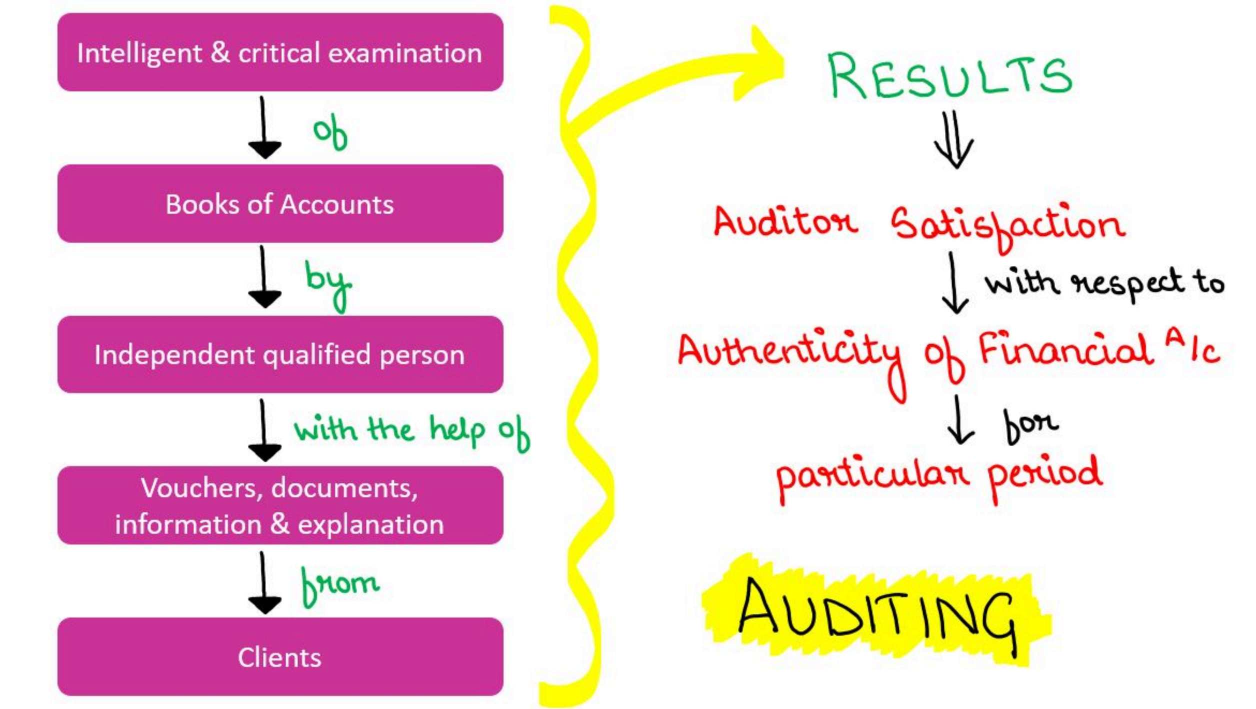
Auditing Course Material

Part 1 of 61 (Chapters 1-100)

1. Introduction of Auditing

The **Audit** is defined as an independent appraisal activity within an organization for the review of accounting, financial and other operations as a basis of service to the management.



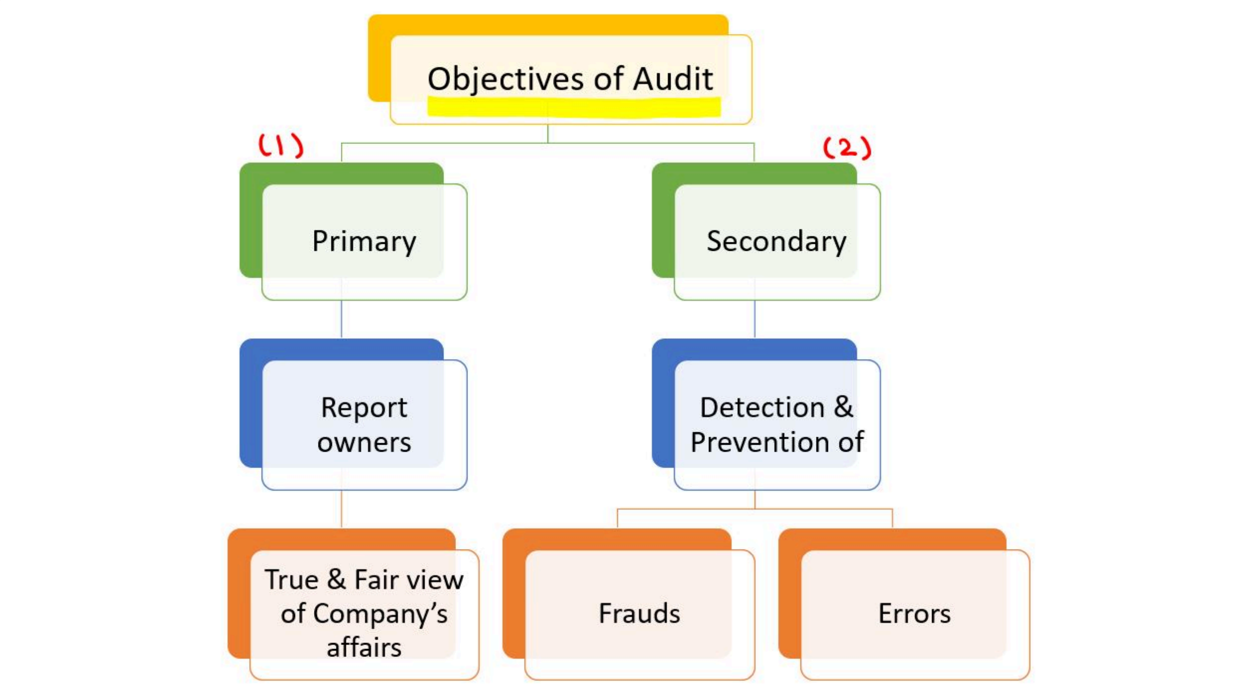
The **Financial Audit** is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon.

The financial statements serve as the basis for decision-making by the management, and even corrective action, including the possible closure of the organization or a part of it. Therefore, it is crucial for the financial statements to be reliable, as decisions based on incorrect accounting statements may prove harmful or even fatal to the business. The management and shareholders, who are unable to participate in the business's management, need assurance that the annual statements of accounts sent to them are reliable. Auditing plays a vital role in ensuring the authenticity of accounting statements.

An **Auditor** is a person conducting audit and is responsible to ensure that financial statements would not mislead anybody.

This, he can do honestly by satisfying himself that:
1) the accounts have been drawn up with reference to entries in the books of account;
2) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
3) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
4) the information conveyed by the statements is clear and unambiguous;
5) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
6) the statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

1. Introduction of Auditing



The objective of audit is to express an opinion on the financial statements. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

While conducting an audit of financial statements, an auditor has to take care of certain objectives.

SA-200 (Standard on Auditing) deals with the **Overall Objectives of the Independent Auditor**.

The objectives of an auditor are mentioned below.
1) To obtain reasonable assurance that the financial statements as a whole are free from material misstatements (a material misstatement is an untrue information in a financial statement that is sufficient enough to affect the financial decisions of one who relies on the financial statements); and
2) To report on the financial statements, and communicate material misstatements as required by the SAs (Standards on Auditing), in accordance with the auditor's findings.

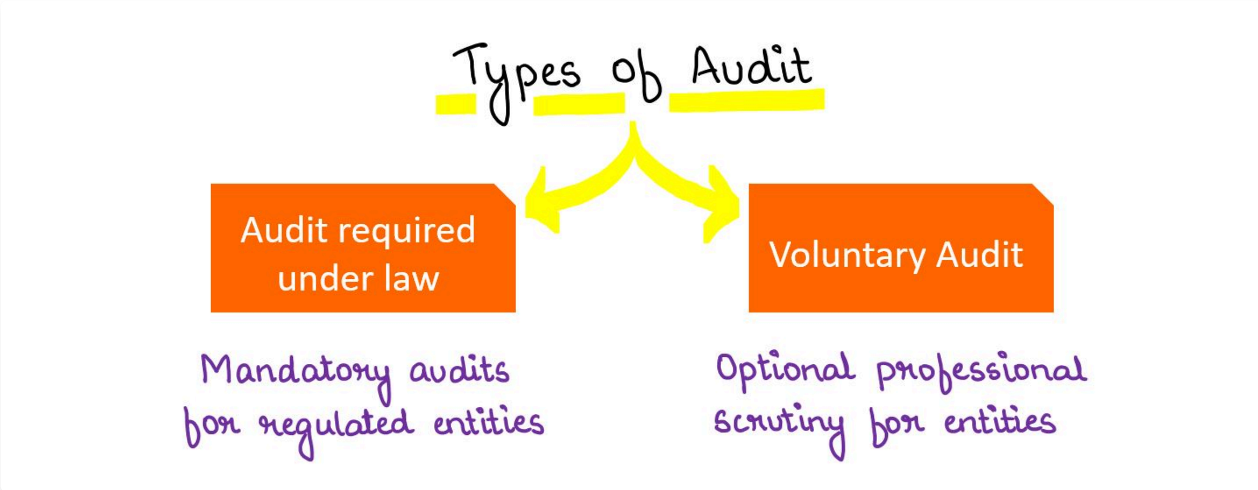
The objective of an auditor is not to perform duties which fall outside the scope of his *competence*. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain asset.

1. Introduction of Auditing

It is not necessary that audit is always legally mandatory. There are entities like companies who are compulsorily required to get their accounts audited under law. Even non-corporate entities may be compulsorily requiring audit of their accounts under tax laws. For example, in India, every person is required to get accounts audited if turnover crosses certain threshold limit under income tax law.

It is also possible that some entities like schools may be required to get their accounts audited for the purpose of obtaining grant or assistance from the Government.

Similarly, many entities may get their accounts audited voluntarily because of benefits from the process of audit. Many such concerns have their internal rules requiring audit due to advantages flowing from an audit.



Thus, Audits may be classified into 2 categories, i.e., audits required under law and voluntary audits.

1. Audit required under law
The organizations which compulsorily require audit under law include companies governed by the Companies Act; banking companies; other statutory bodies required by their regulators or by a specific Act.

2. Voluntary Audit
In the voluntary category, are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc. Some may be required to get their accounts audited on the directives of Government for various purposes like sanction of grants, loans, etc. But the important motive for getting accounts audited lies in the advantages that follow from an independent professional audit. This is perhaps the reason why large numbers of proprietary and partnership business firms get their accounts audited.

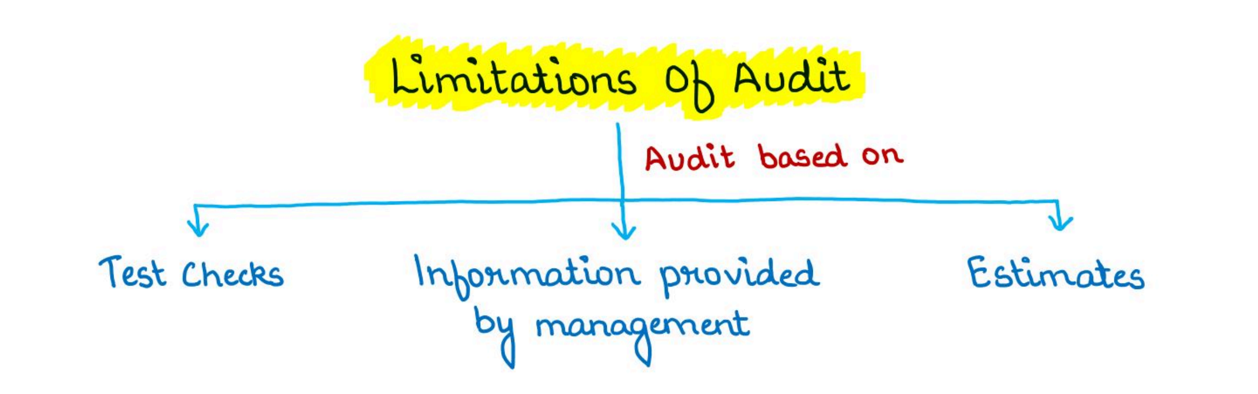
1. Introduction of Auditing

The audit of financial statements carries a number of advantages, which are stated below.
a) It **safeguards the financial interest** of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, financial institutions, public at large etc.
b) It acts as a **moral check on the employees** from committing defalcations or embezzlement.
c) Audited financial statements are **helpful in settling liability** for taxes, negotiating loans, for determining the purchase consideration for a business, settlement of accounts at the time of admission or death of partner.
d) These are also **useful for settling trade disputes** for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
e) An audit keeps a **check on internal controls**, thus, helps in the detection of wastages and losses.
f) As an appraisal function, audit **reviews the existence and operations of various controls** in the organisations and reports weaknesses, inadequacies, etc. in them.

The Government may require audited and certified financial statements before it gives assistance or issues a license for a particular trade.

1. Introduction of Auditing

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.



The reasons for inherent limitations of an audit can be described as follows.

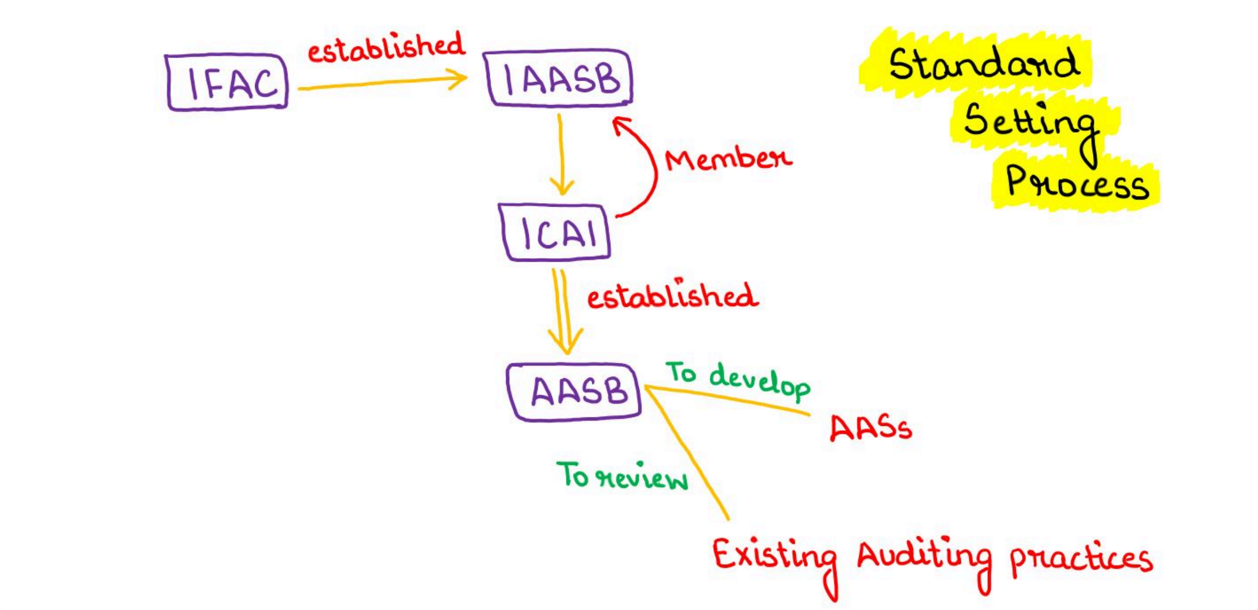
a) Nature of Financial Reporting
The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. *Financial reporting framework* is the format prescribed by law for preparation, disclosure and presentation of financial information of organisations. For example, the companies have to follow AS and Ind AS in the preparation of financial statements. The companies registered under Companies Act, 2013 have to follow accounting standards prescribed under Section 133 and format of financial statements as prescribed under Schedule III.

b) Nature of Audit Procedures
There are practical and legal limitations on the auditor's ability to obtain audit evidence, such as where the assets of the company are remotely located or there is a possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements.

c) Timeliness of Financial Reporting and the balance between Benefit and Cost
The relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

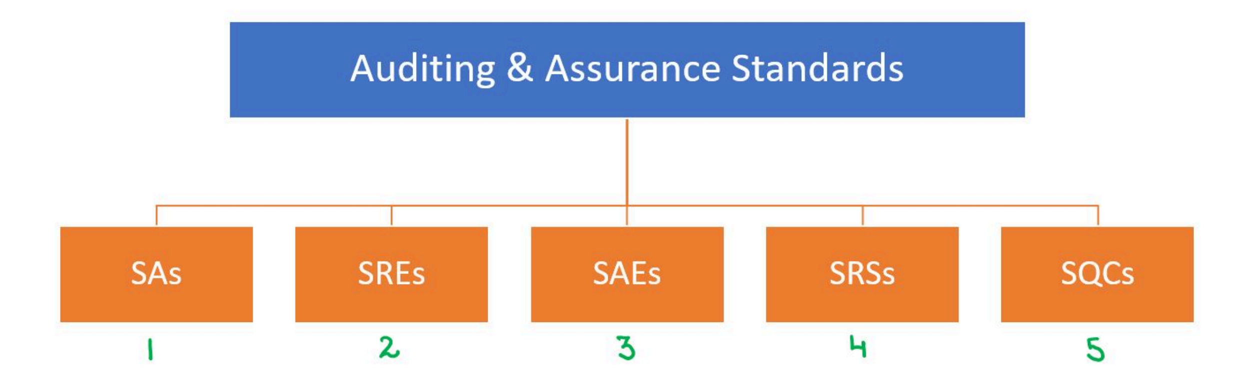
d) Other matters that affect the limitations of an Audit
Some other assertions or subject matters, in which there are significant limitations on the auditor's ability to detect material misstatements include fraud, related party relationships and transactions, non-compliance with laws and regulations, and future events or conditions that may cause an entity to cease as a going concern.

1. Introduction of Auditing



The IFAC (International Federation of Accountants) Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue high quality auditing standards for use around the world. ICAI is a member of the IFAC and is committed to work towards the implementation of the guidelines issued by the IFAC. However, ICAI constituted the AASB (Auditing and Assurance Standards Board) to review the existing auditing practices in India and to develop 'Auditing and Assurance Standards (AASs)' so that these may be issued by the Council of the CA Institute.

1. Introduction of Auditing



The 'Auditing and Assurance Standards' are classified based on the type of assurance provided by the engagement undertaken by a member, in the following manner:

1) **Standards on Auditing (SAs)** – which apply in the audit of historical financial information.
2) **Standards on Review Engagements (SREs)** – which apply in the review of historical financial information.
3) **Standards on Assurance Engagements (SAEs)** – which apply in assurance engagements, dealing with subject matters other than audits and review of historical financial information.
4) **Standards on Related Services (SRSs)** – which apply in agreed upon procedures to information and other related services engagements such as compilation engagements.
5) **Standards for Quality Control (SQCs)** – which apply for compliance with ethical requirements.

The purpose of issue of these standards is to establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services.

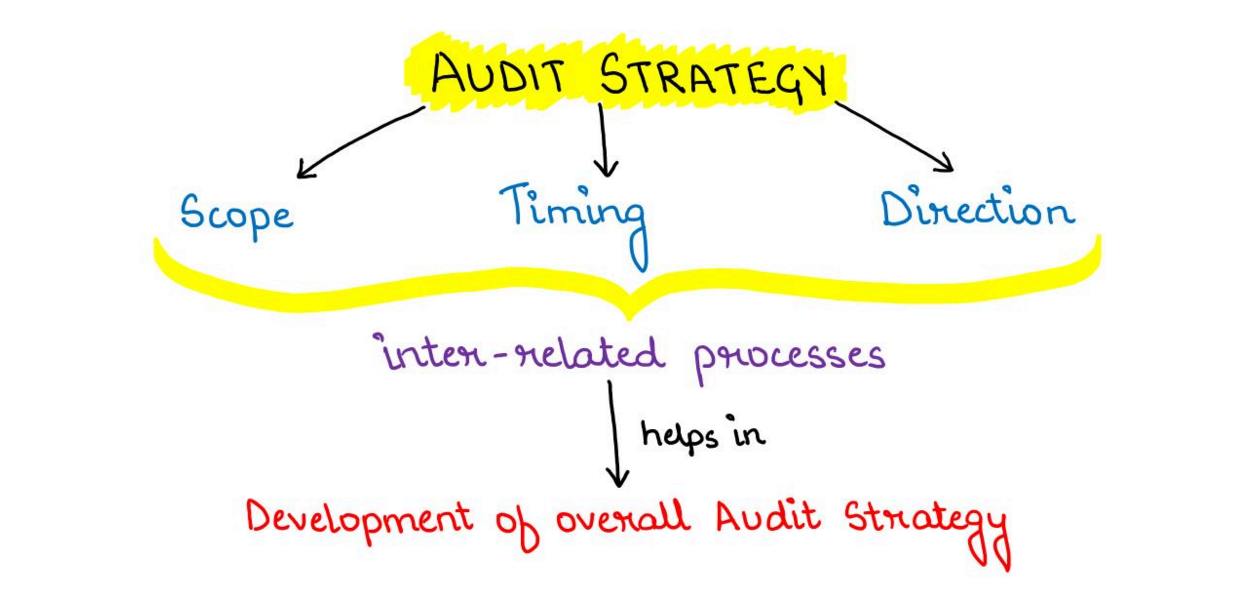
These Standards will apply whenever an independent audit is carried out; that is, in the independent examination of financial information of an entity, when such an examination is conducted with a view to expressing an opinion thereon. While discharging their attest function, it will be the duty of members of the Institute to ensure that the Standards are followed in the audit of financial information covered by their audit reports. If for any reason, a member has not been able to perform an audit in accordance with the Standards, his report should draw attention to the material departures therefrom.

