, to a **Cost Auditor and a Secretarial Auditor** during the performance of his duties under **section 148 and section 204** respectively.

2.6 AUDITOR NOT RENDER CERTAIN SERVICES [SECTION 144]

[SECTION 144]	➢ accounting and book- keeping services; ➢ internal audit; ➢ design and implementation of any financial information system; ➢ actuarial services; ➢ investment advisory services; ➢ investment banking services; ➢ rendering of outsourced financial services; ➢ management services; and ➢ any other kind of services as may be prescribed.

2.7 SIGNING OF AUDIT REPORT [SECTION 145]

SECTION 145	➢ Firm including LLP :- **Only Partners** who are **CA**s :- **act & sign** on behalf of firm ➢ Qualifications, observations or comments on financial transactions which have adverse effect on functioning of Company Read before in GM & open for inspection by members of Company

2.8 AUDITOR'S RIGHT TO ATTEND GENERAL MEETING[SECTION 146]

SECTION 146	All notice of any general meeting shall be forwarded to the auditor of the company and he must attend any **general meeting** either by himself or through his authorized representative (qualified to be an auditor) and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

2.9 PUNISHMENT FOR CONTRAVENTION[SECTION 147]

SECTION 147	1. Default u/s 139-146 [Company & Officer] ➢ Co: **₹25k – ₹5 Lakh** ➢ Officer: **₹10k – ₹1 Lakh** 2. Default u/s 139, 144 & 145 [Auditor] ➢ Auditor: **₹25k –₹ 5L** or 4 times remuneration whichever is lower ➢ If wilful default & intention to deceive then punishable with ❖ Fine **₹50k – ₹25 Lakh** or 8 times remuneration whichever is lower + **imprisonment up to 1 year** 3. Liable to refund remuneration & Pay for damages to Company/statutory bodies/ authorities/ members/ creditors of Company for their losses. 4. If Auditor is a firm ➢ proved that partner(s) involved in fraud à liability of concerned partners & firm (joint & several) For criminal liability in respect of liability other than fine à partners who are involved in fraud only liable

2.10 AUDIT COMMITTEE [SECTION 177]

APPLICABILITY

- Listed Public Company
- Public Company

❖ Paid up Share Capital (PSC)>= 10 Cr or
❖ Turnover (T/o) >= 100 Cr or
❖ L/D/D(Loans/Debenture/Deposits) > 50 Cr

Audit committee performs important functions including:	❖ making recommendation for appointment, ❖ remuneration and terms of appointment of auditor of Co., ❖ reviewing and monitoring auditor's independence and ❖ performance & effectiveness of audit process ❖ examination of F.S. and auditor's report thereon
NOTE:	**AUDIT COMMITTEE** consists of directors of Co. Minimum 3 directors with independent directors forming majority. Audit committee helps in ensuring better standards of corporate governance

Manner & procedure for selection of Auditor [Rule 3 of CAAR, 2014]	**Audit Committee or Board** shall consider Qualification & Experience along with pending proceedings relating to professional conduct ➢ Audit Committee shall recommend name to Board ➢ If board agrees à forward to AGM ➢ If board disagrees à refer back to AC citing reasons ➢ If AC doesn't reconsider, board will record reasons of disagreement & forward own recommendation to AGM

	➢ Auditor will hold office till conclusion of 6th AGM

2.11 COST AUDIT [SECTION 148]

Cost Audit is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company i.e. means auditing of costing records by a **Cost Accountant** in Practice.

As per section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.

Sec 148 of Companies Act 2013 read with Companies (Cost Records & Audit) Rules 2014

Rule 3	Every company whether in regulated or unregulated sector shall maintain costing records. If aggregate turnover of company in immediately preceding Financial year was minimum 35 crore.
Rule 5	Every Co. covered by Rule 3 maintain cost records in **Form CRA-1**

Note	**CARO Clause**: As per Clause (vi) to Para 3 of CARO 2020, auditor has to report whether maintenance of cost records has been specified by CG u/s 148(1) of Companies Act, 2013 and whether such accounts and records have been so made and maintained.

Rule 4 – Cost Audit applicability	
Regulated Sectors	**Unregulated Sector**
1. Aggregate Turnover >= **50 crore** Preceding financial year **And** From individual product/ service is Minimum **25 crore.** **Regulated sector (type A)** : Telecommunication , Power, Petroleum, Sugar, Fertilizer, Drugs.	1. Aggregate turnover >= **100 crore** preceding financial year **And** From individual product / services minimum **35 corer** **Unregulated Sector (type B)** : Other than regulated sector.

2.11.1 APPOINTMENT OF COST AUDITOR

If Audit Committee exist :- Audit Committee will recommend, **BOD** will appoint.

If Audit Committee not exist :- **BOD** will appoint

Remuneration of Cost Auditor

If Audit Committee exist :- Audit Committee will recommend, **BOD** will fix & share holder (members) will approve.

If Audit Committee not exist:- BOD will fix & share holder will approve.

Non-Applicability	• Revenue from exports in forex > 75% of total revenue or • Operating from SEZ • Engaged in generation of electricity for captive consumption through captive generating plant

Rule 6	Appoint auditor within **180 days** of commencement of Financial Year ➢ File notice of appointment with CG in form **CRA-2** with fees within **30 days of Board Meeting or 180 days of commencement of FY**, earlier ➢ Cost auditor shall continue till expiry of **180 days** from closure of FY or till submission of Audit report ➢ Audit report to be submitted in form **CRA-3** within **180 days** of closure of FY & forward to **BOD** ➢ Co. within **30 days** of receipt of copy of report furnish to Central Government in Form **CRA-4** in XBRL format + explanation to every qualification or reservation In case of any default of these rules:- Penalty **u/s 147** for Company., officers & Cost auditor

DIFFERENCE BWTWEEN COST AUDIT AND FINANCIAL AUDIT

BASIS	**COST AUDIT**	**FINANCIAL AUDIT**
Meaning	Cost audit is an independent examination of the correctness of the cost statements and accounts and its conformity with the cost accounting plan.	Financial audit is a systematic unbiased examination of a company or institution's finance books and records, so as to express the opinion on it.
Audit	Performed by a practicing Cost Accountant.	Performed by a practicing Chartered Accountant.
Appointment of auditor	Board of Directors	Shareholders
Analysis	Cost records, cost statements and cost accounts.	Financial Statement, Books of Accounts, Documents, Vouchers, etc.
Emphasis	Analysis of the efficiency of operations and propriety of actions of the management.	Compliance with the accounting standards and effectiveness of the internal control system
Compulsion	cost audit is mandatory for specific entities only and that too which are engaged in manufacturing and production business.	Financial Audit is compulsory for all companies, organizations and institutions

Report Submission	The cost auditor submits the cost audit report to the Board of Directors at the Board Meeting, which is then submitted to the Central Government	The financial auditor submits the financial audit report to the shareholders at the company's Annual General Meeting.

3. AUDIT OF BANK

Bank audit is a procedure performed by an **auditor** appointed by RBI and ICAI to verify the financial statements of the banking institutions and to verify whether the banking concerns are following the law and compliances or regulatory framework applicable on them or not.

3.1 Type of Banking institutions prevailing in India:

- Commercial banks;
- Regional Rural banks;
- Co-operative banks;
- Development banks (more commonly known as 'term-lending institutions');
- Payment Banks; and
- Small Finance Banks

3.2 PROCEDURE OF BANK AUDIT

Banking sector is a dynamically changing sector. Thus, it requires proper and effective audit measures to understand the exact financial condition of the banks for which the following procedure is adopted:	➢ RBI and Indian Institute of Chartered Accountants of India (ICAI) together scrutinise and appoint an auditor or audit firm for the audit of the bank after obtaining **indebtedness declaration** from a respective firm or an auditor ➢ The audit firm or an auditor **cannot assign with any other statutory audit in the year** they are appointed as a bank auditor. Before initialising the audit, the firm needs to establish the undertaking of engagement terms describing the time period of audit term. However, as per ICAI Act, 1949 before getting engaged the auditor need to communicate with the previous auditor of the bank in writing for taking his consent. ➢ After that, the new auditor will review the initial opening balance, and if he founds any material misstatement or errors affecting financial statement, he can assert his point of view in his **audit report** by way of qualified or adverse report. ➢ Auditor then tries to understand the working environment and internal controls of the organisation for deciding the basis of the audit.

	➢ Thereafter, banks accounting process, **risk management process and risk identification** are made along with control and monetary activities considered by the management. At last, after reviewing all the relevant elements, an auditor prepares an audit report defining his opinion regarding the financial condition of the bank as well as if any loopholes found in following the mentioned regulations under Act.
Advances: In relation advances made by bank an auditor need to review the followings	➢ Ensure the internal control is in place in relation to advances made. ➢ To scrutinise the subsidiary, ledger, & control accounts ➢ To ensure the proper documentation of account. ➢ To scrutiny the overdue account and scheme for recovery of such amount. ➢ Cash balance with RBI and other bank and money at call and short Notice. ➢ Month wise details of credit & debit transactions in relation to CC/OD accounts. ➢ Non-performing Assets Statements ➢ Verify the transactions which are the indicator of irregular or fraud outstanding advance accounts. ➢ Classify the various advances according to prudential norms on income recognition & assets classification norms also known as NPA norms
Cash in hand:	➢ Ensure that the Internal control is in place. ➢ Visit the bank branch and inspects physical cash and ensure that it will tallies withs the banks cash book balance. ➢ To verity the amount of foreign currency held by bank and its translation at make rate on the date at which financial statement is prepared.
Balance with RBI:	Inspect the ledger balance in each account with (a) bank confirmation certificates from Reserve Bank of India and (b) Reconciliation Statement
Balance with other bank:	Inspection of reconciliation statement to ensure that no debit or credit for interest have been taken to Revenue account to the year. To examines the large transition and balances with banks outside India. Ensure that they are converted at market rate as on financial statement preparation

Fixed and other Assets:	➢ Accounting method of bank ➢ Ownership document ➢ To examine with reference to **schedule of fixed assets to find new assets** acquired. ➢ To examine **sale deed** in relation to sale of assets by bank. ➢ To ensure appropriateness of basis of revaluation of fixed assets. ➢ Ensure compliance **of section 9** of banking Regulation Act
Banking and Deposits **Borrowings** **Deposits**	➢ To ensure that amount have been property disclosed for ➢ Barrowing in India farm RBI. ➢ Barrowing outside India. ➢ Ensure the rate of interest paid payable with duration of borrowing. ➢ Verity whether the barrowings of money at call and short notice are property authorized ➢ To ensure the **interest accrued but not due on deposits** is not under other liabilities and provision ➢ See Whether there is any instances of window dressing **reporting in LFAR.**
Bills Payable: The auditor should evaluate the existence, effectiveness and continuity of internal controls over bills payable	➢ Unused forms relating to **drafts, traveller's cheques**, etc., should be kept under the custody of a responsible officer. ➢ The bank should have a reliable private code known only to the responsible officers of its **branches coding and decoding** of the telegrams should be done only by such officers. ➢ The signatures on a demand draft should be checked by an officer with the specimen signature book
Bills for Collection	➢ The auditor should examine whether the bills drawn on other branches of the bank are not included in bills for collection. ➢ Inward bills are generally available with the bank on the closing day and the auditor may inspect them at that time. The bank dispatches outward bills for collection soon after they are received. They are, therefore, not likely to be in hand at the date of the balance sheet. The auditor may verify them with reference to the register maintained for outward bills for collection. ➢ The auditor should also **examine collections** made subsequent to the date of the balance sheet to obtain further evidence about the **existence and completeness of bills** for collection.