1. Introduction of Auditing

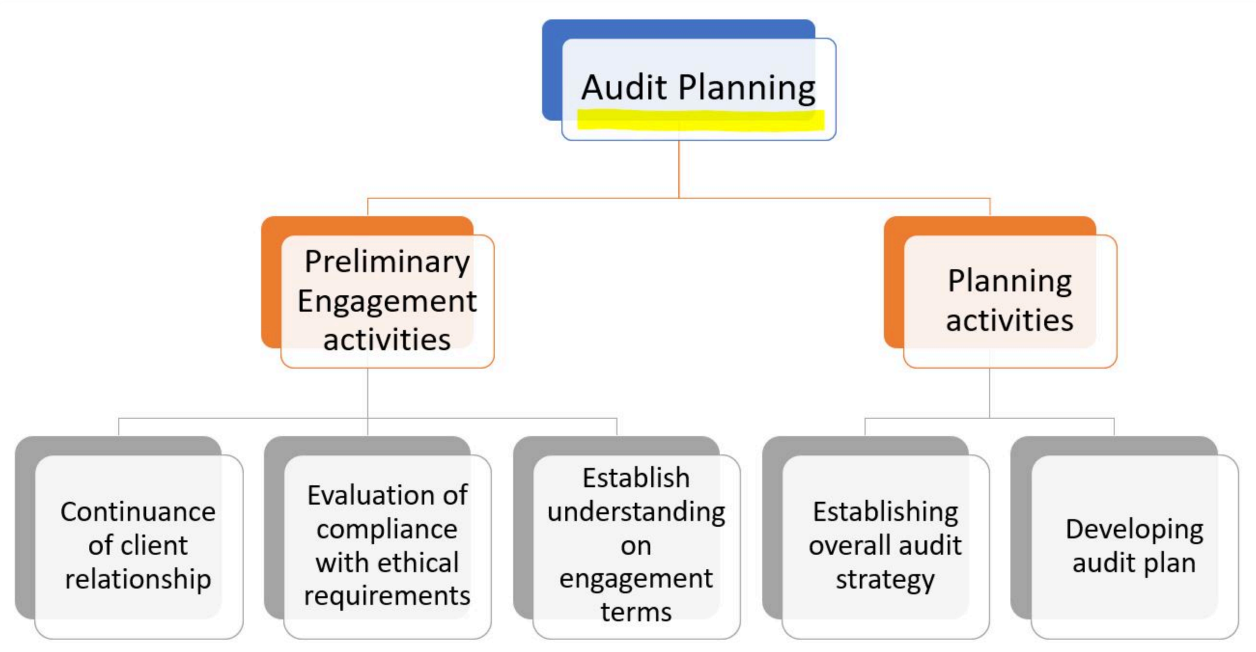
SA-300 states that objective of the auditor is to plan the audit so that it will be performed in an effective manner.

Planning is not a discrete phase of an audit, but rather a continual and iterative process. Elements of planning include preliminary engagement activities and planning activities.
1) *Preliminary engagement activities* include performing procedures regarding continuance of client relationship, evaluating compliance with ethical requirements including independence and establishing an understanding of terms of engagement with the client so that there are no misunderstandings.
2) *Planning activities* include establishing overall audit strategy and developing audit plan.

Audit strategy sets scope, timing and direction of audit.

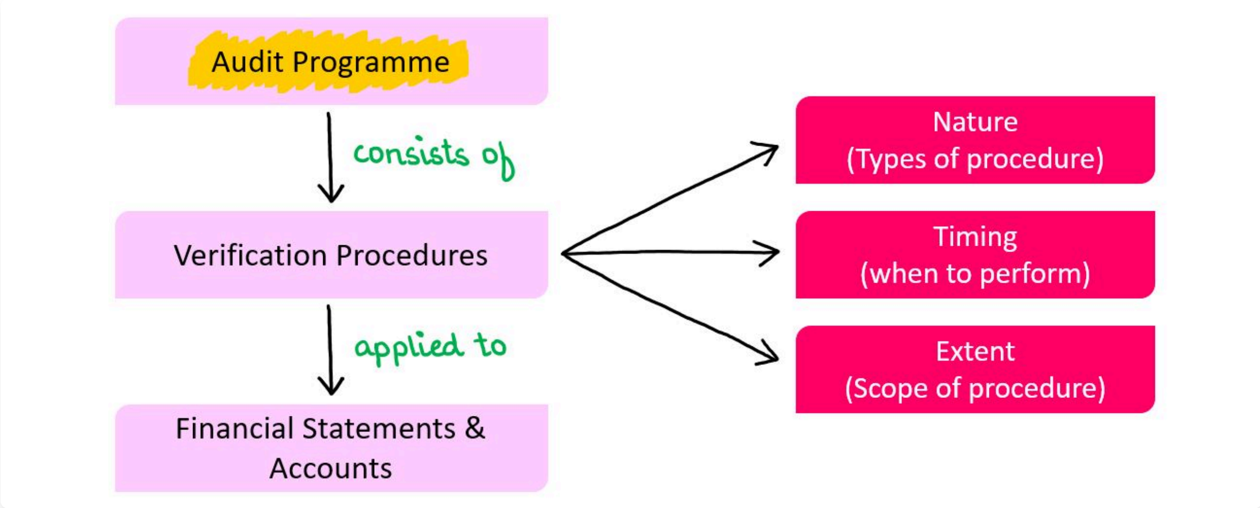


Audit plan addresses various matters identified in overall audit strategy. It includes nature, timing and extent of planned risk assessment procedures, planned further audit procedures and planned other audit procedures in accordance with SAs.



The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

An **audit programme** consists of a series of verification procedures to be applied to the financial statements and accounts of a given entity for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on financial statements.



In other words, an audit programme is a set of instructions which are to be followed for proper execution of audit. After the development of audit plan a detailed written audit programme containing the various steps and procedures shall be required.

The audit programme contains the measures that are generally employed to determine what, and how much evidence must be collected and evaluated. It also lays down the responsibilities for the whole audit team for carrying out different tasks.

The prepared audit program may be revised if needed in accordance with the prevailing circumstances. An audit program largely depends on the size of the organization and other relevant factors. Minimum essential work to be done is Standard Programme and rest is according to circumstances. There is no standard audit programme applicable for all situations.

Audit programme is documented in the Audit Working Papers, which are the official record that contains the planning and execution of the audit agreement.

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1. Introduction of Auditing

Both *audit* and *review* are related to financial statements prepared on the basis of historical financial information. However, both differ from each other.

Audit is a reasonable assurance engagement. It provides reasonable assurance. However, **review** is a limited assurance engagement. It provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.

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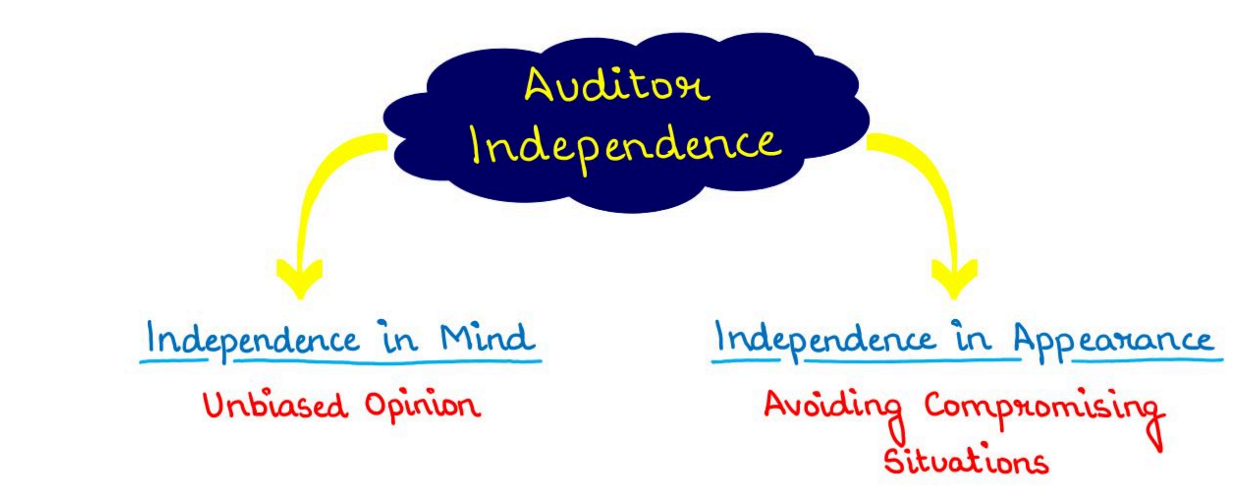
2. Independence of Auditor



Shareholders need to have confidence that the auditors have assessed relevant information objectively, and that they have scrutinized evidence critically and independently. Shareholders also want to be sure that the auditors have undertaken their work and made their judgements free from any bias, and without being influenced unduly by management who prepared the financial statements.

Professional integrity and Independence are considered essential characteristics of all the professions but are more so in the case of accountancy profession.

Independence means that a person's judgment is not controlled by someone who hired them. For an auditor, independence ensures that he can form an unbiased audit opinion without being influenced. Independence helps auditors act with honesty, stay objective, and approach their work with a skeptical and professional mindset. Independence enhances the auditor’s ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

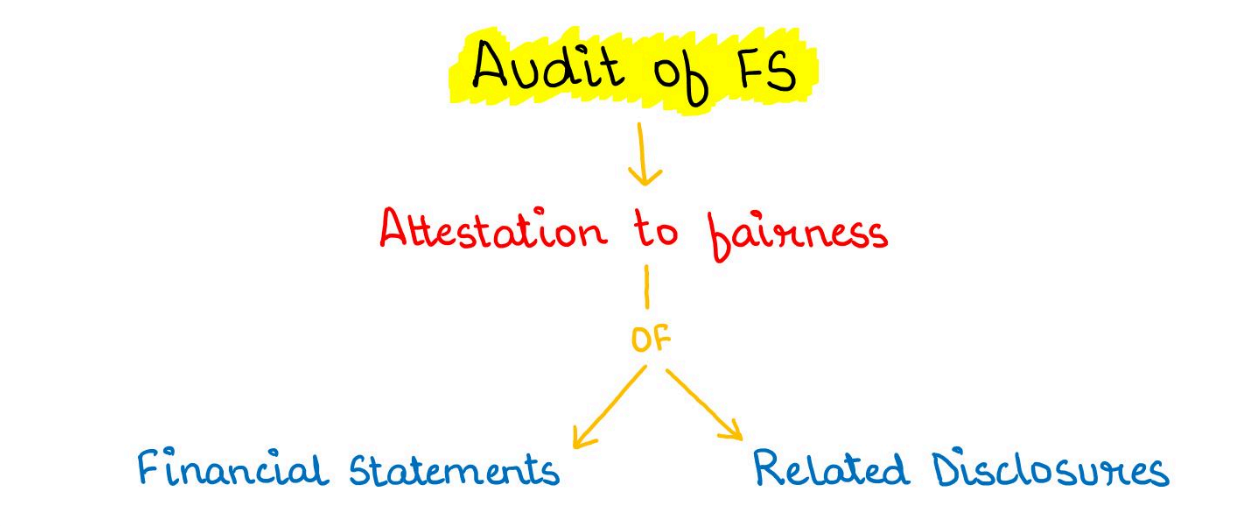
Professional skepticism means having a questioning mindset, staying alert to signs of errors or fraud, and critically evaluating audit evidence. It's not just needed at the planning stage of an audit but throughout the entire process because unusual situations can arise at any point.

Auditor independence has 2 key aspects:
(a) **Independence of Mind:** This means having a mindset that allows the auditor to give an opinion without being influenced, ensuring integrity, objectivity, and professional skepticism.
(b) **Independence in Appearance:** This involves avoiding situations that could make others reasonably think the auditor's integrity, objectivity, or professional skepticism is compromised.

The goal of auditing financial statements is to let the auditor express an opinion on them. This opinion helps users assess the true and fair view of an enterprise's financial position and performance. However, it doesn't guarantee the future success or how efficiently management has run the business.

Auditors need to be honest, sincere, and unbiased in their work. They must remain impartial and appear free from any interests that could affect their integrity and objectivity.

1. Audit of Financial Statements

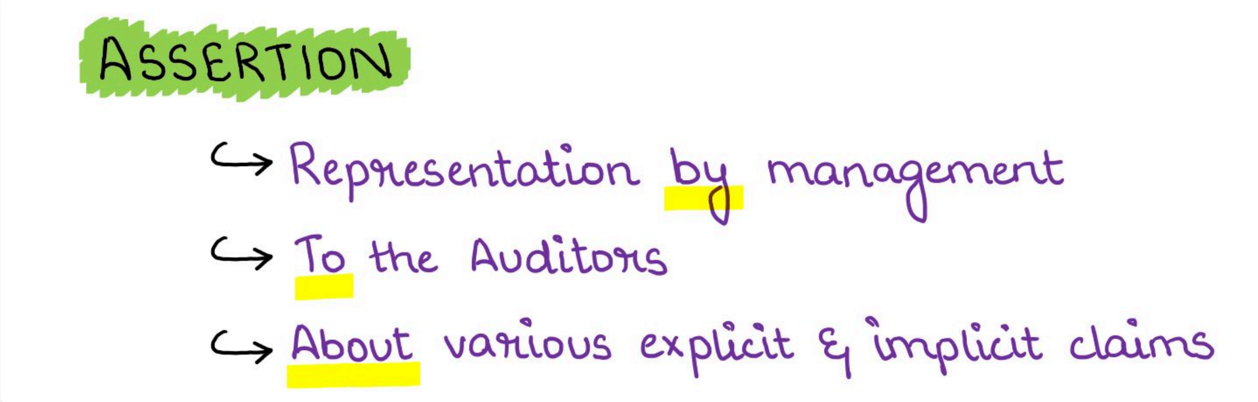


A **financial statement audit** is the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the fairness of presentation of the financial statements and related disclosures.

The auditor's report must accompany the financial statements when they are issued to the intended recipients. The purpose of a financial statement audit is to add credibility to the reported financial position and performance of a business.

1. Audit of Financial Statements

The management of a company is responsible for preparing financial statements. During this process, management implicitly or explicitly makes claims (assertions) about various aspects such as completeness, cut-off, existence/occurrence, valuation/measurement, rights and obligations, and presentation/disclosure. These assertions relate to how assets, liabilities, equity, income, expenses, and disclosures are represented in the financial statements, following applicable accounting standards.

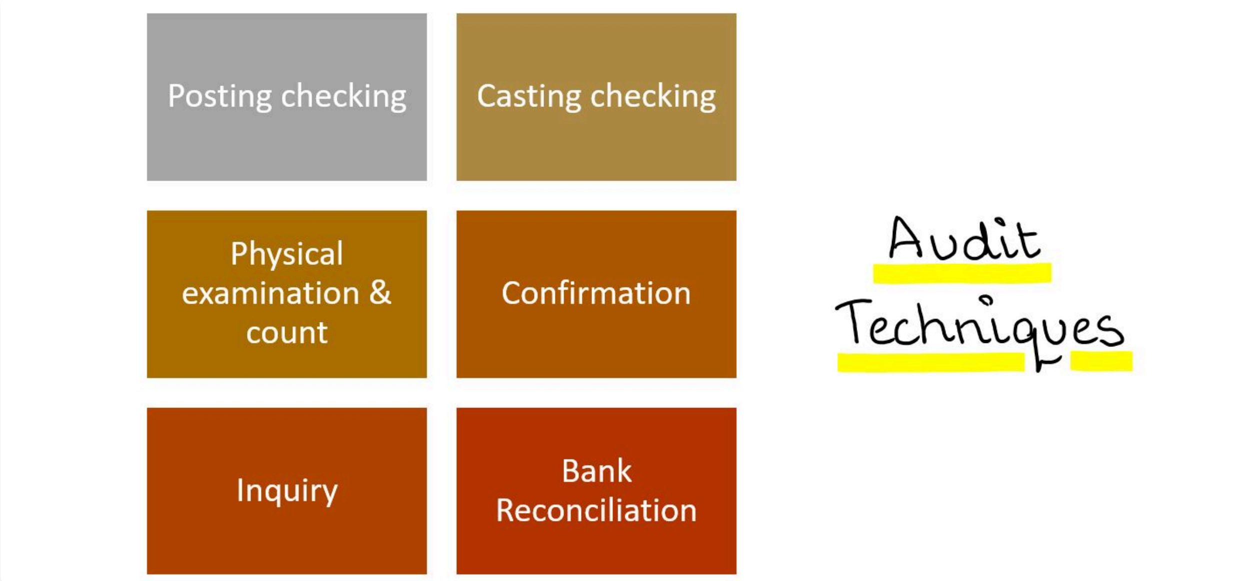


Thus, **assertions** are the representations made by management, either stated clearly or implied, which auditors use to assess potential misstatements in the financial statements.

For example, if company X's balance sheet shows Building with carrying amount of Rs. 50 lakh, the auditor shall assume that the management has claimed/ asserted that:
a) the building recognized in the balance sheet exists as at the period- end (existence assertion);
b) company X owns and controls such building (Rights and obligations assertion);
c) the building has been valued accurately in accordance with the measurement principles (Valuation assertion);
d) all buildings owned and controlled by company X are included within the carrying amount of Rs. 50 lakh (Completeness assertion).

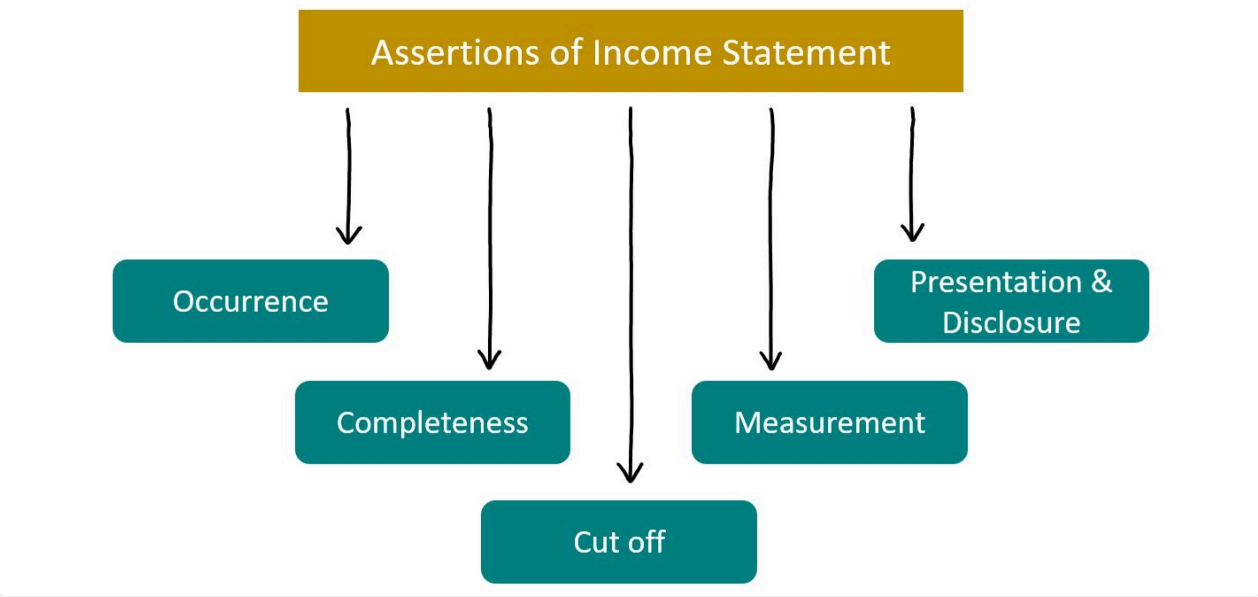
The auditor then needs to draw an audit programme to verify the assertions made by the management by obtaining sufficient and appropriate audit evidences for each of the claims made on Account Balances, Class of Transactions and Related Disclosures.

1. Audit of Financial Statements



In the audit of financial statements, the techniques commonly adopted by the auditors are the following:
1) **Posting checking:** Process of checking, whether debit and credit amounts have been transferred from journal to ledger.
2) **Casting checking:** Process of checking of additions of books of accounts and financial statements.
3) **Physical examination and count:** Physical verification/existence of assets.
4) **Confirmation:** Confirmation with suppliers and customers to verify payable and receivable balances.
5) **Inquiry:** Seeking information of knowledgeable persons, both financial and non-financial, inside or outside the entity.
6) **Bank Reconciliation:** Analyzing bank book of the client and bank balance.

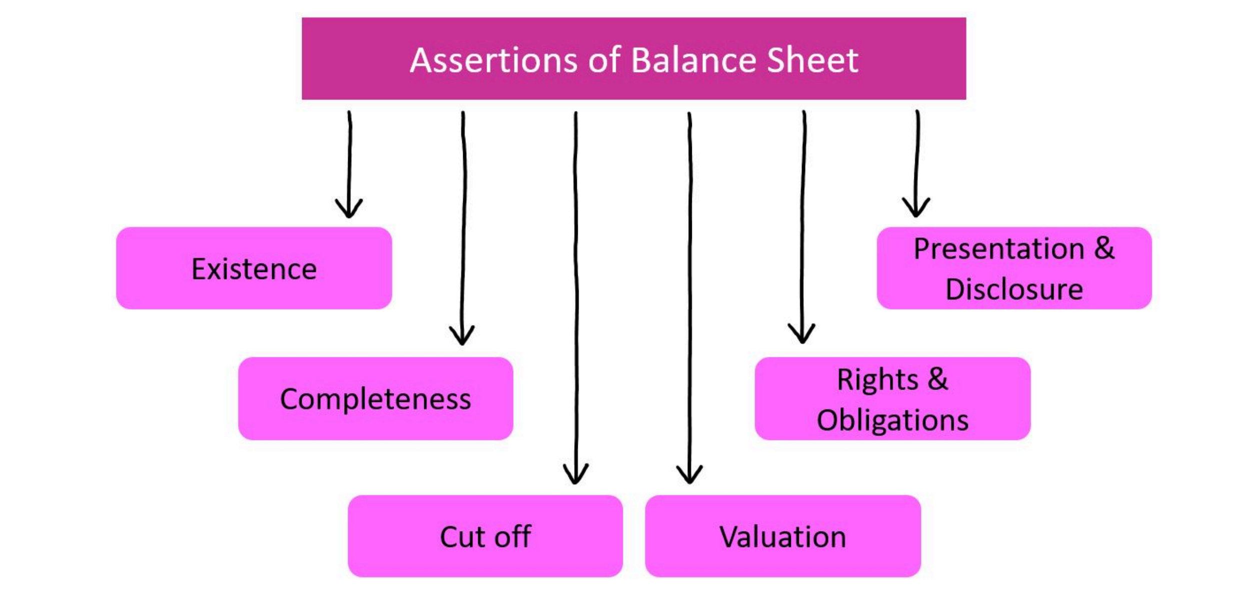
1. Audit of Financial Statements



With respect to income statement, the various assertions can be explained as below.

Assertions	Income statements
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.
Completeness	All transactions that were supposed to be recorded have been recognized in the financial statements. Transactions have not been omitted.
Cut-off	Whether all income and expenses are reported in the correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness.
Measurement	Transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been no errors while preparing documents or in posting transactions to ledger. The figures and explanations are not misstated.
Presentation and Disclosure	Transactions have been classified and presented fairly in the financial statements. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user.

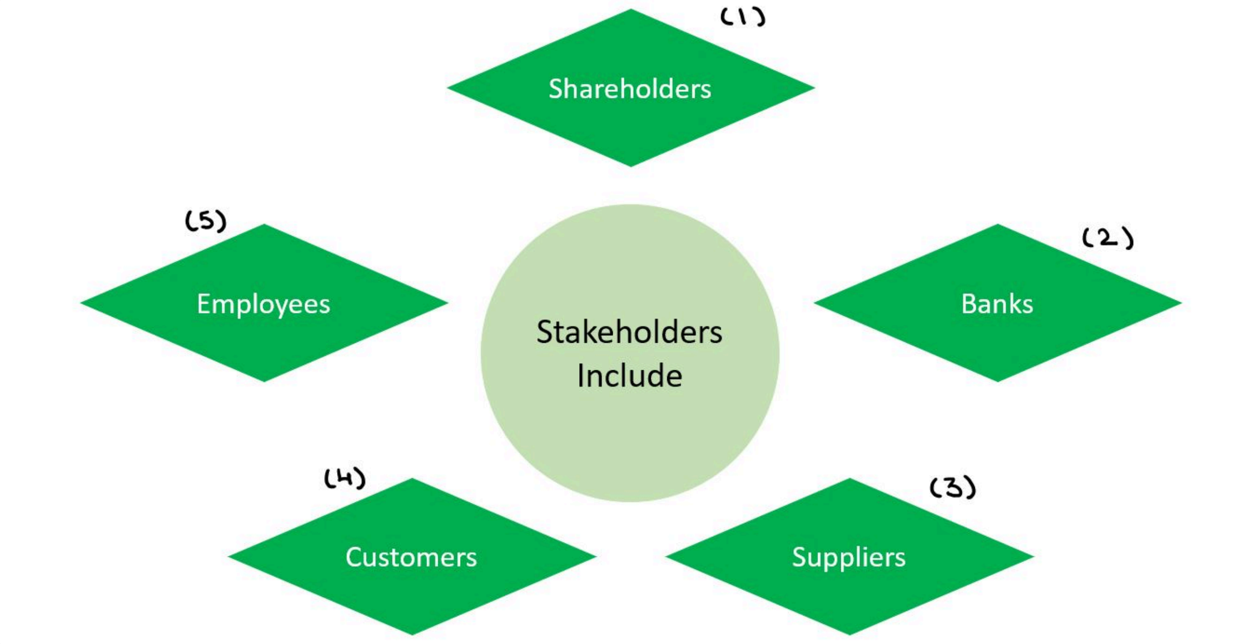
1. Audit of Financial Statements



With respect to balance sheet, the various assertions can be explained as below.

Assertions	**Balance sheet**
Existence	Assets, liabilities and equity balances exist as at the period end.
Completeness	All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.
Cut-off	Whether all assets and liabilities are reported in the appropriate period.
Valuation	Assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate. There has been no overstatement or understatement.
Presentation and Disclosure	Whether particular items in the financial statements are properly classified, described and disclosed. The disclosures that are most susceptible to material misstatement are those that require significant judgment and qualitative assessments. The related disclosures are understandable in accordance with applicable Financial Reporting framework.
Rights and obligations	Entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognized in the financial statements represent all the entity's obligations to repayment as at a given date.

1. Audit of Financial Statements



Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). Companies produce financial statements that provide information about their financial position and performance. This information is used by a wide range of stakeholders (e.g., investors) in making economic decisions. Typically, those that own a company, the shareholders, are not those that manage it. Therefore, the owners of these companies (as well as other stakeholders, such as banks, suppliers and customers) take comfort from independent assurance that the financial statements fairly present, in all material respects, the company's financial position and performance.

To enhance the degree of confidence in the financial statements, a qualified external party (an auditor) is engaged to examine the financial statements, including related disclosures produced by management, to give their professional opinion on whether they fairly reflect, in all material respects, the company's financial performance over a given period(s) (an income statement) and financial position as of a particular date(s) (a balance sheet) in accordance with relevant GAAP. In many cases, this is required by law.

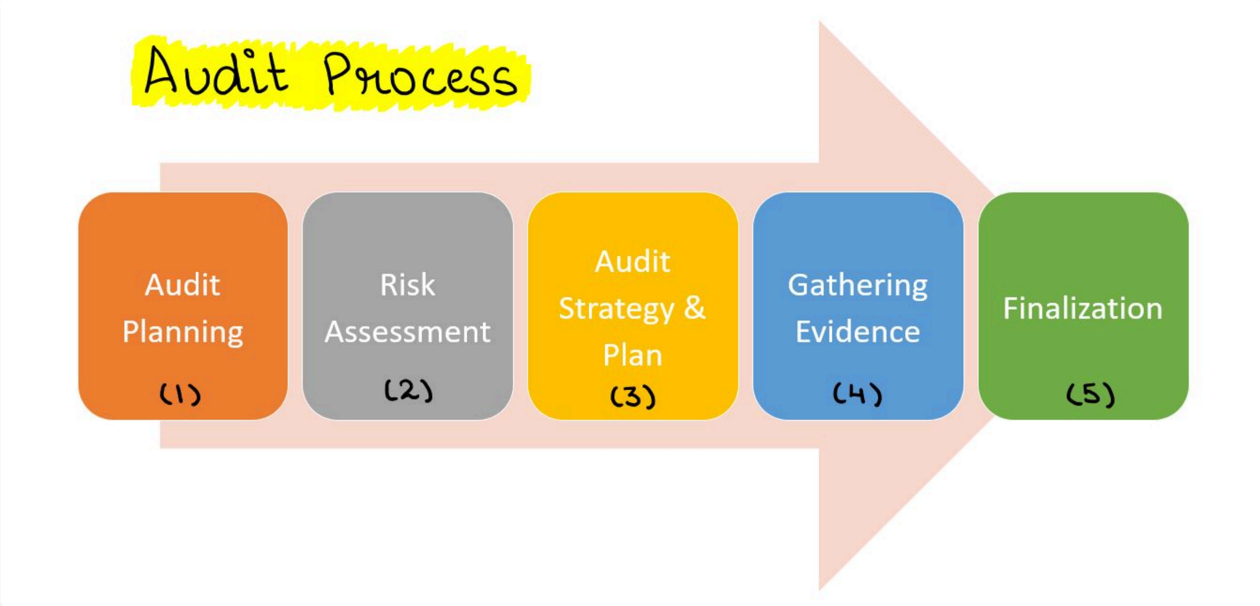
Audit Commitee

The audit committee is a committee of those charged with governance, responsible for the oversight of a company's financial reporting and accounting, financial regulatory compliance, financial risk management processes, and the engagement of and interaction with the company's external auditor on behalf of the company's shareholders. It is typically comprised of a majority of independent non-executive directors.

The auditor's appointment is generally and ultimately approved by the shareholders, in the general meeting, but the auditors are paid by the company itself. The audit committee takes responsibility for overseeing the auditor's independence and performance, and for recommending to the company's highest governing body (typically the board) whether their reappointment should be put to the shareholders at an annual general meeting. The audit committee also reviews the audit fee to satisfy itself that it is competitive yet sufficient to ensure a proper quality audit can be performed.

1. Audit of Financial Statements

Broadly, the audit process can be summarized in 5 phases:



1) Planning

Initial planning activities include formal acceptance of the client by the audit firm, verifying compliance with independence requirements, building the audit team and performing other procedures to determine the nature, timing and extent of procedures to be performed in order to conduct the audit in an effective manner.

2) Risk assessment

Auditors use their knowledge of the business, the industry and the environment in which the company operates to identify and assess the risks that could lead to a material mis-statement in the financial statements. Those risks often involve a high degree of judgement and require a significant level of knowledge and experience by the auditor.

3) Audit strategy and plan

Once the risks have been assessed, auditors develop an overall audit strategy and a detailed audit plan to address the risks of material misstatement in the financial statements. Among other things, this includes designing a testing approach to various financial statement items, deciding whether and how much to rely on the company's internal controls, developing a detailed timetable, and allocating tasks to the audit team members.

4) Gathering evidence

Auditors apply professional skepticism and judgement when gathering and evaluating evidence through a combination of testing the company's internal controls, tracing the amounts and disclosures included in the financial statements to the company's supporting books and records, and obtaining external third party documentation. This includes testing management's material representations and the assumptions they used in preparing their financial statements.

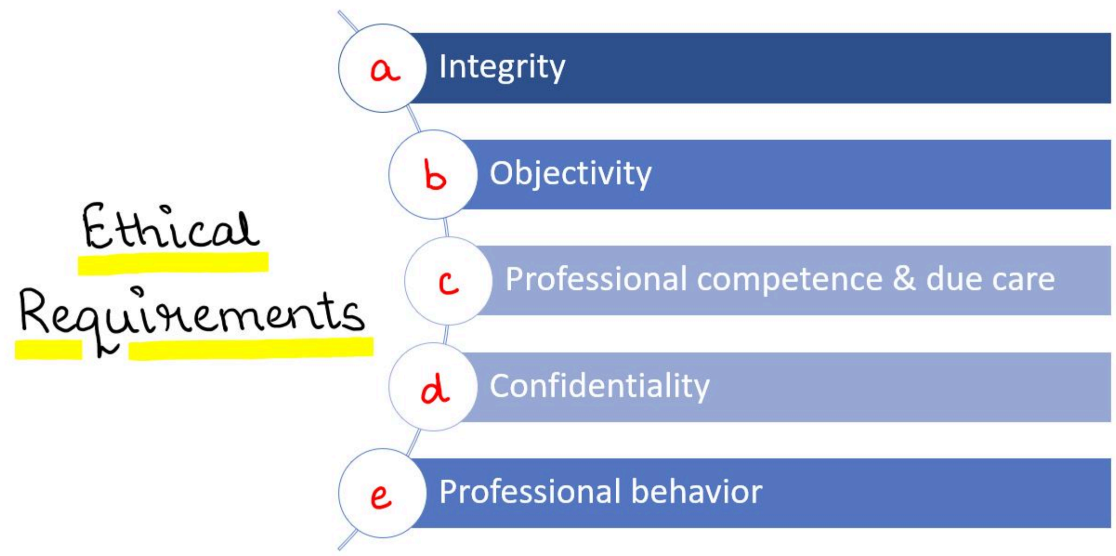
5) Finalization

Finally, the auditors exercise professional judgement and form their overall conclusion, based on the tests they have carried out, the evidence they have obtained and the other work they have done. This conclusion forms the basis of the audit opinion.

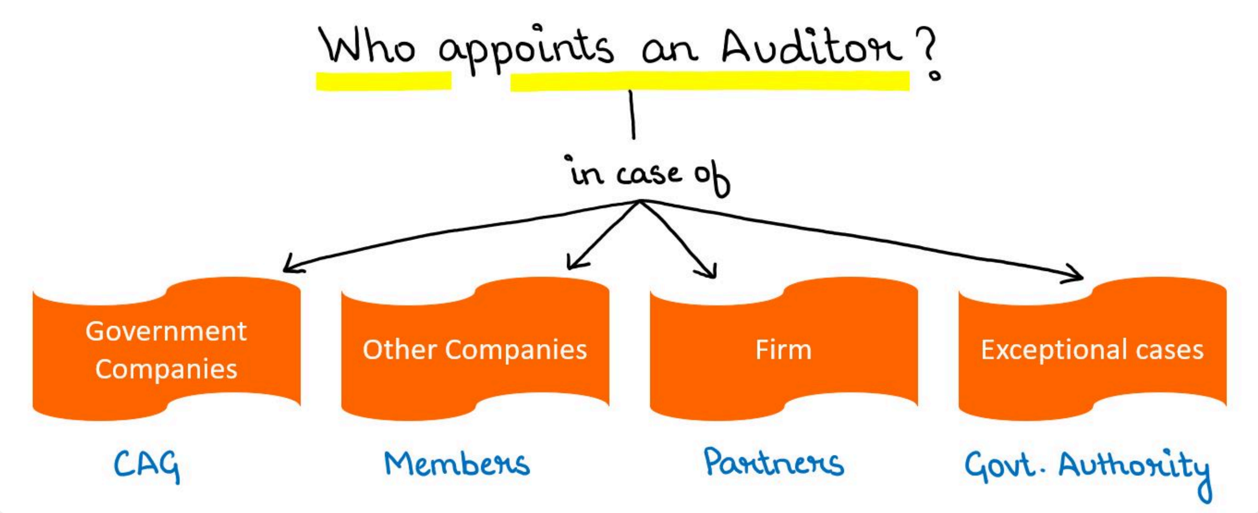
1. Audit of Financial Statements

The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements:



1. Audit of Financial Statements



Generally, an auditor is appointed by owners or in some cases by constitutional or government authorities in accordance with applicable laws and regulations. *For example*, in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM). Shareholders are owners of a company and auditor is appointed by them in AGM. However, in case of government companies in India, auditor is appointed by Comptroller and Auditor General of India (CAG), an independent constitutional authority.

Take case of a firm who engages an auditor to audit its accounts. In such a case, auditor is appointed by partners of firm. There may be a situation in which auditor may be appointed by a government authority in accordance with some law or regulation. *For example*, an auditor may be appointed under tax laws by a government authority.

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1. Audit of Financial Statements

The outcome of an audit is written audit report in which auditor expresses an opinion. The reports is submitted to person making the appointment. In case of companies, these are shareholders, in case of a firm, to partners who have engaged him.

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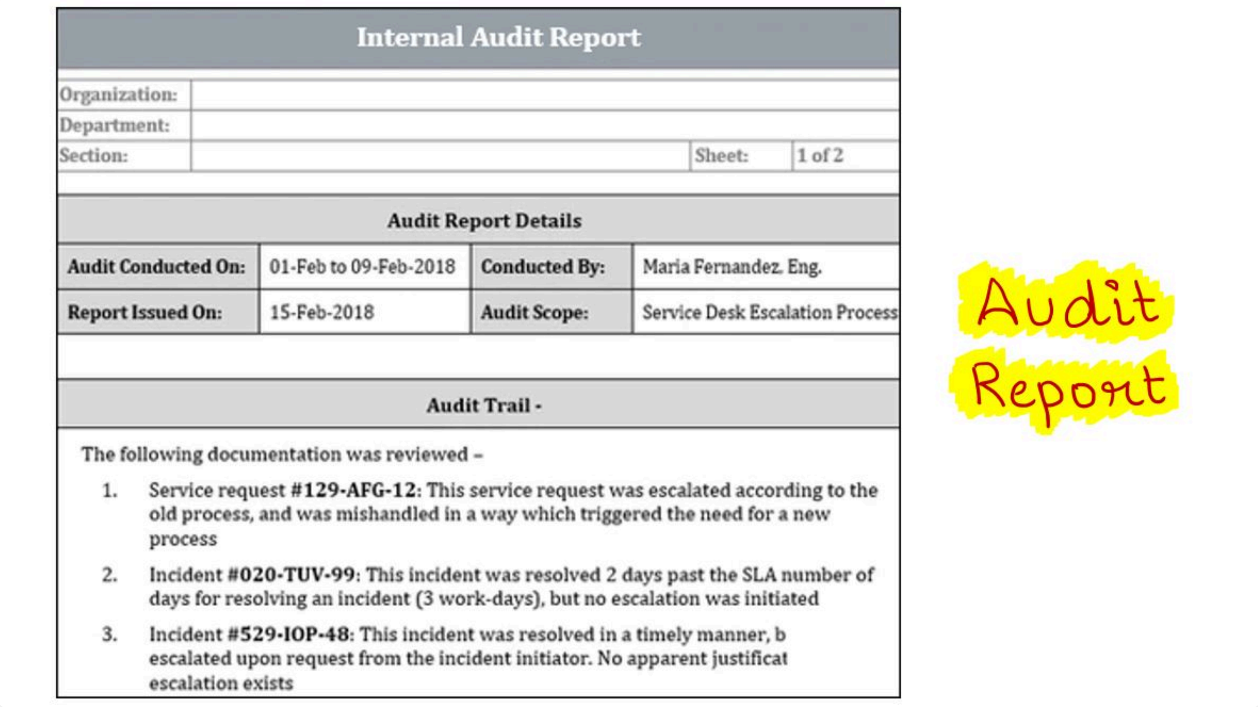
2. Audit Report



Internal Audit Report

Organization:			
Department:			
Section:		Sheet:	1 of 2

Audit Report Details

Audit Conducted On:	01-Feb to 09-Feb-2018	**Conducted By:**	Maria Fernandez. Eng.
Report Issued On:	15-Feb-2018	**Audit Scope:**	Service Desk Escalation Process

Audit Trail -

The following documentation was reviewed –

1. Service request **#129-AFG-12**: This service request was escalated according to the old process, and was mishandled in a way which triggered the need for a new process
2. Incident **#020-TUV-99**: This incident was resolved 2 days past the SLA number of days for resolving an incident (3 work-days), but no escalation was initiated
3. Incident **#529-IOP-48**: This incident was resolved in a timely manner, b escalated upon request from the incident initiator. No apparent justificat escalation exists

For any enterprise, the audit report is a key deliverable which shows the end results of the entire audit process. The users of financial statements like Investors, Lenders, Customers, and others base their decisions and plans on audit reports of any enterprise. An audit report is always critical to influence the perceived value of any financial statement's audit.