<u>3.3Treasury Operation-Foreign Exchange and Derivatives</u>

- ❖ While innovative products and ways of trading create new possibilities for earnings for the bank, they also introduce novel and sometimes **unfamiliar risks** that must be **identified and managed**. Failure to do so can result losses entailing financial and reputational consequences that linger long after the loss has been recognized in financial statements. Hence, auditor should <u>assess controls as part of audit work</u>.
- ❖ It is imperative that an auditor obtains a complete **overview** of <u>the treasury operations of a bank before the commencement of the statutory audit</u>. After conducting <u>appropriate risk assessment of the treasury processes</u>, the audit program needs to be **designed in a manner** that it dovetails into not just the control assessments of the treasury process but there is an assurance that the figures appearing in the financial statements as well as the disclosures **<u>are true and reflect</u>** fairly the affairs of the bank treasury.

<u>3.4 Reports to be given by bank Auditors:</u>

- ➢ The Auditors' Report should state whether the Balance Sheet, Profit and Loss Account and Cash Flow Statement of the Bank, **show a true and fair view** of the financial position / result of operations / cash flows respectively, for the period under audit. This is applicable in respect of Nationalised Banks, as well as Banking Companies.
- ➢ **Unaudited Branches**: Information relating to number of unaudited Branches should be given. Also, information in respect of Advances, Deposits, Interest Income and Interest Expense for such unaudited Branches should be collected and disclosed in the Audit Report

Additional Matters

Sec.30 (3) of Banking Regulation Act requires the Auditor to state the following	1. Whether the <u>Profit & Loss Account</u> shows a true balance of Profit or Loss for the period covered by such account, & **2. LFAR**: Auditors of Public Sector Banks, Private Sector Banks & Foreign Banks (as well as their Branches), are required to submit **<u>Long Form Audit Report (LFAR) on various matters specified by RBI.</u>** 3. **Certificates**: In addition to Reports, the Auditors of Bank Branches as well as Central Statutory Auditors of Banks, have to furnish / issue various "**Certificates" as required by RBI and other Regulations**.

3.5 NON-PERFORMING ASSETS

Non-performing Assets: An asset becomes NPA when it ceases to generate income for the Bank.

A non-performing asset (NPA) is a loan or an advance where -:

- interest and/ or instalment of principal remain overdue for a period of more than **90 days** in respect of a term loan;
- the account remains '**out of order' in respect of an Overdraft/Cash Credit** (OD/ CC);
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted

Out of Order: An account should be treated as 'out of order' if:-

♦ the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or

♦ In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or

♦ credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated **as 'out of order'**

Overdue: Any amount due to the bank under any credit facility is **'overdue' if it is not paid** on the due date fixed by the bank.

Categories of Non-Performing Assets:	**Provision Required**
Substandard Assets:	
Would be one, which has remained NPA for a period less than or equal to 12 months	**15%**
Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.	**(Secured+Unsecure)**
Sub-categories:	**25% +100%**
Doubtful up to 1 Year (D1)	**40%+100%**

Doubtful 1 to 3 Years (D2)	**100%+100%**
Doubtful more than 3 Years (D3)	
Loss Assets: Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly	**100%**

<u>Impact of Non- Performing Assets on Balance Sheet</u>

Profitability due to NPA **Liability Management** **Public Confidence** **Changes in Interest Rates**	<u>Non- Performing Assets</u> not only reduces **the profit of the Bank but also increases the Loss**. Also, banks also providing **25 % to 30% additional provision** on <u>Non-Performing</u> Assets which directly impact the **Profitability of the Bank** Due to high Non-Performing Assets, Bank for <u>forced for lower the interest rates of the deposit and on advances</u> likely to pay **Higher interest rates** on advances. This situation is a **very difficult** situation and also hamper the banking business. The poor performance of the Bank due to increases in Non-Performing Assets not only lower the sentiments of the investor but the bank also lose the faith of Public, this directly affects the deposits into the bank. High Non-Performing Assets **affects the economy** as a whole. Higher NPA reflects the **reduction of interest rate on the deposit** into banks, only poor public directly impact the consequences of Higher NPA's of the bank**.**

4 GOVERNMENT AUDIT

Government audit is applicable to Government departments and departmental undertakings. Government of India maintains a separate department known as Accounts and Audit Department. Comptroller and Auditor General of India heads this department.

The Comptroller and Auditor General of India under Article 149 of the Constitution, which gives the powers and rights and fixes his responsibility for the audit of Government departments and institutions.

4.1 Objectives of Government Audit

1. To make sure that the expenditure is incurred out of the fund, which the competent authority has sanctioned.

2. To verify that the expenditure of the government department is sanctioned as per the rules and regulations of the department concerned.

3. To see that the expenditure already sanctioned has been incurred by an officer who is authorized to do so.

4. To ensure that the payments have been made to the right persons and they are duly entered in the books on the basis of receipts received from them.

5. To see that the payments have been properly classified into capital and revenue.

6. To check the existence of stock and stores and their proper valuation.

7. To ensure that expenditures have been incurred in the interest of public.

8. To ensure that stocktaking is done periodically and stock registers are maintained hi-to-date.

9. To ensure that whether money due from others has been regularly recovered while verifying the receipts.

4.2 POWERS OF C&AG:

1. To inspect any office of accounts under the control of the Union or of a State, including treasuries and such offices responsible for the keeping of initial and subsidiary accounts, and submit accounts to him;

2. To require any accounts, books papers and other document which are relevant to the transactions as under audit, be sent to specified places

3. To put such question or make such observation as he may consider necessary to the person in charge of the office and to call for such information as he may require for preparation of any account or report, which is his duty to prepare

4. To dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transaction as he may determine .

4.3 DUTIES OF C&AG

Audit of Receipt and Expenditure	Where anybody or authority is substantially financed by grants or loan from the Consolidated Fund of India or of any State or of any union Territory , the C&AG shall audit all receipt and expenditure of that body or authority and to report .
General Provision Relating to Audit	❖ To audit and report on all expenses from the Consolidated Fund of India and of each State and of each Union Territory. ❖ To audit and report all transaction of the union and of the state relating to Contingency Fund and Public Accounts. ❖ To audit and report on all trading, manufacturing profit and loss accounts and balance sheet and other subsidiary accounts kept in any department of the union or of state
Audit of Government Companies and Corporation	The duties and powers of C&AG in relation to the audit of the Government Companies shall be performed and exercised by him in accordance with the provision of The Companies Act, 2013
Compile and Submit Accounts of Union and State	1. The C&AG shall be responsible for compiling the accounts of the union and of each state and union territory. 2. He is also responsible to provide such information as may be required by the union Government, state Government or the Government of Union Territories which will enable them to compile the accounts 3. The accounts prepared should be submitted to: ❖ In the case of Union / Central Government, to The President of the Country ❖ In the case of state, to the Governor of each State

	❖ In the case of Union Territory, to the Chief Administrator.

4.4 Supplementary or Test Audit by the Comptroller & Auditor General.

Comptroller and Auditor General of India has the right to comment upon or supplement the audit report of the Statutory auditors in such manner as he may think fit under Section 143(6)(b) of the Companies Act 2013. The supplementary or test audit, conducted by the Comptroller and Auditor General on the audit report of the Statutory Auditors broadly covers the following four aspects:

- ❖ Verification of the technical accuracy of the accounting records, books of account and financial results with reference to the Accounting Standards;

- ❖ Detection or prevention of misstatements in and window dressing of the financial statements; Whether mention of any important defects or irregularities has been omitted, and;

- ❖ That the report does not reveal any important point that would need to be further investigated.

4.5 Audit Report: Reports in relation to the accounts of a Government Company or Corporation are submitted to the Government by the C&AG under the provisions of Section 19-A, of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. The Annual reports on the accounts of the Central Government Companies and Corporations are issued by the **C&AG of India to the Government**

5 AUDIT OF NON-GOVERNMENTAL ORGANISATION

1. NGOs can be defined as **non-profit making organisations** which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education.
2. Therefore, this definition of **NGO** would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc.
3. Non-Governmental Organisations are generally incorporated as societies under the Societies Registration Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Laws enforced in any part of India. NGOs can also be incorporated as a company under section 8 of the Companies Act, 2013.

While planning the audit, the auditor may concentrate on the following:	❖ Knowledge of the NGO's work, its **mission and vision, areas of operations and environment** in which it operates. ❖ Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes. ❖ Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations. ❖ Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any. ❖ Examination of **minutes of the Board/Managing** Committee/Governing Body/ Management and Committees thereof to ascertain the impact of any decisions on the financial records. ❖ Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability. ❖ Setting of materiality levels for audit purposes. ❖ The nature and timing of reports or other communications. ❖ The involvement of experts and their reports. ❖ Review the previous year's Audit Report

The audit programme should include

- Verification of assets,
- Verification of Liabilities,

- Verification of income and
- Verification of expenditure

VERIFICATION OF ASSETS	(i)Fixed Assets: Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc. (ii)Investments: Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest. (iii)Cash in Hand: Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts. (iv)Bank Balance: Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts. (v)Stock in Hand: Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same
VERIFICATION OF LIABILITIES	(i)**Corpus fund**: The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand. (ii)Reserves: Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year." (iii)Ear-marked Funds: Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds. (iv)Project/Agency Balances: Vouch disbursements and expenditures as per agreements with donors for each of the balances. (v)Loans: Vouch loans with loan agreements receipt counter –foil issued."

<u>VERIFICATION OF INCOME</u>	<u>The receipt of income of NGO may be checked on the following lines;</u> (i)Contribution and Grants for projects and programmes: ➢ Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
<u>VERIFICATION OF EXPENDITURE</u>	• Programme and Project Expenses: Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract. • Establishment Expenses: <u>Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc</u>.”

6 AUDIT OF CHARITABLE HOSTEL

1. **General**	i)Study the constitution under which the charitable institution has been set hi whether under the **Society Registration Act**, as a trust or as a company limited by guarantee. Verify whether it is managed as contemplated by the law and rules and regulations made thereunder. (ii)Examine the **internal control structure** particularly with reference to admission to hostel, expenses incurred on different kinds of activities. (iii)Verify the **broad nature of expenses** likely to be incurred with reference to the previous year's annual audited accounts
2. **Verification of the receipts**	(i)Check the amounts received on account of, monthly rentals, etc., and receipts issued for the same. (ii)Ascertain that there is adequate internal control over the issue of official receipts, custody of unused receipt books, printing of receipt books, etc. (iii)Cross – tally the rent received along with the number of students (from the student register) staying in the hostel during the year. (iv)Check the amounts received from additional services rendered like guest fees, receipts for breakage, fines, penalties, etc"
3. **Verification of expenses**	(i)Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.; (ii)Verify whether the expenses incurred are in conformity with the budgets prepared internally or filed with the relevant authorities. (iii)Check the amount spent on provisions of hostel facilities with reference to bills, etc. (iv)See that whenever heavy expenditure has been incurred on renovation of the hostel, computer centre, etc. the same is accounted for properly.(if such facilities are being provided by the hostel
4.	"Verify investments made from surplus funds as well as existing investments by physically verifying the same and that

	they are in the name of the institution and that there is no charge/pledge against the same
5.	Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass, cutlery, kitchen utensils, liner, etc. are adequately depreciated
6.	Library Facilities: See that proper library register are maintained. The system regarding issue and receipt of books is in order. Late fee fines and money received on account of lost book is accounted for properly. Obsolete books are written off only after proper authorisation. Expenses incurred on newspapers and weekly magazines as compared to Journals and periodicals have been accounted for properly
7.	Check the provision of **other additional facilities** like computer facilities, etc. Ensure that proper registers are maintained for charging fees, based on monthly or hourly basis. In case such facility is extended to each room, whether the charges are payable on lump-sum basis or on actual usage basis. Also ensure that amounts spent has been allocated properly
8.	Verify whether the institution is **eligible for income tax exemption** and if not, whether provision for taxation has been made

7 AUDIT OF EDUCATIONAL INSTITUTE

The special steps involved in the audit of an educational institution are the following:

i)Examine the **Trust Deed**, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed there under.

(ii)Read through the **minutes of the meetings of the Managing Committee or Governing Body**, noting resolutions affecting accounts to see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii)Check names entered in the **Students' Fee Register** for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of **internal check** which ensures that demands against the students are properly raised.

(iv)Check fees received by comparing **counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register** to confirm that the revenue from this source has been duly accounted for.

(v)Total hi the various columns of the **Fees Register for each month** or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi)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.**

(vii)See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

(viii)Confirm that fines for **late payment or absence**, etc., have either been collected or remitted under proper authority.

(ix)Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x)<u>Verify rental income</u> from **landed property** with the **rent rolls**, etc.

(xi)<u>Vouch income from endowments and legacies</u>, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

(xii)Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xiii)Report any **old heavy arrears on account of fees, dormitory rents**, etc, to the Managing Committee.

(xiv)Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv)See that the **investments representing endowment funds** for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi)Verify that **the Provident Fund money** of the staff has been invested in appropriate securities.

(xvii)Vouch **donations**, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

(xviii)Vouch all **capital expenditure** in the usual way and verify the same with the sanction for the Committee as contained in **the minute book.**

(xix)Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx)See that **increase in the salaries of the staff** have been sanctioned and minute by the Committee.

(xxi)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.

(xxii)Verify the **inventories of furniture, stationery, clothing, provision and all equipment**, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

(xxiii)Confirm that **the refund of taxes deducted from the income from investment** (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv)Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.”

8. AUDIT OF INSURANCE COMPANIES

8.1 Meaning of Indian Insurance Company:- The Companies Act, 2013requires of an Indian Insurance company. The major purpose of an Indian Insurance Company is to do life insurance, general insurance, or reinsurance operations.

While conducting insurance audits, insurance auditors must evaluate policy and liability processes, tax papers, risk appraisal, and other financial records of insurance.

8.2 Meaning of an Insurance Audit

In terms of Section 12 of the Insurance Act, 1938, the financial statements of all insurers must be **audited annually by the auditor**. As determined by IRDA, 1999, all insurers in respect of their insurance business and shareholders' funds must provide:

- Balance Sheet
- Profit and Loss Account
- Different Receipts Account
- Payments and Income Account

All of this must be done following IRDA rules at the end of each financial year. An insurance audit is an independent audit of accounting records that reflects the expert's opinion on its accuracy.

Premium Verification:	In a **separate bank account**, premium collections are credited. No withdrawals are usually allowed on that account **for general expenses.** ❖ As stated in the insurance company policy, the collection is **forwarded to the Regional Office or Head Office**. ❖ In terms of Section 64VB of the Insurance Act, 1938, the insurer will not take the risk without receiving a premium. ❖ The auditor needs to confirm the premium because the insurance premium is collected when the policies are issued. ❖ It is a consideration **to bear the risk** of the insurance company.

The Auditor-General will apply the following procedures:	❖ Before initiating the **payment of revenue**, the auditor must consider internal controls and compliance rules, which are set for the collection and recording of premiums. ❖ Cover notes should be **numbered sequentially**. ❖ The auditor needs to check how the premium registers are maintained chronologically, providing full details including the GST charged in terms of daily admission advice. ❖ The auditor must verify that he or she has received the amount stated in the register and those indicated in the **general record.** The auditor shall also ensure that the instalments payable on or before the date of receipt of the balance are calculated as revenue for the year under review.
Claims Verification:	The auditor of each division or branch should have access to information for all categories of business. The Auditor-General shall determine the total number of documents to be inspected, giving due consideration to high-value claims. The claim account is deducted from all payments including repair costs, survey fees, photographic costs, etc. The Auditor-General will: ❖ Check the provision of non-adjustable claims. ❖ Check whether the provision is made for those applications that the company is legally responsible for. ❖ Check that the provision is not higher than the insured amount. ❖ Check out Co-insurance programs; the company has made provisions in respect of its expected credit allocation.
Verification of Commission:	The agent's salary is determined by the commission. Remuneration is calculated using the percentage of the proceeds **collected by the agent.** The commission is paid to the agents of the purchased business and is deducted from the commission in the Direct Business Account. Insurance agents usually ask for an insurance business. The Auditor-General will verify: ❖ Vouchers' entries in respect of payment vouchers and copies of commission bills and statements. ❖ Check that vouchers are authorized by law enforcement officers and that income tax is deducted at the point of origin. ❖ Check the amount of commission allowed. ❖ Check commission calculation time.

9. AUDIT OF TRUST

1. Constitution:	The auditor should study the **constitution of the charitable institution,** for example, whether it is set hi under the Societies Registration Act or as per **section 8 of the Companies Act** or as a trust
2. Interest of members:	: **Obtain a list of members of the governing body**. This will help the auditor in identifying whether any of the members of the governing body has any interest in the charitable institution.
3. Budget:	The auditor should obtain a copy of **the budget sanctioned** or the financial statement. This would enable him to acquaint himself with the different heads of income and expenditures of incomes and expenditures of the institution
4. Internal Check:	Examination of the system of internal check, especially as regards the accounting of the amounts collected.
5. Collection & Deposit of income	Check that the amounts received towards income have been duly collected, received and deposited into the bank regularly and promptly.
6. Subscription and donation:	These institutions receive subscriptions and donations which form the major part of their collections. Therefore the auditor should check the following: ► The amount or the rate of the annual subscription. ► Any instructions given by the donors as to the specific utilization of donation. ► Adequacy of internal controls existing as regards unused receipt books, counter foils, etc. ► Where subscriptions are received in advance these should be properly dealt with in the accounts.
7. Legacies received	Verify the amounts of legacies received by reference to correspondence with any figures and other available information's.
8. Income from Investment:	Where the institution has made any investments or given loans, the amount of dividend and interest should be properly vouched with reference to the **counterfoils or dividend warrants received**. It should be ensured that such loans or grants are given under proper authorizations
9. Rent:	If some property is given or taken on rent, then the auditor should **check the tenancy agreement**, **the rent slips and the authorized person for the collection or payment**, as the case may be, of the rent.
10. Income/Expenditure relating to concert:	Most of the **organisations organize special functions such as concert** etc. The auditor should be careful in such cases. All the gross receipts and outgoings are to be properly vouched by him. It should be ensured that proper internal check was maintained as regards the receipts and outgoings. For example, the person responsible for collection and disbursements should be separate persons
11. Physical verification:	: The auditor should physically verify the cash in hand, inventories and fixed assets.

10. FORENSIC AUDIT & ACCOUNTING

10.1 Concept of Forensic Accounting and Audit

• 'Forensic' means' suitable for use in **a court of law'**.
• Forensic accounting can be described as a specialized field of accountancy which investigates fraud and analyse financial information to be used in legal proceedings. Forensic accounting uses accounting, auditing, and investigative skills to conduct investigations into theft and fraud. It encompasses both Litigation Support and Investigative Accounting.
• Forensic audit can be defined as an examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court.
• Forensic accounting does involve elaborate inquiry and investigation into the transactional typicality of the connected issues and events, the job of forensic audit is to provide a double check on the consistency issues, questions that the counsel may ask in the context of arguing in courts.

10.2 Forensic Accounting and Auditing Framework

Accounting	• Looking beyond Numbers while examining Financial Reporting and Business Information Systems. • Compliance of GAAPs and IFRS/ Regional Standards. • Reframing of Accounts Based on Legality and GAAPs.
Auditing & Assurance	• Risk Assessment and Analytical Procedures. • Designing and Performing Extended Audit Procedures • Compliance of Standards of Auditing, where applicable. • Introspective & Sceptical Mindset for Reviewing Transactions and Deals.
Investigation	• Fixation of Direction of Investigation on Realistic Basis. • Gathering Evidences and clues through Scientific and Latest Investigation Techniques. • Analysis of Psychological Behaviour of Human. • Evidence Documentation for Legal Proceedings.

• **Litigation Consultancy**- Jointly working with Lawyers and Clients engaged in litigation to provide expert advice regarding evidence and strategic proceedings.
• **Computer Forensic**- Providing assistance in Electronic Data Recovery and Retrieval.
• **Expert Witness**- Providing Evidence and Preparation of Formal Reports for filing in the Court of Law

10.3 Objectives of Forensic Accounting & Audit:

1. To use the forensic accountant's conclusions to facilitate a settlement, claim, or jury award by reducing the financial component as an area of continuing debate

2. To avoid fraud and theft

3. To restore the downgraded public confidence

4. To formulate and establish a comprehensive corporate governance policy

5. To create a positive work environment

10.4 Forensic Audit vs. Financial Audit

BASIS	FORENSIC AUDIT	FINANCIAL AUDIT
Meaning	Examination of evidence regarding an assertion to determine its correspondence to established criteria carried out in a manner suitable to the court	Examination of Financial Information so as to express an opinion on true and fair view of state of affairs and financial results.
Objective	To determine whether **fraud has taken place**	To express an opinion on **true and fair view.**
Frequency	**No specific** period.	Generally **carried out** for a financial yea
Techniques	Investigative and substantive	Risk based with the help of compliance & substantive procedures
Extent	In-depth checking	Test Checking based
Verification of Asset and liabilities	Verification of suspected / selected items is done where misappropriation is suspected.	All assets and liabilities are verified with the help of audit procedures or management. certificate/representation

10.5 Forensic Audit Reports:

1. Nature of business of the entity.

2. Nature of subject or **aspect examined**.

3. Persons for whom the **report is intended**.

4. Purpose for which the report is prepared

5. Management attitude, directives and needs.

6. **Approach and calibre** of Forensic auditor.

7. Extent of details required by management and persons for whom report is prepared.

10.6 Techniques of Forensic Audit:

Benchmarking	Comparing one financial period with another or the performance of one cost centre, or business unit, with another, overall business performance with its standards defined.
Analytical Tools	Trend Analysis and Ratio Analysis may be used to identify any abnormal trends and changes.
Digital Techniques	Digital investigations are complex techniques and require support from trained digital investigators. Digital techniques comprise of **close scrutiny of relevant emails, accounting records, phone logs** etc. Before applying digital techniques like obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy
CAATs	CAATs known as **Computer-assisted audit techniques** are computer programs that the auditors use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him.
System analysis	To examine the systems in place and identifying any weaknesses that could be opportunities for the fraudsters
Common Software Too	Common Software Tools like spreadsheets (MS Excel), RDBMS (MS Access) and Report writers (Crystal reports) are widely accepted due to their instant availability and lower costs
Data Mining Techniques	It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Forensic Audit Reports Factors to be considered.