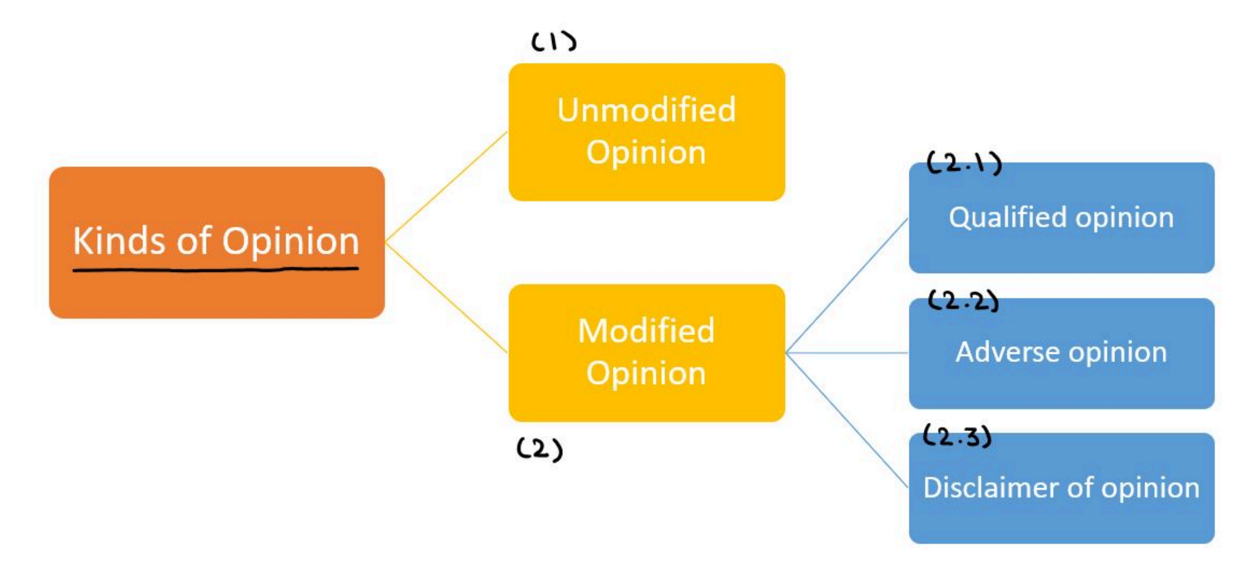
The auditor should be careful in issuing the audit report as there are large number of people placing reliance on such report and taking decisions accordingly. The report should be issued by being unbiased and objective in discharging the functions. The auditor's report shall be in writing.

2. Audit Report

The basic structure of an audit report as prescribed by the Standards on Auditing is as follows:

Heading	**Brief of contents**
Title	Title should mention that it is an 'Independent Auditor's Report'.
Addressee	Should mention clearly as to whom the report is being given to. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited. In case of a company, the report is addressed to the shareholders of the company.
Auditor's Opinion	Should mention the overall impression obtained from the audit of financial statements. For example, Modified Opinion or Unmodified Opinion.
Basis for Opinion	States that the audit was conducted in accordance with Standards on Auditing (SAs). Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
Going Concern	The financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. Financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.
Key Audit Matters	Key audit matters are those matters that, in the auditor's professional judgement are of most significance in the audit of financial statements. Law or regulation may require communication of key audit matters for audits of entities other than listed entities. The key audit matters are generally communicated to the management and those charged with governance.
Responsibilities for the Financial Statements	The responsibility of preparation of financial statements lies on the management. The financial statements should be prepared in accordance with the applicable financial reporting framework.
Auditor's Responsibility	Mention that responsibility of the Auditor is to express an unbiased opinion on the financial statements and issue an audit report.
Location of description of auditor's responsibilities	The description of auditor's responsibilities shall be included within the body of the auditor's report or within an appendix to the auditor's report.
Other Reporting Responsibilities	If any other reporting responsibility exists, the same should be mentioned. For example, Report on Legal or Regulatory requirements etc.
Signature of the Auditor	The engagement partner (auditor) shall sign the audit report.
Place of Signature	The city in which audit report is signed.
Date of Audit Report	Date on which the audit report is signed. The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date.

2. Audit Report



The audit opinion is a key part of the audit report that accompanies the company's financial statements in the annual report. It states the auditor's conclusion on whether the financial statements, including disclosures are presented fairly in all material respects in accordance with the applicable financial reporting framework.

In order to form an audit opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:
a) whether sufficient appropriate audit evidence have been obtained;
b) whether uncorrected misstatements are material, individually or in aggregate;
c) whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

The auditor issues a 'clean' opinion when it concludes that the financial statements are free from material misstatement.

There are primarily 2 kinds of opinions issued by an auditor in his / her audit report; *Unmodified Opinion* (also called Unqualified report) and *Modified Opinion* (also called Qualified report).

1) Unmodified Opinion

It is issued for any audit where the auditor is satisfied that the financial statements present a true and fair view of the operations and transactions in an enterprise during the period. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

An audit report with an Unmodified Opinion is also known as a 'Clean Report'. An Unmodified report develops confidence among users of Financial statements and annual reports of an enterprise. It provides an impression that the financial statements are reasonably free from any misstatements and results as appearing there are true and fair.

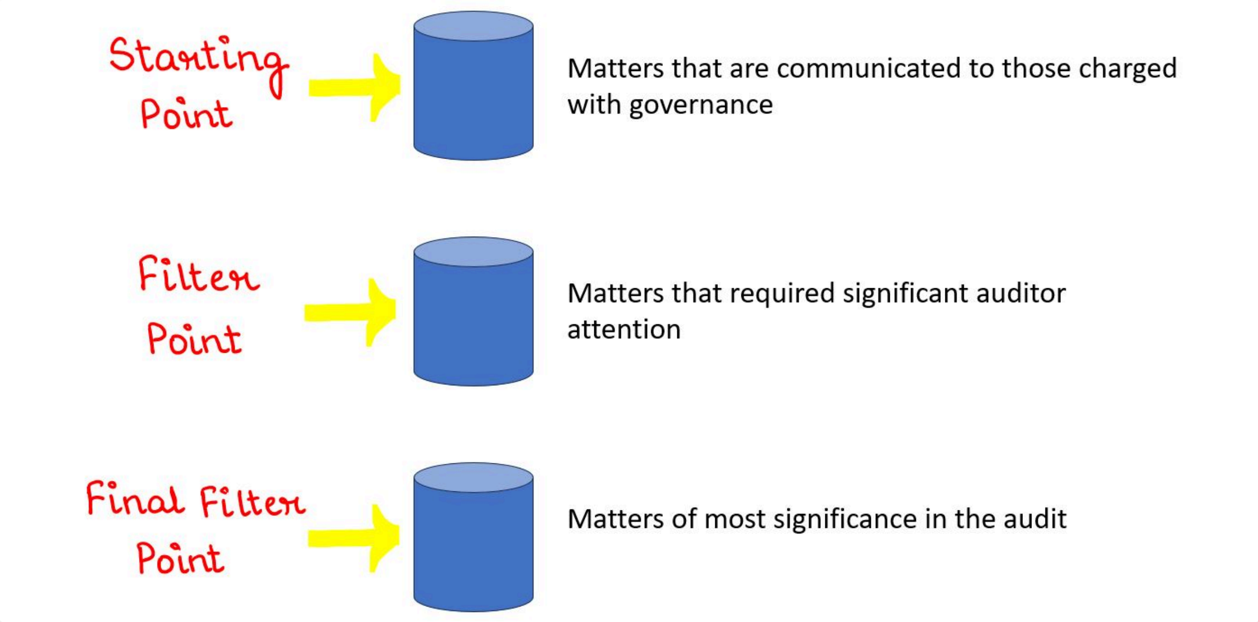
2) Modified Opinion

A Modified Opinion is issued in an audit report, if the auditor concludes that, based on the audit evidence, the financial statements as a whole are not free from material misstatements; or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

There are 3 kinds of modified opinions which are issued according to the findings and circumstances:
a) **A qualified opinion** — the auditor concludes that, except for specific matters explained in the audit report, the financial statements give a true and fair view;
b) **An adverse opinion** — the auditor concludes that the financial statements do not give a true and fair view;
c) **A disclaimer of opinion** — the auditor concludes that the extent of their inability to obtain sufficient appropriate audit evidence is such that it is not possible to form an opinion on the financial statements.

2. Audit Report

SA 701 deals with the auditor's responsibility to communicate key audit matters (KAMs) in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication.



Key Audit Matters are those matters that, in the auditor's professional judgement were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Description of Key Audit Matters

Auditor is required to report in his report a further description of each of key audit matter by stating that:
a) Why the matter was considered to be one of the most significance in the audit
b) How the matter was addressed in the audit
c) Reference to the related disclosures.

Potential examples of Key Audit Matters are as follows.
a) Certain complex areas relating to revenue recognition
b) Provisions and contingencies
c) Taxation matters (multiple tax jurisdictions, uncertain tax positions, deferred tax assets)
d) IT systems and controls. etc.

2. Audit Report

An auditor may include a paragraph in the audit report called Emphasis of Matter Paragraph. **Emphasis of Matter paragraph** is a paragraph included in the auditor’s report that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

Some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph can be:
1) an uncertainty relating to the future outcome of exceptional litigation or regulatory action.
2) a significant subsequent event that occurs between the date of the financial statements and the date of the auditor’s report.
3) early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
4) a major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.

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2. Audit Report

Audit evidence may be defined as the 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.

The quality of audit evidence is affected by the relevance and reliability of the information upon which it is based. The auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements.

Note that while sufficiency is the measure of the quantity of audit evidence, appropriateness is the measure of quality of audit evidence.

The various audit procedures to obtain audit evidence may include inspection, observation, external confirmation, recalculation, reperformance, analytical procedures and inquiry.

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2. Audit Report

Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use. Audit trails help to enhance internal controls and data security.

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2. Audit Report

Audit sampling refers to the application of audit procedures to lesst than 100% of items within a population of audit relevance, such that all sampling units (i.e., all the items in the population) have an equal chance of selection. The objective of auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

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1. Verification and Valuation of Assets and Liabilities

The act of examining/establishing the existence and valuation of Assets and Liabilities may be referred to as **Verification**.

While verifying the assets and liabilities of an entity, an auditor is required to have knowledge of applicable Accounting Standards. *For example*, AS 6 on Depreciation, AS 10 on Property, Plant and Equipment, AS 26 on Intangible Assets, etc. The auditor is further required to check the presentation of various items in the Balance Sheet and Statement of Profit and Loss, *for example*, as per Schedule III to the Companies Act, 2013 in the case of a company.

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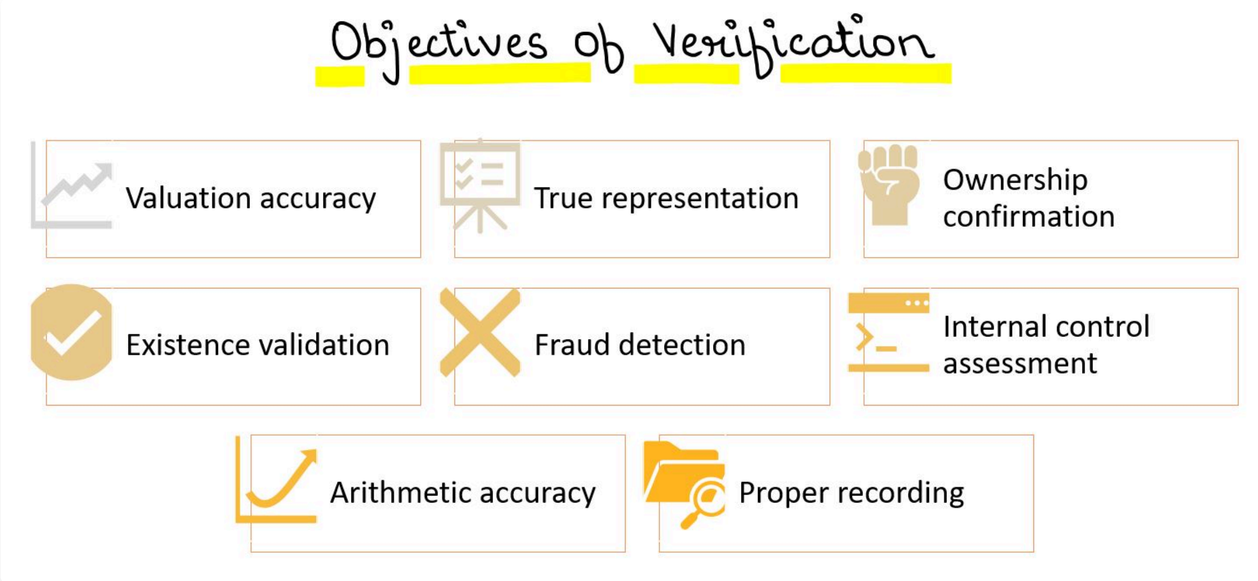
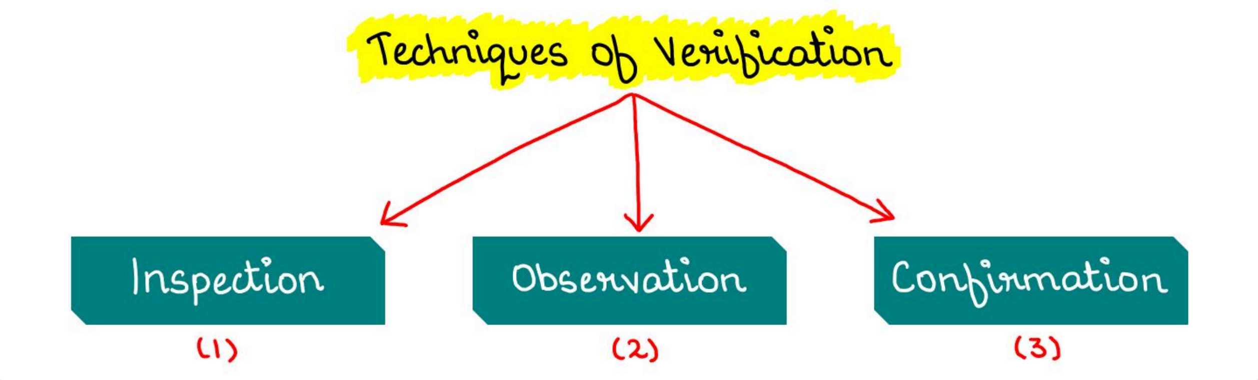
1. Verification and Valuation of Assets and Liabilities



Following are the objectives of verification of assets and liabilities:

1) To show correct valuation of assets and liabilities.
2) To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business.
3) To find out the ownership and title of the assets.
4) To find out whether assets were in existence.
5) To detect frauds and errors, if any.
6) To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.
7) To verify the arithmetic accuracy of the accounts.
8) To ensure that the assets have been recorded properly.

1. Verification and Valuation of Assets and Liabilities



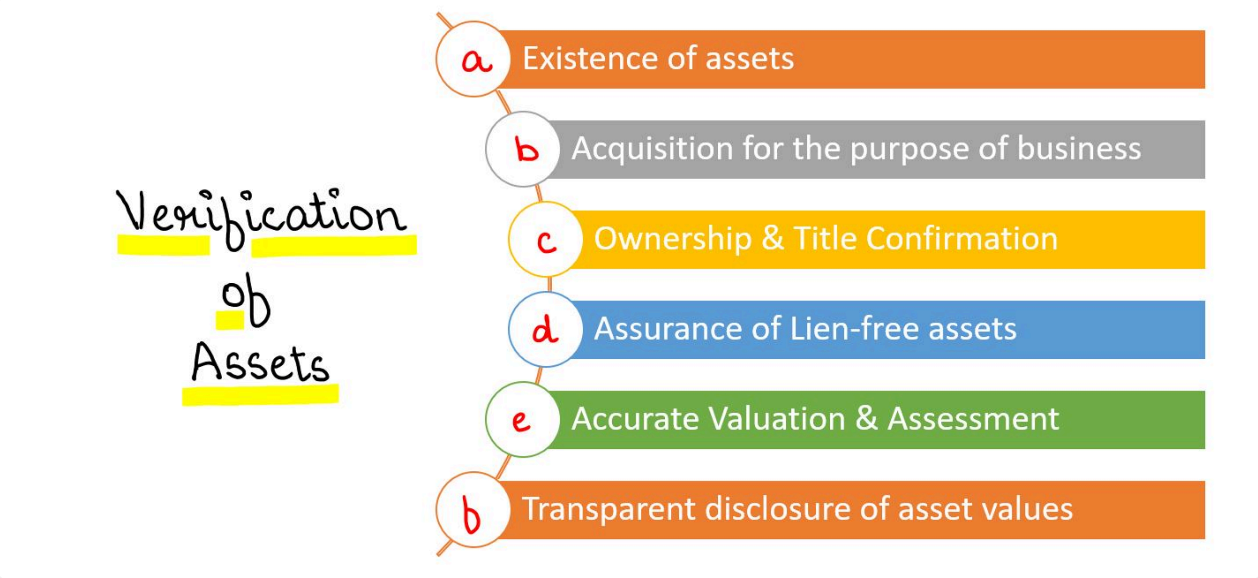
The techniques adopted for the process of verification are as follows:

(a) Inspection
It means physical inspection of the assets, i.e., company's cash in the cash box, physical inventory, inspection of share certificates, documents etc.

(b) Observation
The auditor may observe or witness the inspection of assets done by others.

(c) Confirmation
It means obtaining written evidence from outside parties regarding existence of assets.

1. Verification and Valuation of Assets and Liabilities



Verification of assets is an important audit process.

By convention, its scope has been limited to inspection of assets, where it is practicable, and collection of information about them on an examination of documentary and other evidence so as to confirm:
(a) that the **assets were in existence** on the date of the balance sheet;
(b) that the assets had been **acquired for the purpose of the business** and under a proper authority;
(c) that the **right of ownership** of the assets vested in or **belonged to the undertaking**;
(d) that they were **free from any lien or charge not disclosed** in the balance sheet;
(e) that they had been **correctly valued** having regard to their physical condition; and
(f) that their values are **correctly disclosed** in the balance sheet.

Verification of assets is primarily the responsibility of the management since the proprietor or the officials of the entity are expected to have a much greater intimate knowledge of the assets of the business as regards location, condition, etc. than that which an outsider might be able to acquire on their inspection. Principally, the auditor is required to verify the original cost of assets and to confirm, as far as practicable, that such a valuation is fair and reasonable.

Assets are valued either on a 'going concern' or a 'break-up value' basis. The first mentioned basis considered appropriate when the concern is working and the second, when it has closed down and is being wound-up.

1. Verification and Valuation of Assets and Liabilities

The general principles regarding Verification of Assets can be described as below.

(i) In case of takeover or acquisition

Where a company or a partnership has taken over the assets of a going concern, the agreement of sale should be inspected and that amount paid for them be ascertained. It should be further verified that the allocation of the total cost among the various assets is fair and reasonable.

(ii) In case of piecemeal acquisition

The cost of assets acquired piecemeal should be verified with their invoices, purchase agreements or ownership rights and the receipt of the sellers in respect of the price paid. It should be verified that expenditure on assets newly acquired and that on the renewal and replacement of old assets has been correctly recorded, consistent with the method that has been generally followed in the past.