10.7 Areas of Forensic Audit:

Fraud Detection	Area of Fraud detection comprises of: • Investigating and analysing financial evidence. • Detecting financial frauds • Tracing misappropriated funds
Fraud Prevention	Area of fraud prevention comprises of: • Reviewing internal controls to verify their adequacy • Providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile
Computer Forensics	Area of Computer forensics comprises of developing computerized applications to assist in the recovery, analysis and presentation of financial evidence
Expert Testimony	Area of Expert testimony comprises of • Assisting in legal proceedings, • Testifying in court as an expert witness • Preparing visual aids to support trial evidence

11. AUDIT OF CHARITABLE INSTITUTION

An auditor may evaluate the internal control system in general, to ensure that the procedure is reliable. He may study the nature of the constitution of the charitable institution, which may be a society, private or public trust or a company limited by guarantee. He should ensure that the institution complies with all the requirements of law under which it is set up. He should also verify the effectiveness of the internal checks relating to receipts and payments and ensure that the amounts received are duly deposited into the bank.

Various forms of 'Receipts' of Charitable Institutions

The following are the various receipts that a charitable institution may receive:

1 Subscription and Donation
2 Income from Investment
3 Grants
4 Legacies
5 Rent
6 Special event

Role of an Auditor on Verification of Reports of Charitable Institutions

1. In relation to subscriptions and donations, the auditor may evaluate the internal check relating to the accounting of amount collected.

2. He shall examine all the receipt books used during the period under audit and apply special care while verifying the cancelled receipts.

3. He may test check the counterfoils with cash book.

4. He should also confirm that the total amount collected in the form of subscriptions and donations, as shown by the statements, agrees with the books.

5. He should ensure that the unused receipt books are under the custody of a responsible person.

6. In the case of Legacies and grants, the auditor should examine the correspondence, minutes books and other available information.

7. While verifying the income from investment, the auditor may vouch all the receipts, and examine the schedule of investments to confirm that all income &om the investments are duly accounted. While verifying interest, the rates and calculation of interest are to be checked.

8. The rent received account is to be vouched with the counterfoils of rent receipts and counter checked with the entries in the cash book. The auditor should also examine the

tenancy agreement to find out the amount of rent to be collected and the due dates, on which the rents become due.

9. The institution may organize special events, and generate income for charitable purposes. The auditor should thoroughly vouch the receipts and payments relating to such events.

<u>Auditor should verify payments</u>:

The auditor should ensure that all payments made by the institution are only for the purpose for which the institution is constituted and no person, who is administering the Trust. (i.e., the trustee, the managing trustee or a member of the managing committee) is personally benefited therefrom. He should also verify the existence of the movable and immovable assets and confirm the cash and bank balances.

The above are the important aspects where the auditor should pay special attention.

INSURANCE

1.1 DEFINITION OF INSURANCE

Insurance is form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest

Allen H. Willett	Insurance is that social device for making accumulations to meet uncertain losses which is carried out through the transfer of the risks of many individuals to one person or to a group of persons.
Mowbray and Blan Chard	Insurance is a social device for eliminating or reducing the cost to society of certain type of risk.
Allen Z: Mayerson	Insurance is a device for the transfer to an insurer certain risks of economic loss that would otherwise come to the insured.
D.S.Hancsell	Insurance may be defined as a social device providing financial compensation for the effects of misfortune, the payments being made from the accumulated contribution of all parties participating in the scheme.
Ghosh and Agrawal	Insurance is a cooperative form of distributing a certain risk over a group of persons who are exposed to it.

1.2 HISTORY OF INSURANCE

- India has a long history with insurance. Writings by Manu (Manusmrithi), Yagnavalkya (Dharmasastra), and Kautilya (Arthasastra) all make reference to it.
- **Life Insurance**
  1. The creation of the Oriental Life Insurance Company in Calcutta in 1818 marked the beginning of the life insurance industry in India. However, this Corporation collapsed in 1834.
  2. The Madras Equitable started conducting life insurance transactions in the Madras Presidency in 1829.
  3. The British Insurance Act was passed in 1870, and the Bombay Mutual (1871), Oriental (1874), and Empire of India (1897) were all founded in the Bombay Residency over the final three decades of the nineteenth century.
  4. The first statutory action to control the life insurance industry was the Indian Life Insurance Companies Act of 1912.
  5. The Indian Insurance Companies Act was passed in 1928 to give the government access to statistical data on life and non-life insurance transactions made in India by domestic and international insurers, including provident insurance societies.
  6. The Insurance Act of 1938, which included extensive provisions for effective control over insurers' operations, combined and updated the prior laws.

7. Main Agencies were eliminated by the Insurance Amendment Act 1950 . As a result, the Indian government chose to nationalise the insurance industry.
8. The Life Insurance Corporation was established in 1956, the same year that an Ordinance was adopted to nationalise the Life Insurance industry.
9. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector.

- **General Insurance**
    1. Indian general insurance dates back to the British creation of Triton Insurance Company Ltd. in Calcutta in 1850.
    2. The Indian Mercantile Insurance Ltd. was founded in 1907. This business handled all general insurance business classes for the first time.
    3. The General Insurance Council, a division of the Insurance Association of India, was established in 1957. With the purpose of assuring ethical behaviour and sound business procedures, the General Insurance Council created a code of conduct.
    4. The Insurance Act was modified in 1968 to create minimum solvency buffers and restrict investments. At that time, the Tariff Advisory Committee was also created.
    5. The general insurance business was nationalised on January 1st, 1973 as a result of the General Insurance Business (Nationalisation) Act, which was passed in 1972.
    6. Four companies—National Insurance Company Ltd., New India Assurance Company Ltd., Oriental Insurance Company Ltd., and United India Insurance Company Ltd.—were formed after the merger of 107 insurance providers.
    7. The General Insurance Corporation of India was established as a business in 1971, and on January 1st, 1973, it opened for business.
    8. Current consolidation in Government-run general insurance businesses has been made possible by the Central Government's proposal to consolidate three Public Sector General Insurance Companies, with the exception of New India Assurance Company Ltd.

1.3 INSURANCE AND RISK

External Risk

- Insurance firms assume the risk relating to their customers' assets. The premium obtained for this service is then either invested in securities or lent to third parties who require cash.
- Thus the insurance companies deal with the external environment in two ways.
    1. If the investments an insurance firm made ended up being a bad investment, it might not fulfil its duty.
    2. The assets they have insured may also degrade in quality, leading to more claims than the company had anticipated.

- Insurance companies are exposed to two common problems namely moral hazard and adverse selection.
    1. Moral hazard is the tendency of an insured to take greater risk because she/he is insured.
    2. The adverse selection is the tendency of insuring the low quality asset and not insuring high quality assets.

Internal Risk

- Insurance companies are impacted by the effectiveness in evaluating the insurance proposal, just like financial services firms that engage in direct lending.
- The corporation will end up insuring bad assets if the internal procedure for reviewing the insurance proposal is ineffective.
- Overexposure to one class of asset or significant exposure to one proposition both have an impact on the performance of insurance firms.
- The evaluation of liabilities and the distribution of funds among various investments while taking the anticipated liabilities into consideration are additional significant internal factors.
- The performance of the company on the investment side depends on its efficiency of treasury and investment division which needs to consider the different sources of investment risk in managing the investment portfolio.

1.4 INSURANCE TERMINOLOGIES

- **Proposal (or) Proposal form** denotes the application for insurance contains which solicits information from the Proposer to enable the Insurer to take a decision on whether to accept the risk or not.

- **Proposer** is the person who submits Proposal form for insurance to the insurance company and who is interested in taking an Insurance Policy.

- **Underwriting** is the process of assessment of risk on a proposal by the Insurance company and arriving at the decision (to accept, reject, rate-up, postpone) and the terms and conditions upon which an insurance contract may be accepted.

- **Policyholder** is the person who is issued an Insurance Policy document by the Insurance Company consequent to underwriting and issuance of Insurance Policy to cover the risk stated in the Proposal form.

- **Insurance Policy document (or) Policy document (or) Policy** constitutes the contract between the Insurance company and the Policyholder, stating the terms and conditions of the Insurance coverage provided by the Insurance company to the Policyholder.

- **Subject matter of insurance** is the Person or object upon whose loss or upon the loss of which object the insurance company agrees to pay a specified sum as the compensation to the Policyholder.

- **Life insured (or) Life assured under a Life insurance Polic**y is the subject matter of insurance on whose death a specified sum of money is paid by the Life insurance company.

- **Sum Assured (or) Sum Insured** means the amount promised to be paid by the Insurer upon the death of the Life insured.

- **Nominee** is the person appointed, only for Policies taken on one's own Life, by the Policyholder to receive the Sum Assured or any other policy benefit upon death of the Life assured.

- **Counter offer** denotes the extra premium proposed by the Insurer upon underwriting the proposal to accommodate for the extra risk taken by the insurance company on a Proposal.

- **Benefits illustration** is the document provided to the Policyholder at the point of sale giving the details of premiums payable by the Policyholder year-wise along with the benefits payable at the end of each Policy year.

- **Assignment** is transfer of Insurance Policies to another person with or without consideration

- **Annuity** is a series of regular and periodic payment payable in consideration of usually a lump sum. For example, under Pension Policies, upon the attainment of superannuation age, the corpus available is utilised to purchase a Single premium (lump sum) Annuity Policy under which the Policyholder gets a periodic payout on a monthly basis till his survival.

- **Money Back Policy:** Money back policies are low-risk policies that are not market-linked. Over the policy period, they offer guaranteed returns at regular intervals. A money-back insurance policy gives a sum assured and any applicable incentives in addition to periodic returns that are guaranteed These plans are made to be participating plans so that investors can receive bonuses. This indicates that the insurance firm makes a market investment using some of the premiums received.
  The money-back insurance policy's bonus may take one of two forms:

1. Revisionary bonus: Based on the company's profitability, this bonus is added to the amount guaranteed at the end of each year. Depending on how the company's investments are doing, it may fluctuate every year.
2. Terminal bonus: The investor receives this bonus as payment for timely premium payments. By putting your premium payments to auto-pay, you can be sure that you are qualified for this bonus. This is referred to as a persistency benefit in some policies.

- **A unit linked insurance plan (ULIP)** is a multi-faceted product that offers both insurance coverage and investment exposure in equities or bonds. Policyholders must regularly pay premiums for this product. A portion of the premiums is used to pay for insurance coverage, while the remainder is combined with the assets of other policyholders and invested in either stocks, bonds, or a mix of both equities and bonds.

1.5 INSURANCE INTERMEDIARIES

- Insurance intermediaries assist in managing the distribution of insurance. They offer placement and purchase of insurance services to both the insurer and the insured.
- They are required to be registered under the provisions of the Insurance Act and the IRDA Regulations, 2000.
- Insurance intermediaries include:

A. **Insurance agents**

1. A licence granted under the terms of the Insurance Act permits the bearer to represent any insurer as an insurance agent.
2. They often work under the terms of an agency agreement with the insurer and represent the insurer in the insurance process.

B. **Insurance Brokers**

1. Insurance brokers usually work for the policyholder in the insurance process and act independently in relation to insurers.
2. They obtain quotes from various insurers and guide clients in determining the adequate policy from a range of products.
3. Many brokers sometimes act as an agent of the insurer and at other times as brokers of the client in assisting a client with insuring its risk exposures through an insurance contract.

C. Insurance Surveyors and Loss Assessors

1. Insurance surveyors as technical experts inspect the damage or loss of an insurance company.
2. The insurer, based on the estimation of damage of the surveyor, decides the amount of compensation payable to the insured.

D. Third Party Administrators

1. "One who has secured a licence from the Authority and is contracted for a fee or remuneration, as stipulated in the agreement with the insurance company, for the provision of health services" is referred to as a third party administrator (TPA).

2. A TPA is required to maintain the professional confidentiality of all transactions.
3. The TPA is required to provide an annual report and any other return as required by the IRDA to the insurance company and the IRDA.
4. The TPA cannot charge a separate fee from policyholders.

1.6 INSURANCE CONTRACT

A contract of insurance is an agreement whereby one party, called the insurer, undertakes, in return for an agreed consideration, called the premium, to pay the other party, namely the insured, a sum of money or its equivalent in kind, upon the occurrence of a specified event resulting in a loss to him.

1 **The Proposal:** A proposal must be submitted to the insurer by the party seeking to execute an insurance contract. You have the option of making your request verbally or in writing. The proposal form consists of a number of questions, all of which must be answered honestly. If the proposal is lacking or inaccurate, the insurer may reject it.
2 **The Cover Notes:** Sometimes the proposer may want to have instant coverage while the proposal is being evaluated by the insurer. In this situation, the insurer may, upon request, issue a cover note granting interim protection. So, the primary goal of the cover note is to validate risk coverage prior to the insurer issuing the policy.
3 **The Policy:** The policy is a document which is an evidence of the contract of insurance
.
Having accepted a proposal, the insurer must issue the policy within one month of receiving the first premium.

1.6.1 COMPONENTS OF AN INSURANCE CONTRACT

Basically all insurance contracts consist of the following five parts.

1. **Declaration:**
   - This is the first part of any insurance contract.
   - It contains the information relating to identity of the insured, the property, the type(s) of coverage, term of the contract, insurance amount and the premium.
   - The declaration covers most of the basic information needed by the insurer in deciding whether to issue the contact and at what price.
2. **Insuring Agreement:**
   - The insuring agreement is a formal statement detailing what the insurer promises to do in return for the premium paid.
   - The perils insured against and services promised are stated and defined in the agreement.
   - It contains the basic information about the nature of the risk transferred and what may be recovered in the event of loss.
3. **Exclusions and Limitations**:
   - Insurance contacts may be written on an all risk basis, where the contract insures against all risks except those specifically excluded in the contract.
   - The contract may be also on the named perils basis, where only losses resulting from the perils named in the contract are covered.
4. **Conditions:**

- The clauses are the conditions to be fulfilled by the insured to enforce his rights under the contract.
- Most of these conditions refer to the type of information that must be supplied by the insured in the event of loss or refer to the right of the insured if dispute arises in regard to the loss.

5. **Binders:**
   - The binder is a temporary insurance contract.
   - The binder contains the essential facts about the transaction such as date, amount, name of insured, and risk to be covered.

1.6.2 BASIC FEATURES OF INSURANCE CONTRACTS

1. **Insurable interest:**
   - The person entering into the contract (buyer of insurance or policyholder) should have valid interest in the item being insured. This is called 'insurable interest'.
   - This implies that the policyholder should be able to establish that a loss incurred in the item being insured would lead to direct monetary loss to the policyholder.
   - Any insurance contract without insurable interest is considered in the nature of **'wagering contracts'**. (In terms of Section 30 of the Indian Contracts Act, 1872, all wagering contracts are 'null and void').
   - Generally, one rule to establish insurable interest is through ownership of the assets being insured.
   - There are also certain classes of insurance that do not demand proving insurable interest, such as accident insurance and certain life insurance contracts.

2. **Utmost good faith:**
   - Voluntary disclosure of all information pertinent to the contracts is expected of both the insurer and the insured.
   - Any material fact not disclosed at the time of entering into the contract, which is relevant to the contract, can render the contract null and void.
   - Since it may not be possible in practice to conduct a thorough due diligence on every person or entity wishing to enter into an insurance contract, the agreements contain express 'warranties' from the insured and 'disclosures' from the insurer.

3. **Indemnification:**
   - Under a contract of indemnity, the indemnifier provides assurance to save the counterparty from loss, caused by the action of indemnifier or a third party. Hence, every contract of insurance is a contract of indemnity.
   - The party whose loss is being compensated should only seek damages for the loss and should not try to profit from the damages.

4. **Subrogation:**
   - This means that if the insured suffers a loss due to the action of a third party and the insurance company has settled the insured's claim, the insurance company

can step into the shoes of the insured to recover the loss from the third party that caused the loss.

- Subrogation therefore ensures that all rights in respect of the insured asset are transferred to the insurance company once the loss in indemnified.
- However, if after subrogation, the insurance company is able to recover from the third party more than the indemnified value, the excess amount will have to be paid back to the insured.
- It is to be noted that both 'indemnification' and 'subrogation' are not applicable to life insurance contracts.

5. Warranties:

- These are corollaries of 'uberrimae fidae', and are written as conditions in insurance contracts.
- These are explicit or express warranties. There are also 'implicit' or 'implied' warranties, such as 'affirmative' or 'promissory' warranties.
- For example, in marine insurance, an express warranty may be that the ship is seaworthy for a particular journey, or it would take a specified route to its destination.

6. Proximate cause:

- This important feature of an insurance contract looks at the 'immediate cause' of the event that caused the loss.
- For example, if a machine is insured against floods and damage is caused due to collapse of the factory building in which the machine was kept, the insurance company is not liable to compensate even if the building collapse was due to floods.

7. Assignment and nomination:

- Nomination refers to the procedure by which the nominee to receive the proceeds of the policy without cumbersome legal documents.
- However, if an assignment is made, the assignor (the insured) ceases to be the owner of the policy.
- Hence, once the purpose for which the policy has been assigned is achieved and the insured becomes the owner of the policy once again, he would have to carry out a fresh nomination procedure.

1.6.3 DIFFERENCES BETWEEN INSURANCE CONTRACTS AND OTHER CONTRACTS

1. **Risk transfer**: Insurance contracts are unique in that they involve the transfer of risk from the policyholder to the insurer. In other types of contracts, both parties usually assume some level of risk.
2. **Indemnity principle:** Insurance contracts are based on the principle of indemnity, which means that the insurer agrees to compensate the policyholder for any losses or damages that occur, up to the limits of the policy. This is different from other types of contracts, which may not involve compensation in the event of a loss.

3. **Premium payments:** In an insurance contract, the policyholder pays a premium to the insurer in exchange for coverage. This is different from other types of contracts, which may not involve any payment or may involve a different type of payment.
4. **Adhesion contracts:** Insurance contracts are often considered to be adhesion contracts, which means that the terms of the contract are largely set by the insurer and may not be negotiable by the policyholder. This is different from other types of contracts, which may involve more negotiation and input from both parties.
5. **Government regulation:** Insurance contracts are subject to government regulation and oversight, which is not typically the case for other types of contracts.

1.7 KINDS OF INSURANCE

1.7.1 LIFE INSURANCE

- Life insurance is a contract under which one person, in consideration of a premium paid undertakes to pay to the person for whose benefit the insurance is made, a certain sum of money either on the death of the person whose life is insured or on the expiry of a specified period of time.
- Types of Life Policies:

Whole Life Policies	• Under this policy, the sum assured is payable after the death of the assured. • The premiums on whole life policies may be payable regularly or alternatively they may be payable for a period only (say 20 or 30 years). • If the premiums are paid throughout the life, it is called 'ordinary life policy'. • In the other case when premiums are paid for a limited period, it is called 'limited payment life policy'.
Endowment Life Assurance	• Under this policy the insurer undertakes to pay the sum assured either at the end of a specified period or on the death of the assured, whichever is the earlier. • The money insured is payable to the legal heirs or nominees in the event that the assured passes away before the end of the stipulated time (or before reaching the specified age). • Endowment policies have a higher premium than whole life policies.
Term Assurance	• This is also called temporary assurance. • Under this policy, the sum assured is paid when the assured dies before the stipulated date. • No payment is made if the assured survives to that date.
Joint Life Policy	• This involves the insurance of two lives in the same policy.

	• The sum assured (policy money) is payable by the insurer upon the death of any one of the assured to the surviving person.
Group Insurance	• A group of persons under the same employer are covered under a single policy. • Premium is paid by the employer alone or by the employer and employee jointly. • A group insurance policy may cover all the employees or a particular section of the employee of the same organisation.
Annuity Policies	• This policy is suitable when people desire to have certain income after the attainment of certain age. • Premium may be paid in installments or in lump sum at the beginning. • After the assured attains certain age, insurer pays the amount in instalments.
With Profit or Without Profit Policies	• In the case of with profit policy, the assured is paid, in addition to the sum assured, a share in the profits earned by the insurer. • Without profit policy is one under which the policy holder does not get any share in the profits earned by the insurer. • The premium on without profit policies are lower than those on with profit policies. • With profit and without profit policies are also known as participating and non-participating policies respectively.
Childrens' Endowment Policies	• These policies are taken for the purpose of education of children and marriage expenses of daughters. • Premium (annual or lump sum) is payable by the person (father or guardian or other person) entering into the contract. • Policy matures when the child attains certain age.

1.7.2 GENERAL INSURANCE

In India, general insurance is primarily broken down into fire, marine, and other concerns. In addition, it covers the reinsurance and aviation industries, as well as the comprehensive crop insurance programme, personal accident insurance, and social security programmes. It offers vulnerable groups in society insurance protection.

I. **Property Insurance:**

- Property loss exposures refer to the inherent risks to which the different types of property are exposed.

- The various types of property include: buildings; personal property; money and securities; motor vehicles and trailer property in transit; ships and cargo; boilers and machinery; etc.
- Property insurance defends a person's possessions from a list of specific threats. Risks include the possibility of theft of products or property, sea or fire hazards, and accidental property damage. Property insurance includes home, business, and commercial insurance.

II. Marine Insurance

- Marine insurance is an arrangement by which the insurer undertakes to compensate the owner of a ship or cargo for complete or partial loss at sea.
- Marine insurance covers ship, cargo and freight.
- The marine policy must specify the following aspects

a. The names of the insured and the insurer
b. The subject matter insured and the risks insured against
c. The voyage or time period or both
d. The sum assured
e. The amount of premium

- Types of Marine insurance

Voyage Policy	• Provides protection for a ship or cargo just for a specific journey, from the port of departure to the port of arrival. • Except in cases of safety or human life, the insurer is not responsible if the ship changes its destination or departs from the predetermined course.
Time Policy	• Covers risk during a stated period of time, regardless of number of voyages made. • Normally includes a continuation clause if the ship is still at sea for up to 12 months.
Floating Policies	• Suitable for merchants making regular shipments. • Policy taken for a round amount, with details declared at a later time. • With each shipment, insured makes declaration stating sum to be insured, and total value of policy reduces by that amount.
Mixed Policy	• Combines elements of a time policy and voyage policy. Covers risk during a particular voyage for a specified period.
Valued and Unvalued Policies	• Under valued policy, value of subject matter insured is specified on policy. In full loss, insurer compensates amount specified. In partial loss, proportionate amount is paid. • Under unvalued policy, value of subject matter not stated. Compensation ascertained by assessment of loss, subject to limit of sum insured.

III. Fire Insurance

- Fire policies cover the losses directly caused through fire.
- It is necessary that fire must happen by ignition.
- The fire insurance contract is an indemnity contract. Each contract specifies the maximum amount that can be claimed by the insured in case of loss.
- In order to cover a particular loss or damage under a fire policy, the following three conditions should be fulfilled:

A. The loss or damage should relate to the subject matter of policy.
B. The loss or damage must be caused by ignition or fire.
C. The ignition must be either of goods insured or the premises where it is placed.

- Types of Fire Insurance Policy

Specific Policy	The liability of the insurer is limited to a specified amount, which is normally less than the actual value of the property insured.
Valued Policy	The insurer agrees to pay a fixed amount in the event of loss, irrespective of the actual loss suffered.