(iii) In case of sale of assets

When an asset is sold, its sale-proceeds should be vouched by reference to the agreement, containing the terms and conditions of sale, counterfoil of the receipt issued to the purchaser or any other evidence which may be available. If the sale of a fixed asset has resulted in capital profit, it should be transferred to capital reserve. However, the profit limited to the original cost or a loss should be transferred to the Statement of Profit and Loss.

Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

(iv) Provision for depreciation

It is obligatory for a company to provide for depreciation out of the profits, before any profits can be distributed as dividend. The law requires that depreciation should be provided in the manner as specified in Schedule II to the Companies Act, 2013.

(v) Physical verification of assets

The existence of fixed assets, where practicable, should be verified by a physical inspection and/or by comparing the particulars of assets as are entered in the Schedule attached to the Balance Sheet, with the Plant or Property Register and reconciling their total value with the General Ledger balances.

(vi) Inspection of Documents

Wherever possible, all the securities and documents of title, cash, negotiable instruments, etc. representing the assets, should be inspected at the close of the last day of the accounting period.

(vii) Verification of charge or pledge on assets

It should be ascertained that no unauthorised charge has been created against an asset and all the charges are duly registered and disclosed.

In addition, where assets, e.g., government securities, share scrips and debenture bonds are in the custody of a third party other than a bank, these must be inspected.

1. Verification and Valuation of Assets and Liabilities

In order to make clear the concept of verification of assets, the procedure for verification of few assets is explained below.

Verification of Buildings

The verification of building is done in the following manner:
1) Examine the title deeds of buildings to see whether the client holds the title on the balance sheet date. If the property has been mortgaged, the title deeds will be in the possession of the mortgagee, from whom a certificate should be obtained to that effect.
2) Verify the original cost of buildings by reference to the deed of conveyance. If the building is constructed by the client, verify the original cost by reference to the cost as recorded in the books of account of the year in which the construction was completed.
3) Verify that appropriate depreciation has been provided against the buildings. In case no depreciation is provided on the buildings, a note to this effect should be given in the Statement of Profit and Loss.
4) Check the appropriate lease deed, if the building is leasehold, to ascertain the cost, amortization, etc. Also ensure that all covenants in the lease deed have been fulfilled by the client.
5) Check that the buildings have been valued at cost less depreciation. If any revaluation has taken place, see the basis of revaluation and ensure that the disclosure of the same has been made.
6) Check that the relevant particulars of buildings have been entered in the fixed assets records maintained by the client.

Advances given to suppliers

The procedure for verification of advances given to suppliers can be explained as under:
a) Obtain schedule of debit balances in trade payables' account and pay particular attention to the age of the balances. Also, scrutinize the bought ledger.
b) Enquiry should be made for long unadjusted outstandings and check as to whether any of them would require provisioning.
c) Examine that the advances have not been shown as deposits in balance sheet.

Confirmation of balances should be obtained and reconciliation be done in case of any discrepancies.

1. Verification and Valuation of Assets and Liabilities

The valuation of various assets can be explained as below.

Fixed Assets

Fixed assets are included in the Balance Sheet at their cost less depreciation and impairment loss. It would be incorrect to value them at their sale price since these are not intended to be sold. For the very same reason, the fluctuations in the market values are ignored even when these are permanent.

Floating Assets

In the case of these assets, the attempt is to include them in the Balance sheet at their realisable value. These, therefore, are valued either at cost or market value whichever is less. The term ‘cost’ refers to purchase price including duties and taxes, freight inwards and other expenditure directly attributable to acquisition less trade discount, rebates, duties drawbacks and subsidies, in the year in which they are accounted. The term ‘market value’ may either refer to “net realisable value” or “the replacement cost.”

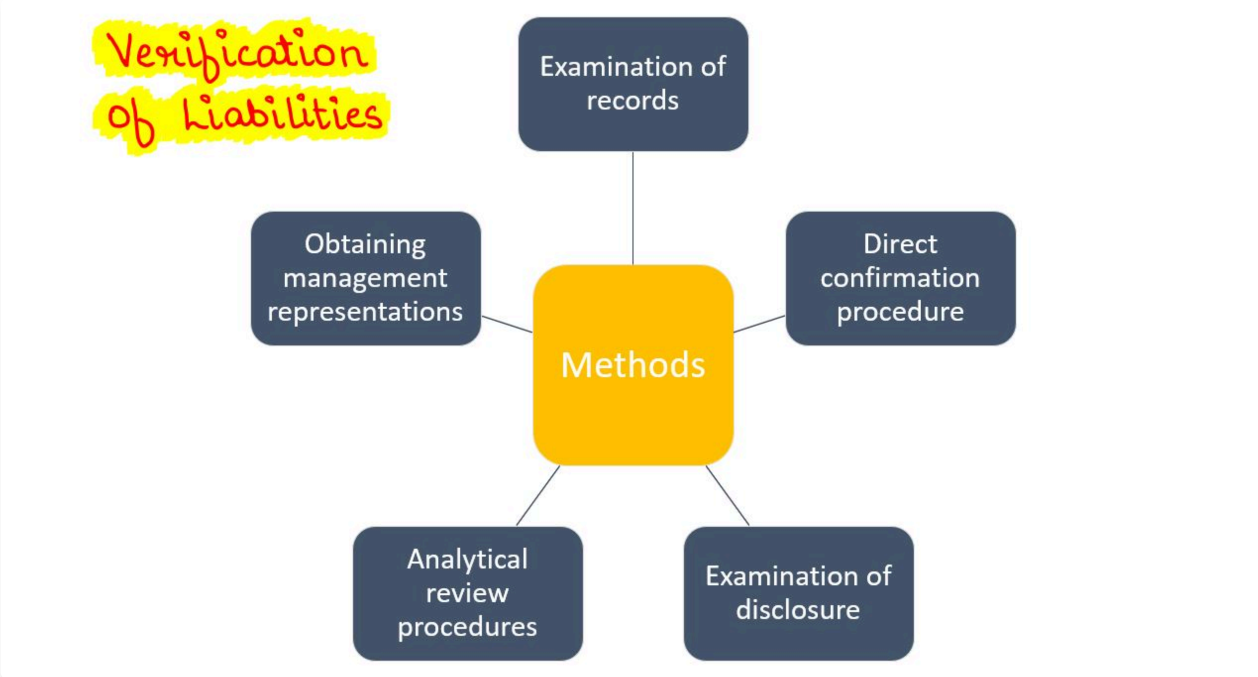
Inventory

Inventory is valued in accordance with AS 2, ‘at cost or net realisable value, whichever is lower’.

Investments

Investments are valued as per AS 13 “Accounting for Investments”. As per AS-13, an enterprise should disclose current investments and long-term investments distinctly in its financial statements. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value. Investments classified as long-term investments should be carried in the financial statements at cost.

1. Verification and Valuation of Assets and Liabilities



Verification of liabilities is as important as that of assets, for, if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the concern.

Verification of liabilities may be carried out by employing the following procedures:

(i) Examination of records
The entities usually maintain detailed records in the form of ledgers showing in respect of each major item the receipts, issues and balances. The extent of examination of these records by an auditor with reference to the relevant basic documents (e.g., accounts payable, supplier's statements, material received notes, etc.) depends upon the facts and circumstances of each case.

(ii) Direct confirmation procedure
The use of direct confirmation using a payables circularization is an option to confirm completeness and valuation, although it is less commonly utilized in practice. The suppliers' statement is considered to be a stronger evidence as compared to a payables' circularization.

(iii) Examination of disclosure
The auditor needs to examine the various disclosures relating to the liabilities such as the parties to the loans, tenure of the loan, interest charged, total processing fees, prepayment terms, and various other information including the terms.

(iv) Analytical review procedures
The comparison of current year figures with the corresponding figures for the previous year is known as analytical review procedures. This may include the following:
1) comparison of closing balances of loans and borrowings, trade payables, etc., with the corresponding figures for the previous year;
2) comparison of the relationship between current year trade payable balances and the current year purchases with the corresponding figures for the previous year;
3) comparison of current year's ageing schedule of trade payables with the corresponding figures for the previous year;
4) comparison of significant ratios relating to loans and borrowings, trade payables, etc., with the similar ratios for other firms in the same industry, if available.

(v) Obtaining management representations
The auditor requires a written representation from the management that the information provided is correct and bonafide.

1. Verification and Valuation of Assets and Liabilities

In order to make clear the concept of verification of liabilities, the procedure for verification of few liabilities is explained below.

Borrowings from a bank

Borrowings from a bank may be either in the form of overdraft limits; or short term or medium term or long-term loans. The audit procedures which an auditor may adopt are outlined below.
1) Ensure that balance as per books of the client and the bank statement tally. In case of difference between the two amounts, reconciliation statement prepared by the client should account for reasons.
2) Examine whether borrowings from the bank have been duly authorized.
3) Examine documents to ensure that statutory requirements, if any, with regards to creation and registration charges have been met.
4) Examine the loan agreement and ensure that the terms therein have been duly complied with.
5) Ascertain the purpose for which loan has been raised and examine whether end use of the funds have been accordingly made.

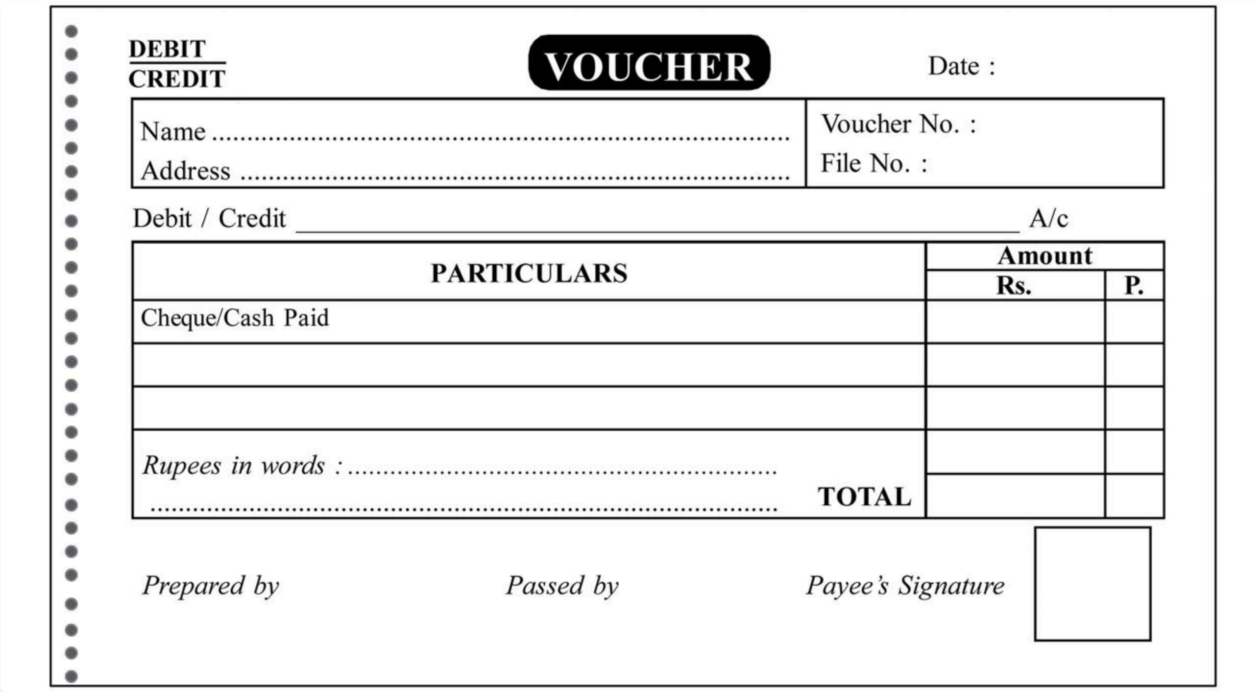
Trade payables

The verification of trade payables can be done in the following manner.
1) Check the adequacy of cut off procedure to ensure that transaction of next period is not accounted and all transactions of year end are accounted.
2) Check posting in the bought ledger from books of prime entry.
3) Compare the balances in the schedule of trade payables with balances in bought ledger.
4) Compare the balances with the confirmation or statement of account received from trade payables.
5) Pay special attention to long outstanding items and enquire about the reason thereof.
6) Verify subsequent payments and reversal entries in the bought ledger of year end entries.

See that trade payables are classified and shown in the balance sheet as per requirement of Schedule III to the Companies Act, 2013.

1. Vouching

Vouching is a method of examination to not only substantiate an entry in the books of account with documentary evidences, but also to see that these evidences are adequate, reliable and really connected with the business. For this, the auditor should go beyond the books of account i.e., he should go to the very source of the transaction to see that it is related to the business and is properly authorized.



DEBIT
CREDIT
VOUCHER
Date :
Name ....
Address ....
Voucher No. :
File No. :
Debit / Credit ________ A/c

PARTICULARS	Amount	
	Rs.	P.
Cheque/Cash Paid		
Rupees in words :		
.... TOTAL		

Prepared by *Passed by* *Payee's Signature*

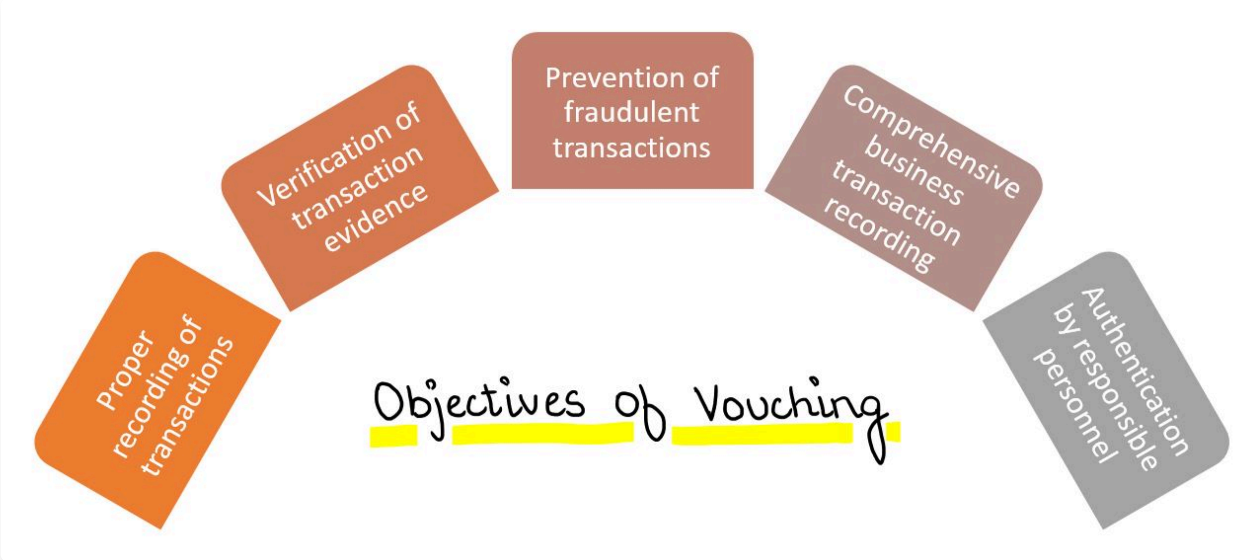
What is a Voucher

A voucher is a documentary evidence produced in support of each and every entry made in the books of account. The vouchers constitute the main source of evidence available to the auditor. Vouchers include lots of documents like purchase invoices, copies of sales invoices, debit/credit notes, bills, cash memos, copies of cash memos, counter-foils of receipts, paying-in-slips, cancelled cheques, receipts given by payees, agreements, minutes of meetings of the companies, insurance policies, order book and all other documents which are created as and when transactions take place. The act of examining vouchers is referred to as 'Vouching'.

The auditor has to keep the following essential points in mind while examining a voucher:
1) that the date of the voucher falls within the accounting period;
2) that the voucher is made out in the client's name;
3) that the voucher is duly authorized;
4) that the voucher comprises of all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and
5) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

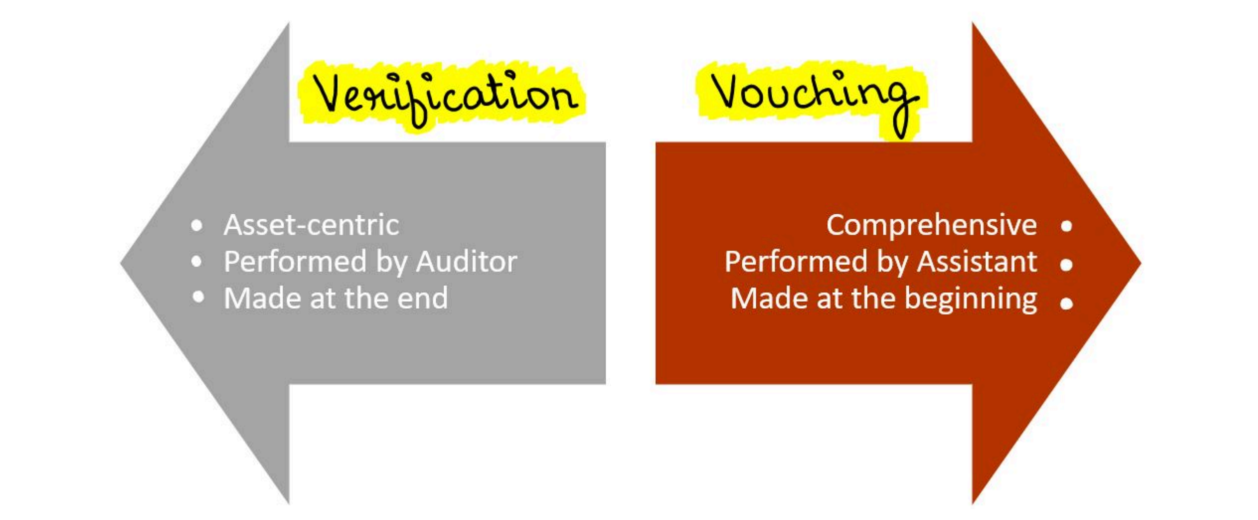
After the examination is over, each voucher should be either impressed with a rubber stamp or initialed so that it may not be presented again in support of another entry.

1. Vouching



The basic objectives of vouching are as under:
1) To ensure that all the transactions are properly recorded in the books of accounts.
2) To see the proper evidence supports all the entries of the transactions.
3) To make sure that fraudulent transactions are not recorded in the books of accounts.
4) To see that all transactions relating to business are recorded in the books of accounts.
5) To see that all transactions are properly authenticated by a responsible person.

1. Vouching



The differences between Verification and Vouching can be described as below.

a) Meaning

Verification is the act of checking title, possession and valuation of assets but vouching is the act of checking the records with the help of evidential documents.

b) Nature

Verification is specially related to the assets and liabilities, but vouching is related to all the accounting documents.

c) Person

Generally, assistant staff or auditor performs the work of vouching but auditor himself performs the work of verification.

d) Time

Vouching is made at the beginning of auditing but verification is made at the end of auditing or at the time of checking balance sheet.

1. Vouching

In order to make clear the concept of vouching, the procedure of vouching of few items is given below.

Vouching of Purchases

Cash purchases should be verified by reference to cash memos or receipted invoices by suppliers. Payments made against credit purchases should be vouched with the receipts issued by the suppliers and the credit to their accounts on the basis of invoices entered in the Purchases Day book. There must be also evidence of the goods having been received through an entry in the Goods Inward Books or inventory ledger.

Vouching of Credit Purchases

The auditor should vouch credit purchases in the following manner.
1) Examine purchase book: The auditor should examine the transactions recorded in the purchase book with reference to related purchase invoice.
2) Examine purchase invoices: The auditor should select a small sample of vendors' invoices at random and should conduct in-depth audit on them i.e., trace the transaction from placing the order to the entries in inventory goods for actual receipt and payment made to the suppliers. In respect of imports, documents such as bill of lading, customs clearance, etc. should be examined. The auditor should ensure that subsidies, rebates, duty drawbacks or other similar items have been properly accounted for.
3) Examine the numerical sequence of source documents: The auditor should ensure the numerical sequence of source documents such as purchase requisitions, purchase orders, receiving reports and vouchers have been maintained and missing numbers have been duly accounted for.
4) Examine cut off points: In order to ensure that purchases were recorded at that point of time when title was passed to the client, the auditor should examine cut-off points on pre-numbered purchase requisitions, purchase orders and goods received notes. The auditor should, then, trace the goods received notes pertaining to a few days before the end of the period under audit to the related purchase invoices. Such a comparison would ensure that purchases represented by such invoices have been recorded as the purchases of the period under audit.