Floating Policy	The amount of the policy may vary from time to time. This type of policy is useful in the case of goods in store where quantity and value change from time to time.
Replacement Policy	The insurer has the option to replace the property/goods damaged by fire, instead of paying the loss by cash.
Loss of Profit Policy	The insured is protected against the loss of profit due to dislocation of business due to fire. Under this policy, insurer compensates to the extent of the loss in profits.
Comprehensive Policy	It provides cover against not only fire but also several other risks such as lightning, riot, earthquake, flood, storm, burglary, war, etc.

IV. Motor Insurance

- Owners of motor vehicles (two or four wheelers) can take insurance policies to cover different types of risks
  (a) loss or damage to the vehicle,
  (b) injuries to or death of any passenger, and
  (c) damages payable to the third parties for accidents.
- A comprehensive motor insurance policy covers not only full third party risks (property as well as persons including passengers), but also damage to the insured vehicle, loss of rugs and other articles, and may also cover the cost of hiring a substitute vehicle, if necessary.
- If no claims are made during the year, a discount or 'no-claim bonus' is allowed at the time of renewal.

V. Social Insurance:

- Financially disadvantaged groups within society are unable to afford a sufficient insurance premium. Social insurance offers protection to these poorer groups of society in this circumstance.
- There are various types of social insurance including pension plans; disability benefits; unemployment benefits; sickness insurance; and industrial insurance.

VI. Miscellaneous Insurance

- **Householder's Policies**: Fire companies now provide a wide variety of coverage options for the structures and possessions of private homes under homeowners' or all-in policies.
  In order for the insurer to be able to charge an acceptable premium under these policies, it is typically required to insure buildings and contents for their full worth.
- **Engineering Insurance:** It is a branch of insurance that has expanded rapidly under recent legislation and especially under the Factories Acts,

which prescribe compulsory inspection at regular intervals of certain types of industrial equipment, such as boilers, electrical plant, cranes and other lifting gear.
The inspection service, plant replacement or repair costs, as well as personal injury and property damage are all covered by insurance policies.

- **Aviation Insurance:** Under aviation insurance, cover is available for loss of or damage to aircraft, personal accidents to passengers, third party risks in respect of both person and property and for cargo sent by air. However, accidents to staff who fly regularly are covered by group insurance schemes.
- **Fidelity Guarantee**: Cashiers and others who handle money are frequently required by their employers to provide security as protection against their personal dishonesty.
  In such cases, fidelity guarantee insurance policy may be taken by the employer.
- **Burglary, Theft and Robbery:** Burglary insurance covers the loss caused on account of burglary, house breaking or theft.

1.8 REGULATORY FRAMEWORK OF INSURANCE BUSINESS IN INDIA

- In 1993, the Government set up a committee under the chairmanship of RN Malhotra to propose recommendations for reforms in the insurance sector.
- Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry.
- The IRDA was incorporated as a statutory body in April, 2000.
- The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.
- The IRDA opened up the market in August 2000 with the invitation for application for registrations.
- Foreign companies were allowed ownership of upto 26%.
- In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted in to a national reinsurer.

1.8.1 ACTS/REGULATIONS GOVERNING BOTH LIFE & GENERAL INSURANCE BUSINESS IN INDIA

1. Insurance Act, 1938
2. IRDA Act, 1999 & Regulations passed thereunder
3. Insurance Amendment Act, 2002
4. Exchange Control Regulations (FEMA)
5. Indian Stamp Act, 1899
6. Consumer Protection Act, 1986
7. Insurance Ombudsman Rules, 2017
8. Labour Law legislations

1.8.2 REGULATIONS GOVERNING/AFFECTING LIFE INSURANCE BUSINESS IN INDIA

1. LIC Act, 1956
2. Amendments to LIC Act

1.8.3 REGULATIONS AFFECTING GENERAL INSURANCE BUSINESS IN INDIA

1. General Insurance Nationalization Act, 1972
2. Amendments to GIN Act, 1972
3. Multi-Modal Transportation Act, 1993
4. Motor Vehicles Act, 1988
5. Inland Steam Vessels Amendment Act, 1977
6. Marine Insurance Act, 1963
7. Carriage of Goods by Sea Act, 1925
8. Merchant Shipping Act, 1958
9. Bill of Lading Act, 1855
10. Indian Ports (Major Ports) Act, 1963
11. Indian Railways Act, 1989
12. Carriers Act, 1865
13. Indian Post Office Act, 1898
14. Carriage by Air Act, 1972
15. Public Liability Insurance Act, 1991
16. Employee State Insurance Act,1948
17. Aircraft Act, 1934.

1.8.4 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA ('IRDAI')

- The IRDAI Act, 1999, established the Insurance Regulatory and Development Authority of India as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies.
- The members of the IRDAI are appointed by the Central Government. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members.
- Every Chairperson and member of IRDAI appointed shall hold office for a term of five years. Chairperson shall not hold office once he or she attains 65 years while whole time members shall not hold office beyond 62 years.

ROLE OF IRDAI AS REGULATOR

a. Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration.

b. Protection of interests of policy holders in matters concerning assignment of policies, nomination, insurable interest, claim settlement, surrender value and other terms and conditions of insurance contract.

c. Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries.

d. Specification of code of conduct for surveyors and loss assessors.

e. Promoting efficiency in the conduct of insurance business.

f. Promoting and regulating professional organizations connected with insurance and reinsurance business.

g. Levying fees and other charges for carrying out the purposes of the Act.

h. Calling for information from or undertaking inspection of insurance companies, intermediaries and other oganisations connected with insurance business.
i. Control and regulation of rates, advantages, terms and conditions that may be offered by general insurance companies.
j. Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries.
k. Regulation of investments of funds by insurance companies.
l. Regulation of maintenance of margin of solvency.
m. Adjudication of disputes between insurers and insurance intermediaries.
n. Supervising the functioning of the Tariff Advisory Committee.
o. Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations.
p. Specifying the percentage of insurance business to be undertaken by insurers in rural or social sectors.
q. Such other powers as may be prescribed.

1.8.5 LIFE INSURANCE COUNCIL AND GENERAL INSURANCE COUNCIL

CONSTITUTION OF LIFE INSURANCE COUNCIL

As per Section 64F(1) of the Insurance Act, 1938, an Executive Committee of the Life Insurance Council shall be formed comprising of the following persons, namely: —

- Four representatives of members of the Life Insurance Council elected in their individual capacity by the members in such manner as may be laid down in the bye-laws of the Council. One of the four representatives shall be elected as the Chairperson of the Executive Committee of Life Insurance Council;
- An eminent person not connected with insurance business, nominated by IRDAI;
- Three persons to represent Insurance agents, Intermediaries and Policyholders, respectively, as may be nominated by the Authority; and
- One representative each from Self-help groups and Insurance Co-operative Societies.

CONSTITUTION OF GENERAL INSURANCE COUNCIL

Similarly, as per Section 64F(2) of the Insurance Act, 1938, an Executive Committee of the General Insurance Council shall consist of the following persons, namely:—

- Four representatives of members of the General Insurance Council elected in their individual capacity by the members in such manner as may be laid down in the bye-laws of the Council. One of the four representatives shall be elected as the Chairperson of the Executive Committee of General Insurance Council;
- An eminent person not connected with insurance business, nominated by the Authority; and
- Four persons to represent Insurance agents, Third party administrators, Surveyors and Loss Assessors and Policyholders respectively, as may be nominated by the Authority

FUNCTIONS OF THE EXECUTIVE COMMITTEE OF LIFE AND GENERAL INSURANCE COUNCILS

As per Section 64J, read with Section 64L of the Insurance Act, 1938, the following are the functions of the Executive Committee of the Life and General Insurance Council:

- To aid, advise and assist insurers carrying on life/general insurance business in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of life insurance policies;
- To render advice to the Authority in the matter of controlling the expenses of insurers in respect of their life/general insurance business in India, respectively; in addition in respect of general insurers, Executive Committee of General insurance council may also advise on Commission and other expenses;
- To bring to the notice of the Authority the case of any insurer acting in a manner prejudicial to the interests of holders of life/general insurance policies, respectively; and

POWERS OF LIFE & GENERAL INSURANCE COUNCILS

- Appoint such officers and servants as may be necessary and fix the conditions of their service;
- Determine the manner in which any prescribed fee may be collected;
- Keep and maintain up-to-date, a copy of list of all insurers who are members of the either Council;
- Make bye-laws for:

1. The holding of elections other than the first election
2. The summoning and holding of meetings, the conduct of business thereat and the number of persons necessary to form a quorum
3. The submission by insurers to the Executive Committee of the Life Insurance Council, or the General Insurance Council of such statements or information as may be required of them and the submission of copies thereof by the insurers to the Authority
4. The levy and collection of any fees
5. The regulation of any other matter which may be necessary for the purpose of enabling it to carry out its duties under this Act

1.8.6 INSURANCE OMBUDSMEN RULES 2017

The Government of India established the Insurance Ombudsman Scheme to provide private policyholders with a cost-effective, speedy, and impartial alternative to the court system for resolving disputes.

- An Executive Council of Insurers shall be established under these Rules comprising of the following representatives:
- Executive Council of Insurers shall comprise of 9 members including the Chairperson Members of the Executive Council of Insurers shall comprise of:
    a. 2 persons representing life insurers to be nominated by the Life Insurance Council
    b. 2 persons representing General insurers, other than stand-alone health insurers, to be nominated by the General Insurance Council

c. 1 person representing stand-alone health insurers to be nominated by the General Insurance Council

d. 1 representative of the IRDAI; and

e. 1 representative of the Central Government in the Ministry of Finance from the Department of Financial Services not below the rank of Director.

f. Chairman, Life Insurance Corporation of India (LIC of India) established under the Life Insurance Corporation Act, 1956 (31 of 1956) or the Chairman, General Insurers' (Public Sector) Association of India (GIPSA) established under the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) provided they are not acting as Chairperson of the Executive Council of Insurers.

- The Chairperson of the Executive Council of Insurers shall be either the Chairman of the LIC of India or the Chairman of the GIPSA by rotation.
- The term of the Chairperson and members of the Executive Council of Insurers shall be three years from the date of assumption of charge.
- A member of the Executive Council of Insurers shall not be eligible for re-nomination for a period of three years from the date he ceases to be a member (not applicable to IRDAI representative, Central Government representative, LIC & GIPSA representatives)

FUNCTIONS OF THE EXECUTIVE COUNCIL OF INSURERS

- Issue guidelines relating to the procedure for the day to day administration, secretariat staffing, secretariat administrative infrastructure, and such other related aspects of functioning of insurance Ombudsman system
- In case any vacancy arises in any Insurance Ombudsman due to resignation or retirement or death of the Ombudsman, the Executive Council of Insurers shall direct an Ombudsman of such other territorial jurisdiction to hold additional charge of the Insurance Ombudsman where such vacancy may arise
- The Executive Council of Insurers may constitute such committees and as and when deemed necessary.

ESTABLISHMENT OF OMBUDSMEN OFFICES AND PROCESS OF SELECTION OF INSURANCE OMBUDSMEN

- An Ombudsman shall be selected from amongst persons having experience of the insurance industry, civil service, administrative service or judicial service.
- An Ombudsman shall be selected by a Selection Committee comprising of

a. Chairperson of the IRDAI, who shall be the Chairman of the Selection Committee.

b. one representative each of the Life Insurance Council and the General Insurance Council from the Executive Council of Insurers – members.

c. A representative of the Government of India not below the rank of a Joint Secretary or equivalent, in the Ministry of Finance, from the Department of Financial Services—member.

- **Term of office of Insurance Ombudsmen**
  An Insurance Ombudsmen is appointed for a term of 3 years. However, no person can continue as Insurance Ombudsman after he/she has attained 65 years of age
- **Remuneration of Insurance Ombudsmen**

The Ombudsman shall be allowed a fixed pay of two lakh twenty-five thousand rupees per month and any pension to which he is entitled from the Central Government or a State Government shall be deducted from his salary. Other allowances and perquisites as may be determined by the Executive Council of Insurers with the prior approval of Central Government, shall also be payable to the Ombudsman.

- **Territorial jurisdiction of Ombudsmen**
  The office of the Insurance Ombudsman shall be located at such places and shall have such territorial jurisdiction as may be specified by the Executive Council of Insurers from time to time.
- **Duties and functions of Insurance Ombudsman**
  The Ombudsman shall receive and consider complaints or disputes relating to:

a. delay in settlement of claims, beyond the time specified in the regulations, framed under the Insurance Regulatory and Development Authority of India Act, 1999;
b. any partial or total repudiation of claims by the life insurer, General insurer or the health insurer ;
c. disputes over premium paid or payable in terms of insurance policy;
d. misrepresentation of policy terms and conditions at any time in the policy document or policy contract;
e. legal construction of insurance policies in so far as the dispute relates to claim;
f. policy servicing related grievances against insurers and their agents and intermediaries;
g. issuance of life insurance policy, general insurance policy including health insurance policy which is not in conformity with the proposal form submitted by the proposer;
h. non-issuance of insurance policy after receipt of premium in life insurance and general insurance including health insurance; and
i. any other matter resulting from the violation of provisions of the Insurance Act, 1938 or the regulations, circulars, guidelines or instructions issued by the IRDAI from time to time or the terms and conditions of the policy contract

- **Procedure before Ombudsmen**

a. Any person who has a grievance against an insurer, may himself or through his legal heirs, nominee or assignee, make a complaint in writing to the Insurance Ombudsman within whose territorial jurisdiction the branch or office of the insurer complained against or the residential address or place of residence of the complainant is located.
b. No complaint to the Insurance Ombudsman shall lie unless:
   (i) the complainant makes a written representation to the insurer named in the complaint and
   - either the insurer had rejected the complaint or
   - the complainant had not received any reply within a period of one month after the insurer received his representation or
   - the complainant is not satisfied with the reply given to him by the insurer;

   (ii) the complaint is made within one year.
c. The Ombudsman is empowered to excuse delays in cases where he deems it necessary. If the delay is excused, the date of the condonation

shall be deemed to be the date the complaint was filed for purposes of further proceedings under these rules.

- **Prohibition of simultaneous remedies in multiple fora**
  No complaint before the Insurance Ombudsman shall be maintainable on the same subject matter on which proceedings are pending before or disposed of by any court or consumer forum or arbitrator.
- **Proceedings before the Ombudsmen**
  During the course of proceedings before him, the Ombudsmen has the following powers:

a. The Ombudsman shall have the power to ask the parties concerned for additional documents in support of their respective contentions and wherever considered necessary, collect factual information relating to the dispute available with the insurer and may make available such information to the parties concerned.

b. The Ombudsman may obtain the opinion of professional experts, if the disposal of a case warrants it.

c. The Ombudsman shall dispose of a complaint after giving the parties to the dispute a reasonable opportunity of being heard.

- **Recommendations made by the Insurance Ombudsman**

a. Where a complaint is settled through mediation, the Ombudsman shall make a recommendation which it thinks fair in the circumstances of the case, within one month of the date of receipt of mutual written consent for such mediation and the copies of the recommendation shall be sent to the complainant and the insurer concerned.

b. If the recommendation of the Ombudsman is acceptable to the complainant, he shall send a communication in writing within fifteen days of receipt of the recommendation, stating clearly that he accepts the settlement as full and final.

- **Awards by Ombudsmen**

a. Where the complaint is not settled by way of mediation under rule 16, the Ombudsman shall pass an Award, based on the pleadings and evidence brought

b. The Award shall be in writing and shall state the reasons upon which the award is based. Where the Award is in favour of the complainant, it shall state the amount of compensation granted to the complainant after deducting the amount already paid, if any, from the award.

c. The Ombudsman shall not award any compensation in excess of the loss suffered by the complainant as a direct consequence of the cause of action or shall not award compensation exceeding `30 lakhs (including relevant expenses, if any).

d. The Ombudsman shall finalize its findings and pass an award within a period of 3 months of the receipt of all requirements from the complainant.

e. A copy of the award shall be sent to the complainant and the insurer named on record. the complaint.

f. The insurer shall comply with the award within 30 days of the receipt of the award and intimate compliance of the same to the Ombudsman.

g. The complainant shall be entitled to such interest at a rate per annum as specified in the regulations, framed under the Insurance Regulatory and Development Authority of India Act, 1999, from the date the claim ought to have been settled under the regulations, till the date of payment of the amount awarded by the Ombudsman.

h. The award of Insurance Ombudsman shall be binding on the insurers.

The Ombudsman shall prepare an annual report detailing the activities undertaken during the previous financial year under their jurisdiction, statement of accounts and any other relevant information and submit to the Executive Council of Insurers with a copy to the IRDAI by the 30th June every year.
An Advisory Committee consisting of eminent persons not exceeding five and including one Central Government nominee shall be constituted by the IRDAI to review the performance of the Insurance Ombudsman from time to time.

1.9 INSURANCE AS A SOCIAL SECURITY TOOL

Insurance serves as a social security tool in addition to a tool for personal and commercial security. Social insurance is helpful in addressing a variety of societal issues, including unemployment, ageing, crime, disability, and elderly care.
The Government of India has also provided article 41 in Indian Constitution regarding social security. Thus, insurance is not only a device of individual and business security but also a device of social security.
It works as a social security tool as following.

1. **Social Insurance** : The LIC of India has set up Social Security Fund and provided special insurance plans for the benefit of poor and the people having below poverty line. It is also helpful to agriculturist and the persons engaged in unorganized sector.
2. **Protection to wealth** : General Insurance Corporation of India and other private insurance companies provides protection to properties of the society. Insurance against loss of personal wealth is available. The society will be protected financially from things like old age, death, destruction, and disappearance of its material and human resources.
3. **Economic growth of the nation:** It helps to mobilise domestic savings. Insurance generates a little quantity of premium and transforms collected cash into profitable investments. Financial stability is made possible through insurance, which also promotes trade and business.
4. **Reduction in Inflation** : Too much circulation of money can increase the inflation in the economy. With premiums, insurance companies take money from society as household savings, so reducing the flow of currency. Contrarily, insurance offers funding for production, which reduces the inflation gap.

1.9.1 GOVERNMENT SPONSORED SOCIALLY ORIENTED INSURANCE SCHEMES

- **Pradhan Mantri Jeevan Jyoti Bima Yojana(PMJJBY):**
    1. It is a one-year life insurance scheme renewable from year to year offering coverage for death.
    2. The scheme is administered through both public and private sector insurance companies in tie-up with scheduled commercial banks, regional rural banks and cooperative banks.
    3. With the target to include the poor and the underprivileged section of the society, this social security scheme was envisaged to foster the spirit of inclusive growth tandem with the vision of 'Sabke Saath Sab ka Vikas'
- **Pradhan Mantri Suraksha Bima Yojana(PMSBY)**:
    1. The Scheme is available to people in the age group 18 to 70 years with a bank account who give their consent to join / enable auto-debit on or

before 31st May for the coverage period 1st June to 31st May on an annual renewal basis.

2. Aadhar would be the primary KYC for the bank account. The risk coverage under the scheme is Rs.2 lakh for accidental death and full disability and Rs. 1 lakh for partial disability.
3. The premium of Rs. 20 per annum is to be deducted from the account holder's bank account through 'auto-debit' facility in one installment.
4. The scheme is being offered by Public Sector General Insurance Companies or any other General Insurance Company.

- **Life Cover under Pradhan Mantri Jan Dhan Yojana (PMJDY):**
  1. The Pradhan Mantri Jan DhanYojana (PMJDY) sets out to provide a basic Bank account to every family who till now had no account.
  2. The bank account comes with a RuPay debit card with a built-in accidental insurance cover of Rs. 1 lakh.
  3. It announced a life cover of Rs. 30,000/- for those subscribing to a bank account with a RuPay debit card before 26th January, 2015 to complement the Rs. 1 lakh accident insurance cover.
  4. The scheme aims to provide security to families from economically weaker sections who cannot afford direct purchase of such insurance. The premium subscription for the life cover under PMJDY is borne by the Government of India.
- **Varishtha Pension Bima Yojana**:
  1. The scheme is administered through Life Insurance Corporation of India (LIC). Under the Scheme the subscribers on payment of a lump sum amount get pension at a guaranteed rate of 9% per annum (payable monthly).
  2. Any gap in the guaranteed return over the return generated by the LIC on the fund is compensated by Government of India by way of subsidy payment in the scheme.
- **Pradhan Mantri Fasal Bima Yojana(PMFBY):**
  1. PMFBY provides a comprehensive insurance cover against failure of the crop thus helping in stabilising the income of the farmers.
  2. The Scheme covers all Food & Oilseeds crops and Annual commercial/Horticultural Crops for which past yield data is available and for which requisite number of Crop Cutting Experiments (CCEs) are conducted being under General Crop Estimation Survey (GCES).
  3. The scheme is implemented by empanelled general insurance companies.
  4. The scheme is compulsory for loanee farmers availing Crop Loan /KCC account for notified crops and voluntary for other others. The scheme is being administered by Ministry of Agriculture.
- **Pradhan Mantri Vaya Vandana Yojana(PMVVY):**
  1. It is is being implemented through Life Insurance Corporation (LIC) of India.
  2. As per the scheme, on payment of an initial lump sum amount ranging from a minimum purchase price of Rs. 1, 50,000/- for a minimum pension of Rs 1000/- per month to a maximum purchase price of Rs. 7,

50,000/- for maximum pension of Rs. 5,000/- per month, subscribers will get an assured pension based on a guaranteed rate of return of 8% per annum, payable monthly.

1.10 PENSION

"Pension" is a payment made by an employer to his retired or ex-employee in consideration of the services rendered by him in the past during his employment with the employer or in his organization.
Webster's New international Dictionary defines pension as "a stated allowance or stipend made in consideration of past services."

TYPES OF PENSION PLANS

1. **Defined-Contribution Plan:** Employees contribute to retirement accounts that are either explicit or implicit under a defined-contribution plan.
    - the level and timing of contributions,
    - the rate of return on the retirement accounts and
    - the form in which benefits are realised, including annuitization, programmed withdrawals and lumpsum distribution.
2. **Pay-as-you-go System:** Pension payments are made using the taxes gathered from the younger taxpaying generation in a pay-as-you-go arrangement. The additional taxes gathered are then used to fund their pension payments.
3. **Funded System:** In a Funded System, pension payments are invested in a variety of financial assets. Funding provides an opportunity to capitalise from investment in financial markets, where the rate of return is likely to be higher than the implicit rate of return to contributions in a pay-as-you-go pension system. The benefits of funding can be enhanced by investment diversification.
4. **Participating Pension Plans:** To reduce risks, IRDA (Insurance Regulatory Development Authority) regulates investments in these schemes. Government of India (GOI) securities should make up at least 20% of the investment, followed by GOI or GOI-backed assets at 20%, and approved bonds and stocks, the majority of which have AAA ratings, at 60%.