Vouching of Sales

In vouching sales, the primary focus is on detecting any mishandling of cash sales. It's important to verify how cash memos are issued. If cash memos are issued for both cash and credit sales, and if credit sales are collected long after, it's uncertain whether all cash sales were collected by the end of the year or if some collected amounts were misappropriated.

Vouching of Cash Sales

The auditor should vouch cash sales in the following manner.
1) Examine the system of internal check to ascertain any loopholes therein.
2) Ascertain the practice followed in the matter of issuing cash memos and trace the memos into cash sale summary.
3) Ensure that the date of cash memos tally with the entry in the cash book/summary.
4) Verify that prices of goods sold have been correctly recorded and check the calculation.
5) Verify the entry in the goods outward book with the sales summary.
6) Check that the cancelled cash memos are not removed from the receipt book.

Vouching of Advertisement expenses

The advertisement expenses will be vouched in the following manner.
1) Ascertain the nature of advertisement expenses to ensure that the same have been charged properly.
2) Obtain the complete list of advertisement, media wise, i.e., newspapers, slides, hoardings, magazines, television, radio, etc. showing the dates, exact location, timings, etc., along with the amounts paid in respect of each category.
3) Check that advertisement expenses relate to the client's business.
4) Ascertain whether there is a regular contract with an advertising agency. See that regular statements are obtained from the agency showing the advertising media and amounts debited to the client. Discounts, if any, should be properly adjusted and disclosed in the bills.
5) Check the receipts for amounts paid for the advertising expenses incurred.
6) Check that outstanding advertising expenses have been properly disclosed on the liabilities side of the balance sheet.

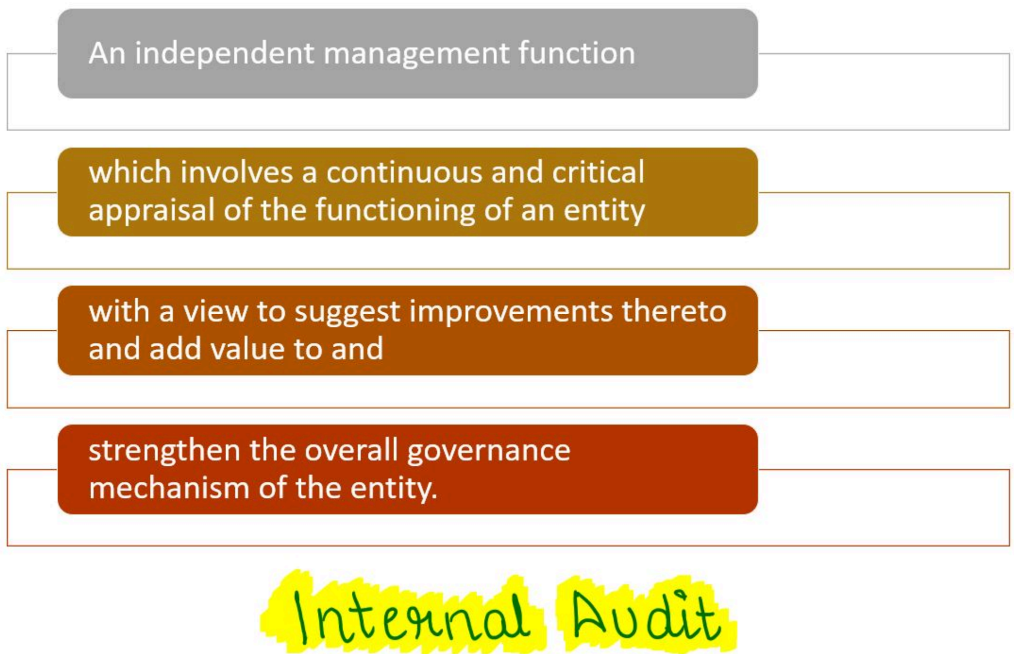
Vouching of Rental receipts

The vouching of rental receipts is done in the following manner.
1) Copies of bills issued to tenants should be test checked by reference to copies of tenancy agreements and bills of charges paid by the landlord on behalf of the tenants, i.e., house tax, water tax, tax deducted at source, electricity consumed, etc.
2) The entries in the Rental Register in respect of rents accrued afterwards should be verified by reference to copies of rental bills.
3) The amounts collected from tenants on account of rent should be checked by reference to receipts issued to them. These afterwards should be traced into the Rental Register.
4) At the end, the register should be scrutinized to find amount or rents which have not been recovered and are considered bad or irrecoverable, for deciding whether these should be written off or as provision against the same should be made.

In similar way, the vouching of other items can be done.

1. Internal Audit

Section 138 read with Rule 13 of the Companies (Accounts) Rules 2014, provides for internal audit in a company. Accordingly, the companies shall appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board.



1. Internal Audit

Category	Requirement
Listed Companies	Must appoint Internal auditor
Unlisted Public Companies	Paid-up capital ≥ Rs. 50 crore
	Turnover ≥ Rs. 200 crore
	Loans ≥ Rs. 100 crore
	Deposits ≥ Rs. 25 crore
Private Companies	Turnover ≥ Rs. 200 crore
	Loans ≥ Rs. 100 crore

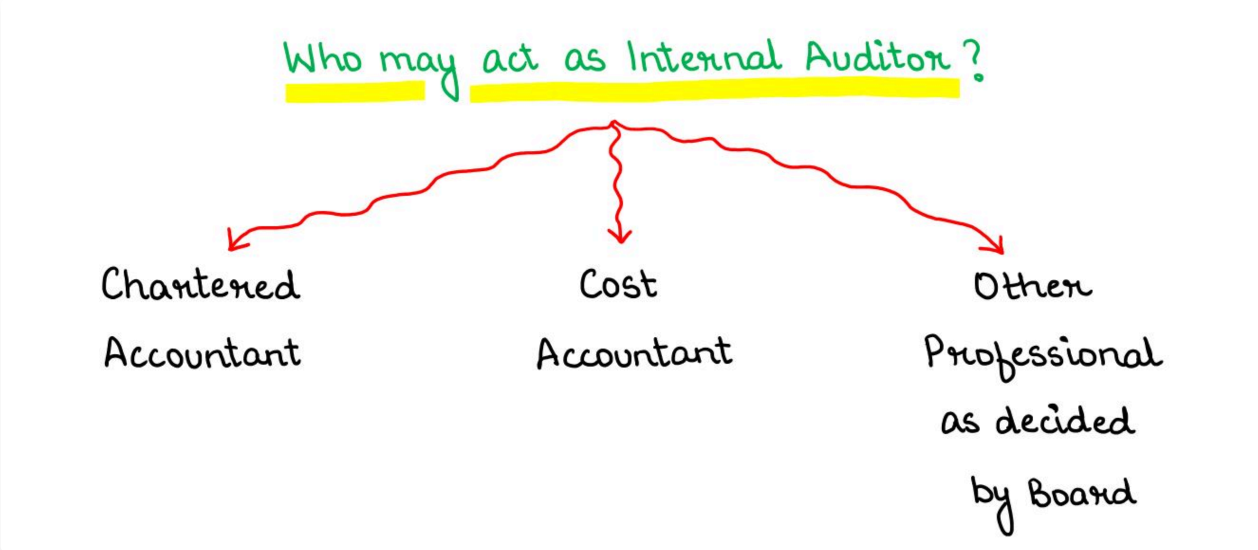
The following companies shall be required to appoint an Internal Auditor, who or which may be either an individual or a partnership firm or a body corporate, namely:
(a) every listed company;
(b) every unlisted public company having:

1. paid up share capital of Rs. 50 crore or more during the preceding financial year; or
2. turnover of Rs. 200 crore or more during the preceding financial year; or
3. outstanding loans or borrowings from banks or public financial institutions exceeding Rs. 100 crore or more at any point of time during the preceding financial year; or
4. outstanding deposits of Rs. 25 crore or more at any point of time during the preceding financial year; and

(c) every private company having:

1. turnover of Rs. 200 crore or more during the preceding financial year; or
2. outstanding loans or borrowings from banks or public financial institutions exceeding Rs. 100 crore or more at any point of time during the preceding financial year.

1. Internal Audit



Internal Auditor shall either be a Chartered Accountant or a Cost Accountant, or such other professional as may be decided by the Board.

The term **Chartered Accountant** or **Cost Accountant** shall mean a **Chartered Accountant** or a **Cost Accountant**, as the case may be, whether engaged in practice or not. The internal auditor may or may not be an employee of the company. The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

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1. Auditing under Companies Act, 2013

Under the Companies Act, 2013, there are various sections relating to appointment, removal, qualifications, disqualifications etc. of auditor.

Let us discuss these sections one by one.

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1. Auditing under Companies Act, 2013

Section 139 of the Companies Act, 2013 provides the provisions for appointment, reappointment, term etc. of auditors.

The provisions of Section 139 are described below.

Appointment of Auditor

(i) Every company shall appoint an individual or a firm as an auditor at the first Annual General Meeting (AGM).
(ii) The auditor shall hold office from the conclusion of 1^{st} AGM till the conclusion of its 6^{th} AGM and thereafter till the conclusion of every 6^{th} AGM.
(iii) The auditor shall be appointed by the audit committee or Board of Directors depending upon the type of company.
(iv) Before the appointment is made, a written consent and a certificate of eligibility shall be obtained from the auditor. After the appointment is made, the company shall inform the Registrar within 15 days of appointment. Here, "appointment" includes re-appointment.

Thus, the tenure of an auditor in any company, as specified by Section 139 of the Companies Act, 2013, is generally for a period of 5 years.

Constitution of Audit Committee

An Audit Committee is mandatory for following types of companies:
1) every listed public companies
2) all public companies with a paid-up capital of Rs. 10 crore or more;
3) all public companies having turnover of Rs. 100 crore or more;
4) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore or more.

Term of an Auditor

(i) Listed companies and other prescribed classes of companies (except one person companies and small companies) shall not appoint or re-appoint:
a. an individual as auditor for more than 1 term of 5 consecutive years; and
b. an audit firm as auditor for more than 2 terms of 5 consecutive years.

The prescribed classes of companies include the following:
a. all unlisted public companies having paid up share capital of Rs. 10 crores or more;
b. all private limited companies having paid up share capital of Rs. 50 crore or more;
c. all companies having paid up share capital of below the threshold limit of Rs. 10 crores and Rs. 50 crore mentioned above, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.

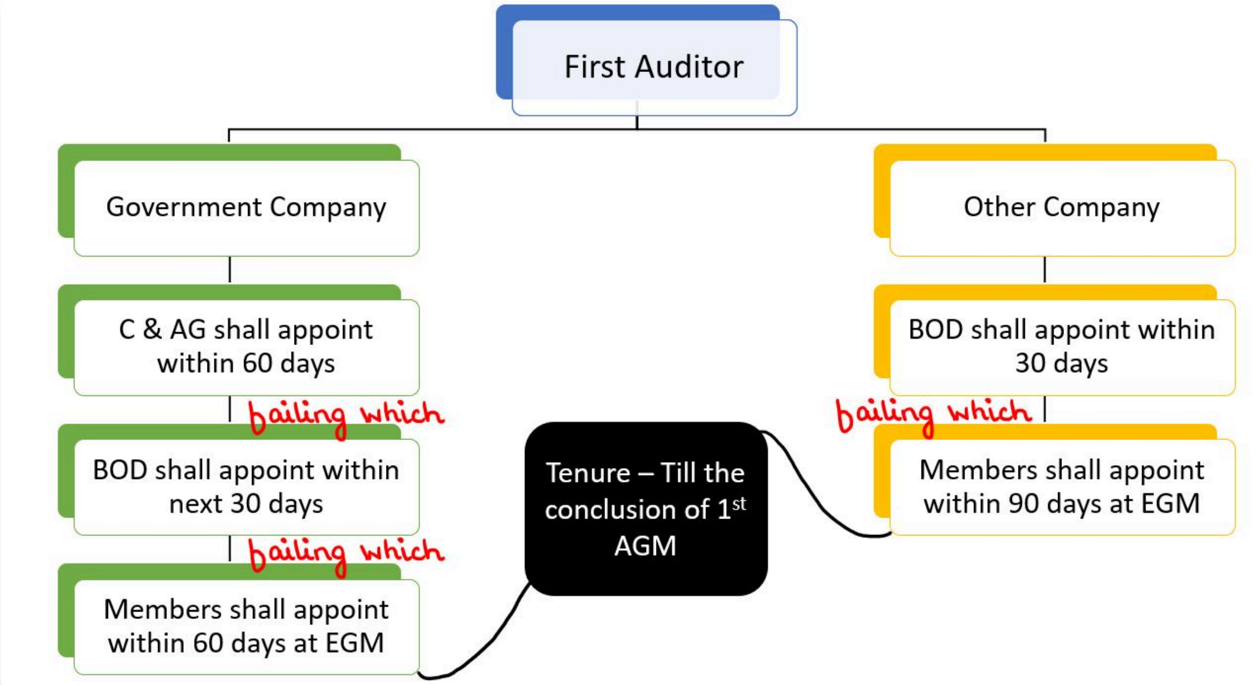
Cooling Period

Cooling period regulations aim to ensure rotation and prevent the same auditor or audit firm from holding office continuously for extended periods, promoting independence and fresh perspectives in auditing practices.

Accordingly, an individual auditor/ audit firm which has completed its term (i.e., one term of 5 consecutive years, in case of an individual auditor or two terms of 5 consecutive years, in case of an audit firm) shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term.

Further, as on the date of appointment, an audit firm shall not be appointed as auditor of the same company for a period of 5 years, which has a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year.

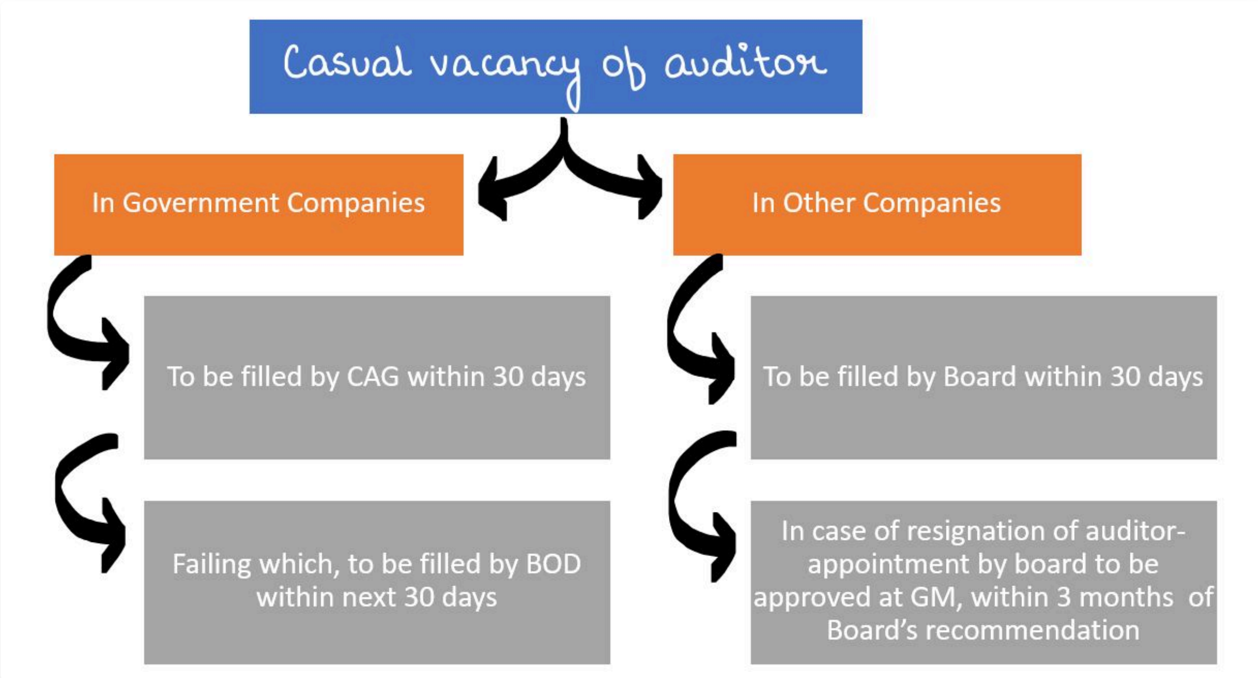
First Auditors



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 and failing which, the Board shall inform the members of the company, who shall within 90 days at an EGM, appoint such auditor to hold office till the conclusion of the first AGM.

Filling up casual vacancy

When the office of auditor gets vacant due to death, resignation or disqualification etc., it results into a casual vacancy. The Board of Directors may fill any casual vacancy within 30 days.



If vacancy is caused by Resignation, appointment by Board shall also be approved by Company at General Meeting convened within 3 months of the recommendation of the Board.

Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

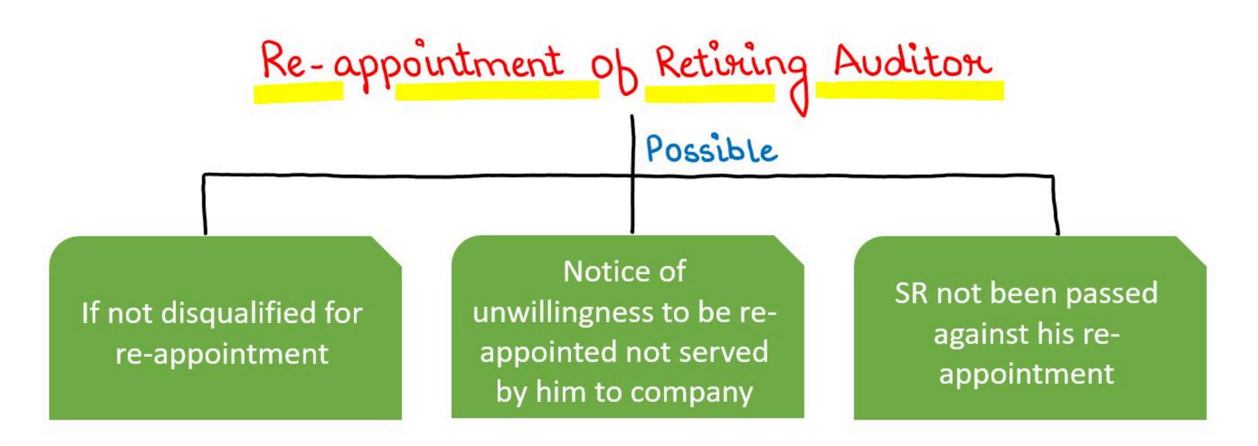
Appointment of auditors in case of Government Company

The auditor in Government Company or a company controlled by State or Central Government, is appointed by the Comptroller and Auditor-General of India (CAG). The auditor shall be appointed within a period of 180 days from the commencement of the financial year and shall hold office till the conclusion of AGM.

The *first auditor* in such companies shall be appointed by the CAG within 60 days from the date of registration of the company. In case the CAG fails to do so, 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 EGM (Extraordinary General Meeting), who shall hold office till the conclusion of the first AGM.

Any *casual vacancy* of an auditor shall be filled by the CAG within 30 days. In case the CAG does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

Re-appointment of retiring auditor



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

Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

1. Auditing under Companies Act, 2013

Section 140 of the Companies Act, 2013 provides for removal, resignation of auditor and giving of special notice. The relevant provisions are as follows.

Removal of auditor before the expiry of his term

An auditor may be removed from his office before the expiry of his term only by a special resolution of the company and after obtaining the previous approval of the Central Government. The application for approval shall be made within 30 days of the resolution passed by the Board.

The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

Giving opportunity of being heard (Audi Alteram Partem)

Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

Resignation by Auditor

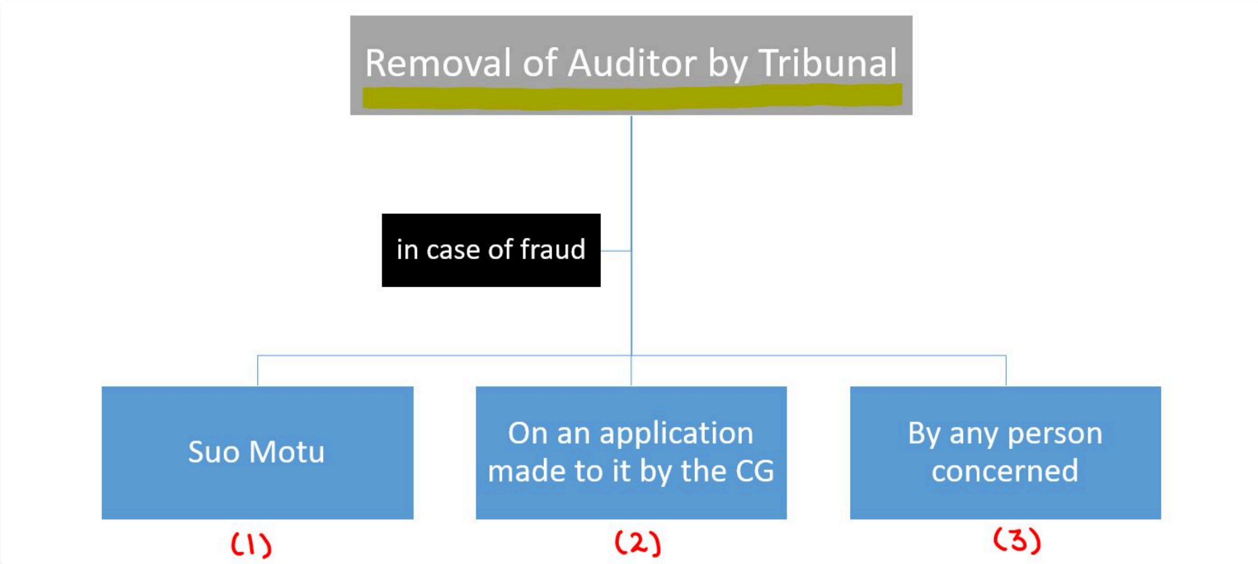
If the Auditor has resigned from company, he shall file a statement in prescribed form with the company and Registrar within a period of 30 days from the date of such resignation. The statement shall include the reasons and other relevant facts for resignation.

In case of government companies or companies controlled by Central Government or State Government, the auditor shall file such statement with the CAG along with the Company and Registrar.

Appointing Auditor other than the Retiring Auditor

If the retiring auditor has not completed a consecutive tenure of 5 or 10 years, a special notice shall be required for a resolution at an AGM, to appoint as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed. A copy of such special notice shall also be sent to the retiring auditor.

The retiring auditor can make representation in writing to the company and request its notification to members of the company.



Auditor acts in a fraudulent manner or abetted or colluded in any fraud

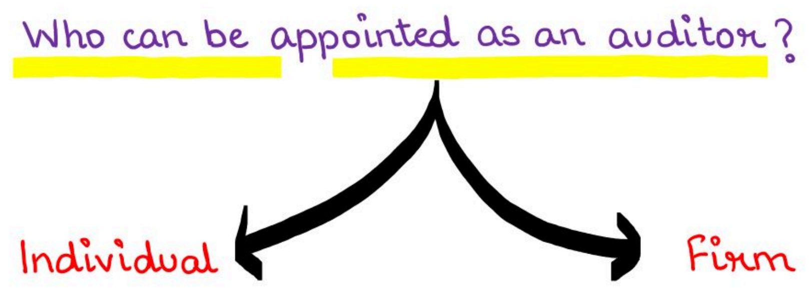
If the Tribunal is satisfied that the auditor of a company has acted in a fraudulent manner or abetted or colluded in any fraud, it may direct the company to change its auditors. The Tribunal can act as such, either:
1) suo motu, or
2) on an application made to it by the Central Government, or
3) by any person concerned.

Where the application is made by the Central Government, the Tribunal shall within 15 days of receipt of such application, make an order that the alleged auditor shall not function as an auditor and the Central Government may appoint another auditor in its place.

An auditor, against whom final order has been passed by the Tribunal, 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. Such an auditor shall also be liable for action under Section 447 (punishment for fraud) of the Companies Act, 2013.

1. Auditing under Companies Act, 2013

Section 141 of the Companies Act, 2013 provides for eligibility, qualifications and disqualifications of auditors. The relevant provisions of Section 141 are given below.



Qualifications of an auditor

A person shall be eligible to be appointed as an auditor of a company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

A firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Where a firm including a Limited Liability Partnership is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorized to act and sign on behalf of the firm.

Disqualifications of an auditor

The following persons **shall not be qualified** for appointment as auditor of a company:

(i) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(ii) an officer or employee of the company;

(iii) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(iv) a person who, or his relative or partner,
1. is holding any security or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company (i.e. fellow subsidiary). However, if the relative holds security or interest in the company of face value not exceeding Rs. 1,00,000, such person is not disqualified. Where the relative acquires any security or interest above the prescribed threshold i.e. Rs. 1,00,000, the corrective action to maintain the limits shall be taken by the auditor within 60 days of such acquisition or interest.
2. is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 5,00,000; or
3. has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 1,00,000.

(v) a person or a firm who, has business relationship with the company, or its subsidiary or its holding or associate company or subsidiary of such holding company or associate company. The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except:
1. commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949;
2. commercial transactions which are in the ordinary course of business of the company at arm’s length price like sale of products or services to the auditor as customer by the companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

(vi) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(vii) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies (other than one person companies, small companies and private companies having paid-up share capital less than Rs. 100 crores).

(viii) a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction;

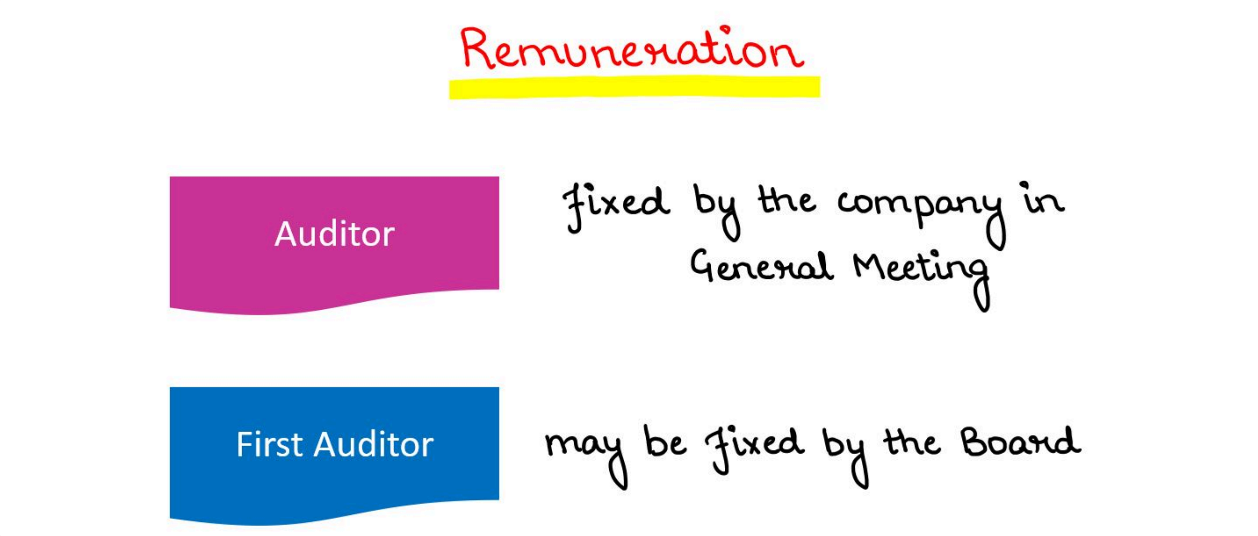
(ix) a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company. (Section 144 is discussed later).

Vacation of office by an auditor

If a person appointed as an auditor incurs any of the disqualifications, he shall be deemed to have vacated his office. Such vacation shall be deemed to be a casual vacancy.

1. Auditing under Companies Act, 2013

Section 142 of the Companies Act, 2013 provides for remuneration of auditors.

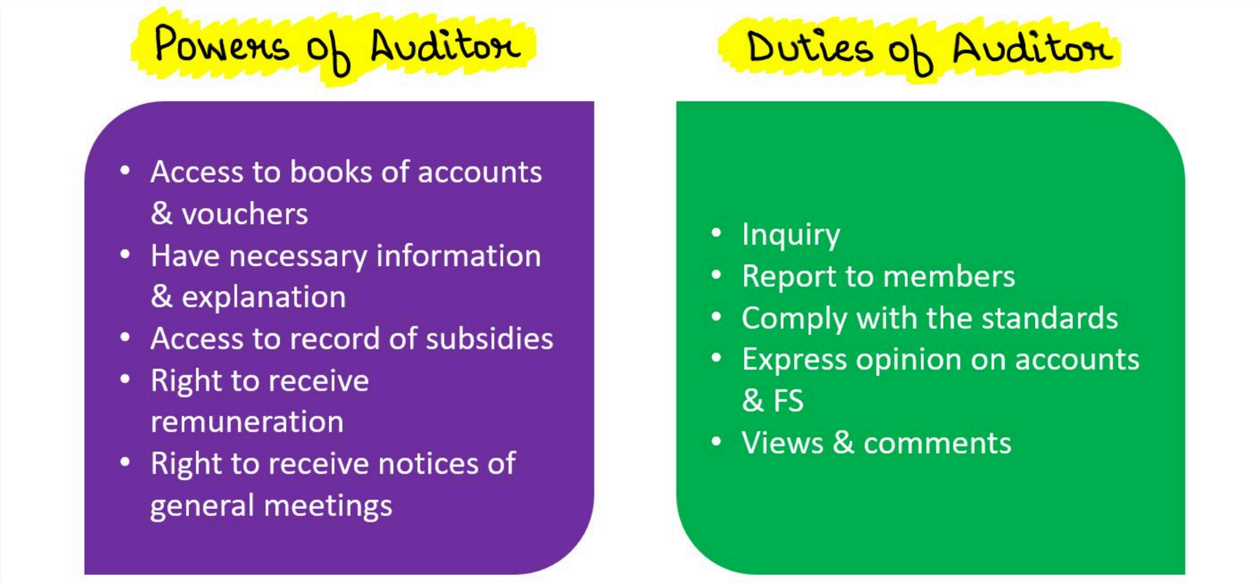


The remuneration of auditors of a company shall be fixed by the company in general meeting. In the case of first auditor, remuneration may be fixed by the Board.

The remuneration mentioned aforesaid shall, in addition to the fee payable to an auditor, **include** the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. But, the remuneration **does not include** any remuneration paid to him for any other service rendered by him at the request of the Company.

1. Auditing under Companies Act, 2013

Section 143 of the Companies Act, 2013 provides provisions related to powers and duties of auditors and auditing standards.



Powers/Rights of Auditors

The following are the powers/rights of auditors:
(i) **Access to books of accounts and vouchers:** Every auditor shall have a right of access to the books of accounts and vouchers of the company.
(ii) **Entitled to have necessary information and explanation:** The auditor shall be entitled to require from the officers of the company such information and explanations as he may consider necessary.
(iii) **Access to record of all its subsidiaries:** The auditor of a holding company shall have the right of access to the records of all its subsidiaries and associate companies, in so far as it relates to the consolidation of its financial statements with that of such subsidiaries and associate companies.
(iv) **Right to receive remuneration:** On completion of his work, an auditor is entitled to his remuneration.
(v) **Right to receive notices of General Meetings:** The auditor of the Company has a right to receive notices of any general meeting of the Company.

Duties of Auditors

The following are the duties of auditors:

(i) **Matters of inquiry:** The auditor has the duty to inquire into the following matters:
a. Whether loans and advances made by the company on the basis of security have been properly secured and also whether terms and conditions of such loans and advances have been made prejudicial to the interests of the company or its members;
b. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
c. Whether the company (not being an investment company or a banking company) has sold its shares, debentures and other securities, at a price less than the purchase price;
d. Whether loans and advances made by the company have been shown as deposits;
e. Whether personal expenses have been charged to revenue account;
f.Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(ii) The auditor shall make a **report to the members** of the company on the following:
a. On the accounts examined by him; and
b. On every financial statement which are required by the Companies Act, 2013 to be laid before the company in general meeting.

(iii) The auditor shall **comply with the provisions of Companies Act, 2013, accounting and auditing standards**, while making the audit report.

(iv) The auditor shall **express his opinion on the accounts and financial statements** examined by him, to the best of his information and knowledge, whether the financial statements give a true and fair view of the state of company's affairs as at the end of the financial year.

(v) The **auditors' report shall also state**:
a. whether the auditor has obtained all necessary information required for the purpose of audit, and if not, the details thereof, and its effect on financial statements;
b. whether, in his opinion, proper books of accounts as required by law, have been kept by the company and proper returns as necessary for the purpose of audit have been received from those branches (of the company) not visited by him;
c. the report on accounts of branch office of the company, in case, branch office accounts have been audited by person other than statutory auditor;
d. whether the company's balance sheet and profit and loss account dealt within the report are in agreement with the books of accounts and returns;
e. whether, in his opinion, the financial statements, comply with the accounting standards;
f. the observations of the auditors on financial transactions or matters which have any adverse effect on functioning of the company;
g. any disqualification of director;
h. any qualification, reservation or adverse remark relating to maintenance of accounts and other connected matters;
i. whether the company has adequate internal financial controls with reference to financial statements and its operating effectiveness;
j. such other prescribed matters.

(vi) The auditor's report shall also include their **views and comments** on following matters, namely:
a. whether the company has disclosed impact of any pending litigation in financial statements;
b. whether the company has made all required provisions with respect to material foreseeable losses, if any, on long-term contracts including derivative contracts;
c. whether there is delay in transferring amounts to Investor Education Protection Fund (IEPF) by the company.

(vii) Where any of the matters is answered in negative or with qualification, the auditor's report shall state the reason for the same.

(viii) If an auditor of a company has reason to believe of **committing of an offence of fraud** of Rs. 1 Crore or above, by its officers or employees, the auditor shall **report the matter to the Central Government** within the prescribed time period.

(ix) Every auditor shall **comply with auditing standards**, as prescribed by the Central Government (as recommended by ICAI in consultation with NFRA- National Financial Reporting Authority).

(x) In case of specified companies, the auditor's report shall also include a **statement on specified matters. CARO 2020** (i.e., Companies (Auditor's Report) Order, 2020), issued by MCA, should be complied by the statutory auditor of every company on which it applies.

1. Auditing under Companies Act, 2013

There are certain particular issues which are important to be reported with the financial statements for certain entities as a part of their audit reports. Therefore, MCA, in the form of CARO 2016, has mandated the auditor of such prescribed entities to report on the points mentioned under the said order after performing procedures for verification of the same. This order applies to foreign companies also and, thus, the auditors for such companies are also required to report on the matters specified in CARO, 2016.

Applicability of CARO 2016

CARO 2016 is applicable to all the companies **except the following** which are specifically excluded from its purview, i.e.,
1) Banking Company
2) Insurance Company
3) Company registered for Charitable Purposes
4) One Person Company as defined under Companies Act
5) Small Company as defined under Companies Act.

Further, a **private limited company is also exempt** from the requirements of CARO, 2016, if it is:
a. not a holding or subsidiary of a public company, and
b. whose paid-up capital plus reserves is less than or equal to Rs. 1 Crore as at the reporting date, and
c. whose borrowings are less than or equal to Rs. 1 Crore at any time during the year, and
d. whose revenue is less than or equal to Rs. 10 Crores in the financial year.

1. Auditing under Companies Act, 2013

CARO 2020 is a new format for issue of audit reports in case of statutory audits of companies under Companies Act, 2013. CARO 2020 has included additional reporting requirements after consultations with the National FinaNFRA). CARO 2020 is applicable for all statutory audits commencing on or after 1 April 2021 corresponding to the financial year 2020-21. The order is applicable to all companies which were covered by CARO 2016.

Matters to be specified in CARO, 2016 vis-a-vis CARO 2020

The Company Auditor's Report Order (CARO), 2016 and 2020 includes the following matters on which the auditor is required to report mandatorily:

CARO 2016	**CARO 2020**
Fixed Assets	Details of tangible and intangible assets
Inventory	Details of inventory and working capital
Loans given by Company	Details of investments, any guarantee or security or advances or loans given
Loan to Directors and Investment by the Company	Compliance in respect of a loan to directors
Deposits	Compliance in respect of deposits accepted
Cost records	Maintenance of costing records
Statutory Dues	Deposit of statutory liabilities
Repayment of Loans	Unrecorded income
Utilization of funds	Default in repayment of borrowings
Reporting of Fraud	Funds raised and utilization
Approval of Managerial Remuneration	Fraud and whistle-blower complaints
Nidhi Company	Compliance by a Nidhi Company
Related Party Transactions	Compliance on transactions with related parties
Private Placement or Preferential Issues	Internal audit system
Non-cash transactions	Non-cash dealings with directors
Registration under RBI Act	Registration under section 45-IA of RBI Act
	Cash losses
	Resignation of Statutory Auditors
	Material Uncertainty on meeting liabilities
	Transfer to fund specified under Schedule VII of Companies Act, 2013
	Qualifications or adverse auditor remarks in other group companies

1. Auditing under Companies Act, 2013

If an auditor believes that an offence of fraud, which involves an amount of Rs. 1 crore or above, is committed in the company by its officers or employees, the auditor shall report the matter to the Central Government. In case of a fraud involving amount less than Rs. 1 crore, the auditor shall report the matter to the audit committee constituted under Section 177 or to the Board.

Note: The provisions of Section 143 shall *mutatis mutandis* apply to Cost Accountants conducting cost audit and the Company Secretary in Practice conducting secretarial audit.

1. Auditing under Companies Act, 2013

Section 144 of the Companies Act, 2013 provides for auditor not to render certain services. An auditor shall provide to the company only such other services as are approved by the Board of Directors or the audit committee.

However, the auditor is **prohibited from providing the following services**, directly or indirectly:

1. Auditing under Companies Act, 2013

Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports. In case of firm including LLP, only Chartered Accountants are authorized to act as statutory auditors and sign. The qualifications, observations, or comments on financial transactions or matters, which have any adverse effect on the functioning of the Company mentioned in auditor's report shall be read before the Company in general meeting and shall be open to inspection by any member of the Company.

1. Auditing under Companies Act, 2013

Section 146 of the Companies Act, 2013 provides for auditors to attend general meeting.

It provides that:
(a) all notices and other communications relating to, any general meeting shall be forwarded to the auditor of the company, which means the auditor of the Company has a right to receive notices of any general meeting of the Company.
(b) the auditor shall attend the general meeting either himself or through his authorized representative.
(c) the auditor shall have right to be heard at the meeting, on any part of the business which concerns him as an auditor.

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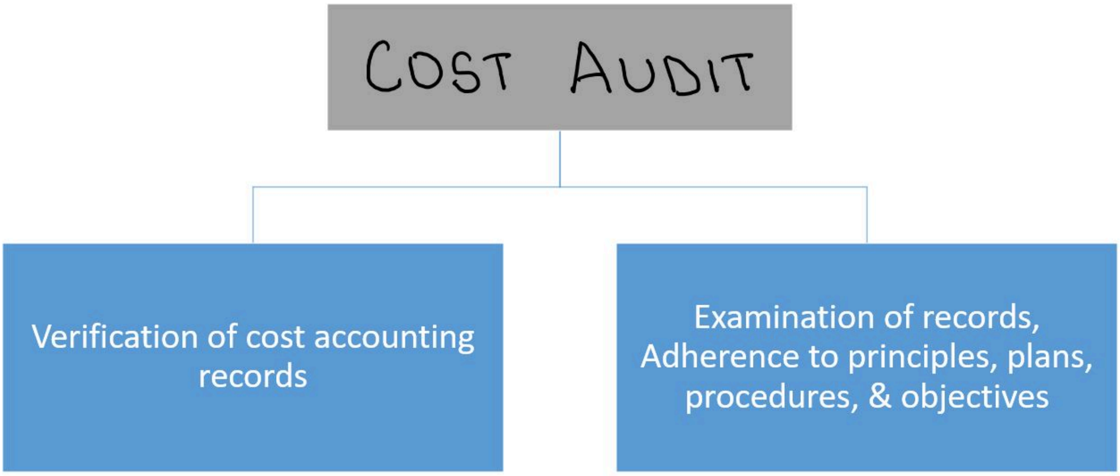
1. Cost Audit



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

Cost audit, therefore, comprises:
(a) verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing techniques, and
(b) examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objectives.