1.11 CURRENT STATE OF INSURANCE IN INDIA

- India is ranked 11th in Global Insurance business. In 2020, India's share of the global insurance market was 1.72%, while the country's total volume of insurance premiums climbed by 0.1%.
- With life insurance penetration at 3.2% and non-life insurance penetration at 1%, India's insurance penetration was estimated to be 4.2% in FY21 (up from 3.76% in 2019–20).
- Private sector businesses increased their market share in the non-life insurance industry from 15% in FY2004 to 49.3% in FY2021.
- Government programmes and initiatives to promote financial inclusion should have aided in accelerating uptake and penetration across all categories. Crop insurance premium income has significantly increased as a result of the

government's main programme, PMFBY, and it now covers more than 55 million farmer applicants per year.

- The insurance regulator IRDAI has also taken a number of steps to increase insurance penetration, including allowing insurers to conduct video-based Know Your Customer (KYC) processes, introducing standardised insurance products, and allowing insurers to encourage low-risk behaviour.
- The rise of online channels and digital issuance is anticipated to continue. Web aggregators already account for 30–40% of the origination of digital insurance, and their market share within it has been steadily growing.
- Important government initiatives, robust democratic elements, a supportive regulatory framework, growing alliances, product innovations, and lively distribution channels all contribute to the expansion of the insurance sector.
- The Union Budget's announcement to boost FDI in insurance from 49% to 74% will help to further encourage improved penetration and coverage by opening up new channels for the capital support needed to grow the Indian insurance market.
- The recent pandemic has emphasized the importance of healthcare on the economy, and health insurance would play a critical role in the effort to strengthen the healthcare ecosystem.

GROWTH DRIVERS

- **Favourable Demographics**
  In 2020, 55% of India's population (the working population) was under the age of 60, and that percentage is expected to rise to 56% by 2025. The country has a young population—68% of whom are under the age of 30. This indicate that India has a young population that is insurable.
- **Wide middle-class expansion**
  By 2030, India will add 140 Mn middle-income and 21 Mn high-income households which will drive the demand and growth of Indian insurance sector.
- **Digital behaviour patterns**
  Consumers are beginning to favour digital methods for their insurance requirements: 73%/62% of clients chose GI/HI goods purchased online (2020). The comfort level of agents using digital technologies has also increased; 63% of agents feel at ease video-calling clients, and >50% are agreeable to online renewals. The second-largest market for Internet users is India. 1 Bn people will be online by 2026.
- **Pandemic-related shift in demand patterns**
  Digital adoption has accelerated as a result of COVID, and according to 67% of agents, clients are now more inclined to use portals and apps. Moreover, the pandemic raised awareness of insurance, boosted insurance penetration, and increased demand for protection products, particularly health insurance.
- **Government Program**
  Government initiatives such as PM-JAY, PMFBY, PMJJBY, PMSBY etc. are increasing insurance penetration

1.12 EMERGING CONCEPTS IN INSURANCE INDUSTRY

- **Digitalisation**

A technology-driven shift in the way insurance is sold is the emerging trend in the industry.
The insurers will concentrate more on marketing insurance products using tele-medical procedures in conjunction with e-KYC procedures to complete the customer verification process. By purchasing insurance through digital channels, the procedure is simplified and customers have a wide range of options to choose the best insurance plan for their needs.

- **New Insurance Products**
  Since the start of the pandemic, awareness of the necessity for protection has multiplied. Demand for insurance products for a wide range of hazards that insurance firms typically did not cover has begun to pick up steam. These insurance policies cover everything from pandemic protection to protection against seasonal ailments like dengue.
- **Rise in Demand for Standardised Products**
  By the introduction of standard insurance products across all major insurance sectors – Health, Life and Travel – IRDAI is leaving no stone unturned to increase the insurance penetration rate in the country. The standard features and wordings of these products will make them the first choice of buyers who cannot afford a comprehensive insurance policy.
- **Personalisation and data**
  Usage-based insurance policies, for instance, tap into customer data in order to charge users according to their specific needs and behaviors, putting the consumer in charge of their own fees.
  Such personalization and clever data-usage benefit both customers and insurers. Along with improving user satisfaction, tailored products enable companies to enjoy more accurate risk assessment, and stable margins.

1.14 MULTIPLE CHOICE QUESTIONS

1. **When was the Oriental Life Insurance Company established in Calcutta?**
   A) 1818
   B) 1834
   C) 1829
   D) 1870

Answer: A) 1818.

Explanation: The Oriental Life Insurance Company was established in Calcutta in 1818, marking the beginning of the life insurance industry in India.

2. **Which act gave the government access to statistical data on life and non-life insurance transactions made in India by domestic and international insurers?**
   A) Indian Insurance Companies Act
   B) Insurance Amendment Act 1950
   C) Insurance Act of 1938
   D) Insurance Act of 1928

Answer: D) Insurance Act of 1928.

Explanation: The Indian Insurance Companies Act was passed in 1928 to give the government access to statistical data on life and non-life insurance transactions made in India by domestic and international insurers.

3. **Which was the first Indian company to handle all general insurance business classes?**
   A) Indian Mercantile Insurance Ltd.
   B) Oriental Insurance Company Ltd.
   C) United India Insurance Company Ltd.
   D) New India Assurance Company Ltd.

Answer: A) Indian Mercantile Insurance Ltd.

Explanation: Indian Mercantile Insurance Ltd. was founded in 1907 and handled all general insurance business classes for the first time.

4. **When was the General Insurance Corporation of India established?**
   A) 1956
   B) 1971

C) 1928
D) 1973

Answer: B) 1971.

Explanation: The General Insurance Corporation of India was established as a business in 1971, and on January 1st, 1973, it opened for business.

5. What is the role of a third-party administrator (TPA)?
A. Representing the policyholder in the insurance process
B. Inspecting the damage or loss of an insurance company
C. Providing health services to policyholders
D. Obtaining quotes from various insurers

Answer: C

Explanation: TPAs are contracted for a fee or remuneration to provide health services to policyholders and are required to maintain professional confidentiality.

6. What is an internal risk for insurance companies?
a. Overexposure to one class of asset
b. The tendency of an insured to take greater risk because she/he is insured
c. The tendency of insurance companies to invest in risky securities
d. The tendency of insuring the low quality asset and not insuring high quality assets.

Answer: a. Overexposure to one class of asset.

Explanation: This is an internal risk because it is something that is within the control of the insurance company, and can be mitigated by diversifying their portfolio.

7. The principle of insurable interest means that:
A) The insured must own the assets being insured
B) The insurance company must own the assets being insured
C) The insured must have a direct financial interest in the assets being insured
D) The insured must have a third-party interest in the assets being insured

Answer: C)

Explanation: The insured must have a direct financial interest in the assets being insured. This means that a loss incurred in the item being insured would lead to direct monetary loss to the policyholder.

8. Which of the following is not applicable to life insurance contracts?

A) Subrogation
B) Warranties
C) Indemnification
D) Insurable interest

Answer: A) Subrogation. Explanation: Both indemnification and subrogation are not applicable to life insurance contracts.

9. Which of the following features of an insurance contract allows for the insured to seek damages for the loss, but not try to profit from the damages?

A) Utmost good faith
B) Insurable interest
C) Indemnification
D) Warranties

Answer: C) Indemnification. Explanation: Under a contract of indemnity, the party whose loss is being compensated should only seek damages for the loss and should not try to profit from the damages

10. Which policy pays the sum assured only when the assured dies before a stipulated date?

a) Whole Life Policy
b) Endowment Life Assurance
c) Term Assurance
d) Joint Life Policy

Answer: c) Term Assurance. Explanation: Term Assurance is a policy in which the sum assured is payable only if the assured dies before a stipulated date.

11. Which committee was set up by the Indian government in 1993 to propose recommendations for reforms in the insurance sector?

A) Insurance Regulatory and Development Authority (IRDA)

B) General Insurance Corporation of India
C) Exchange Control Regulations (FEMA)
D) RN Malhotra Committee

Answer: D) RN Malhotra Committee

Explanation: In 1993, the Indian government set up a committee under the chairmanship of RN Malhotra to propose recommendations for reforms in the insurance sector.

12. When was the Insurance Regulatory and Development Authority (IRDA) incorporated as a statutory body?

A) 1999
B) 2000
C) 2002
D) 2005

Answer: B) 2000

Explanation: The Insurance Regulatory and Development Authority (IRDA) was incorporated as a statutory body in April 2000.

13. Which act established the Insurance Regulatory and Development Authority of India (IRDAI)?

a. IRDAI Act, 2000
b. IRDAI Act, 1999
c. IRDAI Act, 1998
d. IRDAI Act, 2001

Answer: b. IRDAI Act, 1999

Explanation: The IRDAI Act, 1999, established the Insurance Regulatory and Development Authority of India as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies.

14. How many part-time members can the IRDAI have?

a. 3
b. 4
c. 5
d. 6

Answer: b. 4

Explanation: The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members.

15. Who can nominate members to the Executive Council of Insurers under the Insurance Ombudsman Scheme?

a) The Life Insurance Council
b) The General Insurance Council
c) The IRDAI
d) All of the above

Answer: d) All of the above

Explanation: The Executive Council of Insurers is comprised of representatives nominated by the Life Insurance Council, General Insurance Council, IRDAI, and the Central Government.

16. Who appoints the Insurance Ombudsman?

a) The Life Insurance Council
b) The General Insurance Council
c) The IRDAI
d) The Selection Committee

Answer: d) The Selection Committee

Explanation: The Insurance Ombudsman is selected by a Selection Committee comprising of the Chairperson of the IRDAI, one representative each of the Life Insurance Council and the General Insurance Council from the Executive Council of Insurers, and a representative of the Government of India not below the rank of a Joint Secretary or equivalent, in the Ministry of Finance, from the Department of Financial Services.

17. What is the main objective of the Prevention of Money Laundering Act (PMLA)?

A. To seize illicit profits and assets related to money laundering
B. To create agencies and methods to combat money laundering
C. To deal with any other issue relating to money laundering in India
D. All of the above

Answer: D. All of the above.

Explanation: The main objective of the PMLA is to combat money laundering and associated activities, including the seizure of illicit profits and assets, the creation of agencies and methods to combat it, and dealing with any other issue relating to money laundering in India.

18. Which government agency administers the Varishtha Pension Bima Yojana?

A. Reserve Bank of India
B. Life Insurance Corporation of India (LIC)
C. Pension Fund Regulatory and Development Authority (PFRDA)
D. Insurance Regulatory and Development Authority of India (IRDAI)

Answer: B. Life Insurance Corporation of India (LIC)

Explanation: The Varishtha Pension Bima Yojana is administered through Life Insurance Corporation of India (LIC).

19. Which crops are covered under the Pradhan Mantri Fasal Bima Yojana?

A. Only food crops
B. Only oilseeds crops
C. Only commercial crops
D. All food & oilseeds crops and Annual commercial/Horticultural Crops for which past yield data is available

Answer: D. All food & oilseeds crops and Annual commercial/Horticultural Crops for which past yield data is available

Explanation: The Pradhan Mantri Fasal Bima Yojana covers all Food & Oilseeds crops and Annual commercial/Horticultural Crops for which past yield data is available and for which requisite number of Crop Cutting Experiments (CCEs) are conducted being under General Crop Estimation Survey (GCES).

20. Which of the following is not covered under marine insurance?

a) Ship
b) Cargo
c) Freight
d) Loss due to fire on the ship

Answer: d) Loss due to fire on the ship

Explanation: Marine insurance covers the loss or damage of ships, cargo, and freight due to various reasons such as accidents, natural disasters, piracy, etc. But fire insurance is a separate type of insurance that covers losses due to fire.