It, therefore, means that the cost auditors attention and approach should be to see that the cost accounting plan is in consonance with the objectives set by the organization and the system of accounting is geared towards the attainment of the objectives.

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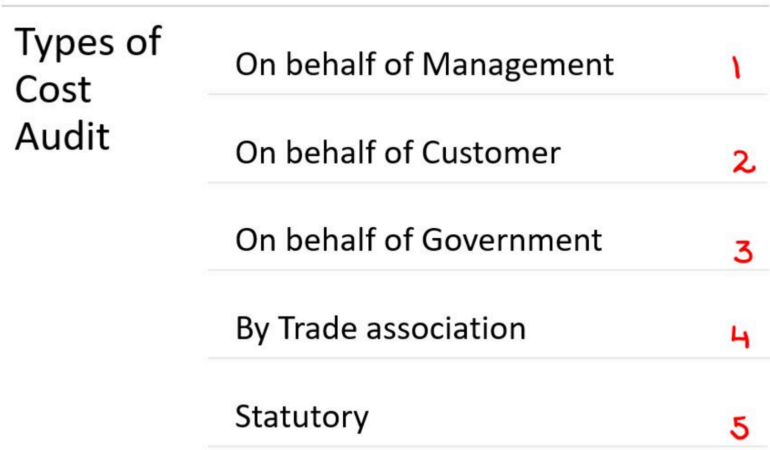
1. Cost Audit



The various types of cost audit are given below.

Cost audit on behalf of the management

The principal object of this audit is to see that the cost data placed before the management are verified and reliable and they are prepared in such detail as will serve the purpose of the management in taking appropriate decisions.

Cost audit on behalf of a customer

In case of contracts, often the buyer or the contractee insists on a cost audit to satisfy himself about the correct ascertainment of cost. The provision for a cost audit in such a circumstance is put in the relevant contract with the stipulation that the supplier or the contractor will extend all co-operation to the cost auditor. The cost of production arrived at for this purpose may differ from the cost of production ascertained for internal purposes.

Cost audit on behalf of Government

Sometimes, government is approached with requests for subsidies, protection, etc. Before taking a decision, the government may prefer to have the cost of production of the product determined on the basis of cost audit to satisfy itself whether the need is genuine or the industry seeking assistance is generally efficiently run. The government, on its own also may initiate cost audit, in public interest to establish the fair price of any product.

Cost audit by trade association

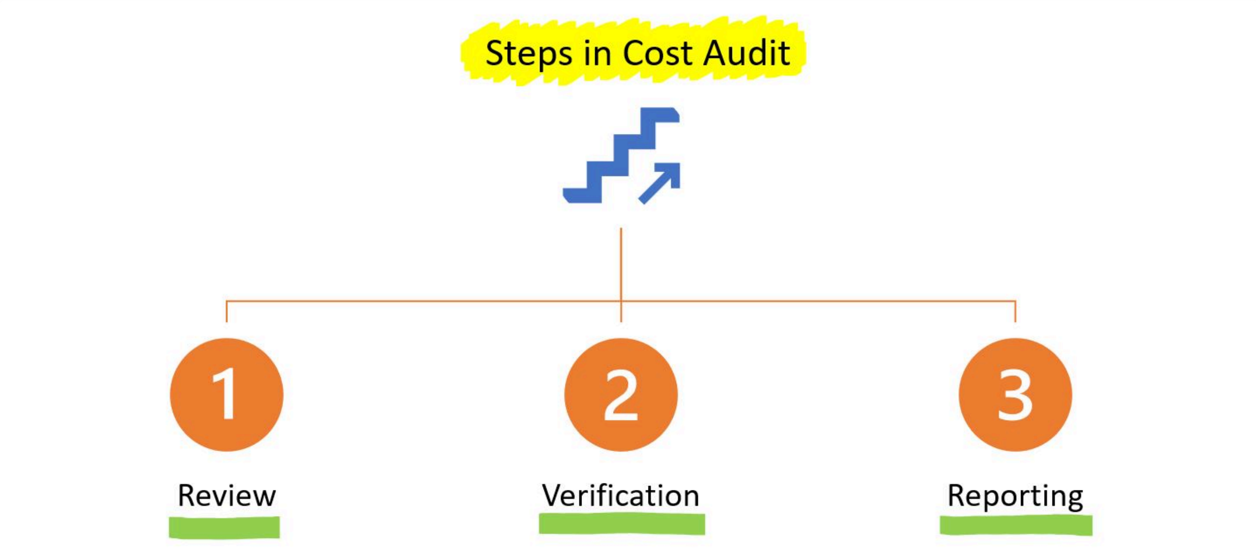
Where activities of a trade association include maintenance of a price of the products manufactured by the member units or where there is pooling or contribution arrangements, the trade association may require the accuracy of costing information submitted by the member-units checked. The trade association may seek full information on the costing system, level of efficiency, utilization of capacity, etc.

Statutory cost audit

Section 148 of the Companies Act, 2013 empowers the Central Government to make the rules in the area of maintenance of cost records by the companies engaged in the specified industries.

1. Cost Audit

Cost audit includes 3 steps, i.e., review, verification and reporting. The steps under cost audit are explained below.



(i) Review

Collection and assimilation of all the relevant information and technicalities about the industry is an essential prerequisite of cost audit. The review includes aspects like:

a. Nature of the industry - priority industry, export-oriented industry etc.;
b. Production method/process;
c. Important raw materials and their sources;
d. Licenced capacity and installed capacity;
e. Method of Stock-taking and its valuation including inventory policies;
f. System of budgetary control;
g. System of internal auditing;
h. Method of costing in use etc.

(ii) Verification of cost statements and other data

The examination of the cost statements and other records by the cost auditor will generally cover the following:

a. Licensed capacity, installed and utilized capacities;
b. Financial ratios;
c. Production data;
d. Cost of raw materials consumed;
e. Cost of power and fuel;
f. Employee costs;
g. Reconciliation with financial books etc.

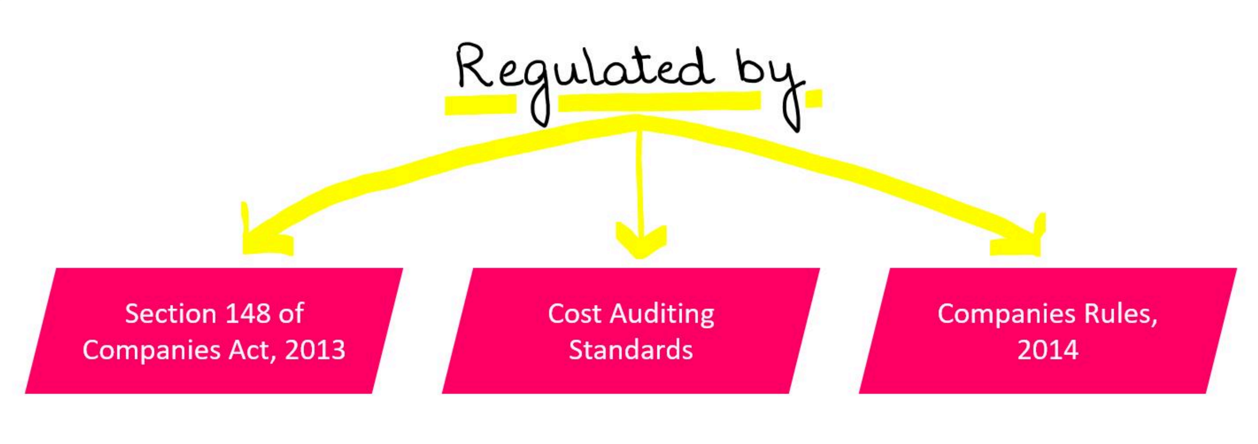
(iii) Reporting

After completion of audit of costing and other relevant records, the cost auditor is required to submit his report. A company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

2. Cost Audit under Companies Act, 2013

Cost Audit is covered by Section 148 of the Companies Act, 2013. As per Section 148, the Central Government may by order specify audit of items of cost in respect of certain companies.

Accordingly, the auditor conducting the cost audit shall also comply with the 'cost auditing standards.' Here, the expression "cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India (ICWA), constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.



In addition, MCA has notified Companies (Cost Records and Audit) Rules, 2014 in relation to maintenance of cost records and cost audit. Let us discuss them one by one.

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2. Cost Audit under Companies Act, 2013

Rule 3 of such Rules provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of Rs. 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account.

These companies **include** Foreign Companies but **exclude** a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006. The said Rule has divided the list of companies into regulated sectors (Part A) and non-regulated sectors (Part B).

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2. Cost Audit under Companies Act, 2013

Further, as per Rule 5 of the said Rules (which provides for Maintenance of Records), every company under these rules, including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in Form CRA-1.

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

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2. Cost Audit under Companies Act, 2013

Rule 4 of such Rules, states the provisions related to the applicability of cost audit depending on the turnover of the company as follows:

(i) **Classes of companies specified under item (A)** "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is Rs. 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under Rule 3 is Rs 25 crore or more.

(ii) **Classes of companies specified under item (B)** "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is Rs. 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under Rule 3 is Rs 35 crore or more.

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2. Cost Audit under Companies Act, 2013

The requirement for cost audit under these rules **shall not apply** to a company which is covered in Rule 3, and,
(i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or
(ii) Which is operating from a SEZ (Special Economic Zone),
(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

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2. Cost Audit under Companies Act, 2013

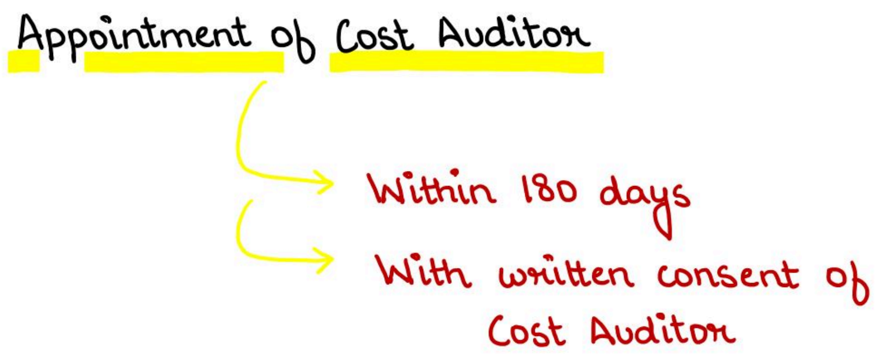
The audit shall be conducted by a Cost Accountant who shall be appointed by the Board.

The qualifications, disqualifications, rights and duties applicable to auditors (i.e. applicable to company auditor) shall apply to a cost auditor appointed under section 148 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

It may be noted that no person appointed under Section 139 as an auditor of the company, shall be appointed for conducting the audit of cost records.

2. Cost Audit under Companies Act, 2013

Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within 180 days of the commencement of every financial year. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him shall be obtained.



2. Cost Audit under Companies Act, 2013

The report on the audit of cost records shall be submitted by the cost accountant to the Board of Directors of the company. A company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language (XBRL) format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015.

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1. Introduction

The Auditing is not confined to Financial Auding only. There are few other types of auditing as well.

Let us discuss some of them one by one.

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2. Environmental Audit

The Environmental Auditing is “a management tool comprising a systematic, documented periodic and objective evaluation of how well environmental organization, management and equipment are performing with the aim of safeguarding the environment and natural resources in its operations/projects”. Environmental audit is done to safeguard the environment and minimize risks to human health.

Objectives of Environmental Audit

The key objectives of an environmental audit are to:

- determine how well the environmental management information systems and equipment are performing;
- verify compliance with the relevant national, local or other laws and regulations;
- minimize human exposure to risks from environmental, health and safety problems.

Environmental audit does not stop at compliance with legislation. Nor is it a ‘green-washing’ public relation exercise. Rather, it is a total strategic approach to the organization’s activities.

In 1993, ISO began work on the ISO 14001 standards for environmental management systems. Incorporated within these standards are guidelines for environmental audit tools and procedures.

An environmental management system (ISO 14001) must comprise:

- An environmental policy;
- An assessment of environmental aspects and legal and voluntary obligations;
- A management system;
- A series of periodic internal audits and reports to top management;
- A public declaration that ISO 14001 is being implemented;
- An environmental audit (ISO 14010) is required to establish that ISO 14001 is being complied with.

ISO 14000 views environmental audit as a management tool which involves both types of auditing:

- Internal audit carried by company’s own staff to look on its own system, procedures and activities in order to ascertain whether they are adequate and are being complied with; and
- An external audit performed by some independent party on the facility to assess their capabilities in meeting specified requirements.

2. Environmental Audit

Environmental auditing involves a systematic evaluation of an organization's environmental performance.

The process is divided into the following four stages:

1. Pre-Audit or Planning Stage
In this initial stage, preparatory steps are undertaken to ensure the audit is organized and focused.

Key activities include:

- *Background Information Collection:* Gather data on the entity's environmental policies, goals, compliance requirements, budgets, and significant environmental issues like material costs and risk areas.
- *Defining Audit Objectives:* Establish the goals of the environmental audit.
- *Defining Scope:* Specify the operations, programs, and timeframes to be examined during the audit.
- *Selecting Audit Criteria:* Identify the regulations or standards against which the facility will be evaluated.
- *Audit Team Selection:* Choose team members with the required knowledge and experience. To maintain impartiality, internal staff like the facility environmental manager should not be part of the audit team.
- *Audit Plan and Protocol Development:* Prepare detailed guidelines for conducting the audit, including applicable regulations and review activities. Computers and regulatory databases may assist in creating and sharing audit protocols.
- *Facility Notification:* Inform the facility about the audit and arrange on-site activities.

Stage 1	Stage 2	Stage 3	Stage 4
Pre-audit or Planning Stage	On-site or Field Audit	Post-audit	Follow up
• Collect background information • Define objectives • Define scope • Select audit criteria • Select audit team members • Develop audit plan or use protocol • Inform the facility • Review the background information	• Opening conference • Identify areas of concern • Site/facility inspection • Records/document review • Staff interviews • Initial review of findings • Closing/exit conference	• Final evaluation of findings • Submit preliminary report • Get approval of management • Hold exit conference • Submit final report	• Verify the actions taken on audit findings or recommendations

2. On- Site or Field Audit Stage
This stage involves data collection and on-site evaluation.

The steps include:

- *Opening Conference:* Brief key personnel on the audit's objectives and schedule meetings and interviews.
- *Facility Tour:* Assess the site to identify areas requiring detailed inspection and adjust the audit schedule as needed.
- *Site Inspection:* Conduct inspections guided by established protocols, focusing on key areas identified during the tour. Sampling techniques may be used for large sites.
- *Evidence Collection:* Gather sufficient and reliable evidence to evaluate environmental activities and impacts.
- *Records Review:* Examine documents and records per audit protocols.
- *Staff Interviews:* Conduct interviews to gain operational insights and identify potential issues, while acknowledging the limitations of human memory.

- *Initial Findings Review:* Compare evidence against audit criteria to identify gaps and deficiencies.
- *Closing Conference:* Present preliminary findings to auditees for clarification and feedback.

3. Post-Audit Stage

In this stage, the collected data is analyzed and reported.

Key steps include:

- *Final Findings Evaluation:* Validate findings with evidence, highlighting areas of major or minor deficiency and noting unresolved issues from previous audits.
- *Preliminary Report Drafting:* Prepare a draft report summarizing findings and recommendations.
- *Management Approval*: Submit the draft for review and approval by the management.
- *Exit Conference:* Share final findings and discuss key issues with stakeholders.
- *Recommendations Discussion:* Propose actionable improvements, if applicable.
- *Final Report Submission:* Submit the Environmental Audit Report (EA Report), which includes audit results and improvement recommendations.

4. Follow-Up or Review Stage

Also known as the corrective action phase,this stage involves:

- *Corrective Action Plan:* The audit manager or team leader may assist in developing a plan to address audit findings.
- *Progress Reporting:* Regular updates to senior management on the implementation of corrective actions.

The end product of environmental audit is Environmental Audit Report (EA Report) which contains findings or results of environmental audit and recommendations for improvement, if any.

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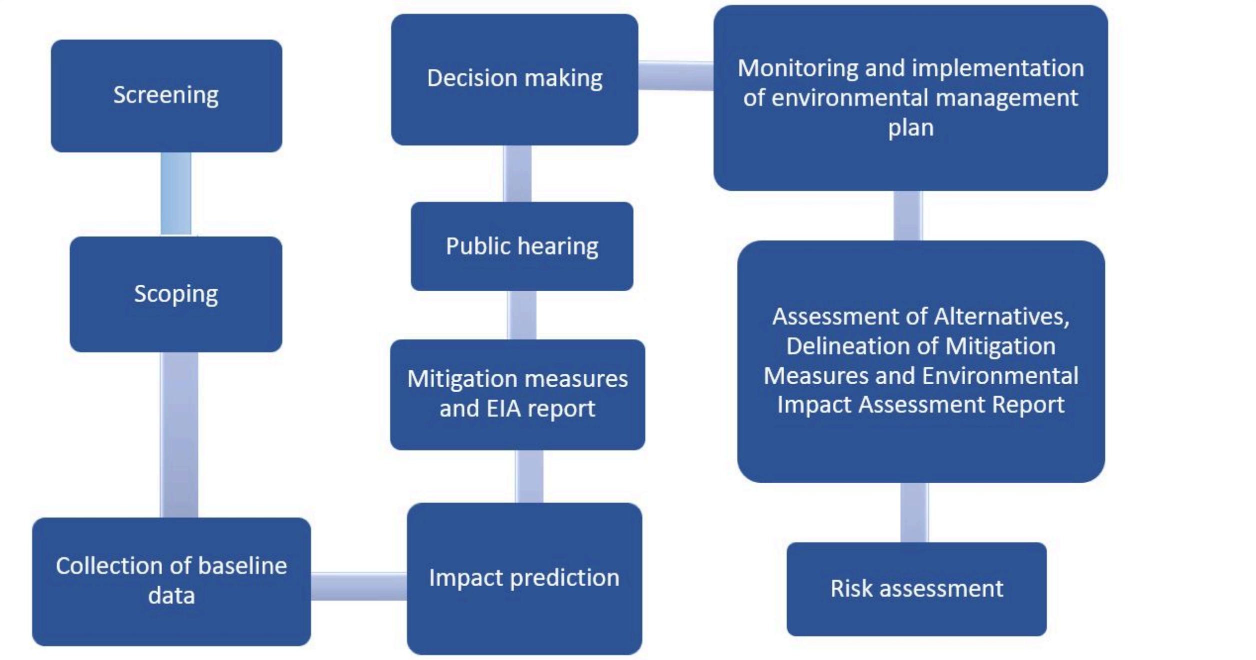
2. Environmental Audit

The Environmental Auditing should not be confused with Environmental Impact Assessment (EIA).

The Environmental Impact Assessment (EIA) as a tool is used to identify the environmental, social and economic impacts of a project prior to decision-making. It aims to predict environmental impacts at an early stage in project planning and design, find ways and means to reduce adverse impacts, shape projects to suit the local environment and present the predictions and options to decision-makers.

Steps of Environmental Impact Assessment (EIA)

The EIA involves the following steps. However, EIA process is cyclical with interaction between the various steps.



- *Screening:* The project plan is screened for scale of investment, location and type of development and if the project needs statutory clearance.
- *Scoping:* The project's potential impacts, zone of impacts, mitigation possibilities and need for monitoring.
- *Collection of baseline data:* Baseline data is the environmental status of study area.
- *Impact prediction:* Positive and negative, reversible and irreversible and temporary and permanent impacts need to be predicted which presupposes a good understanding of the project by the assessment agency.
- *Mitigation measures and EIA report:* The EIA report should include the actions and steps for preventing, minimizing or by passing the impacts or else the level of compensation for probable environmental damage or loss.
- *Public hearing:* On completion of the EIA report, public and environmental groups living close to project site may be informed and consulted.
- *Decision making:* Impact Assessment (IA) Authority along with the experts consult the project-in-charge along with consultant to take the final decision, keeping in mind EIA and EMP (Environment Management Plan).
- *Monitoring and implementation of environmental management plan:* The various phases of implementation of the project are monitored.
- *Assessment of Alternatives, Delineation of Mitigation Measures and Environmental Impact Assessment Report:* For every project, possible alternatives should be identified and environmental attributes compared. Alternatives should cover both project location and process technologies. Once alternatives have been reviewed, a mitigation plan should be drawn up for the selected option and is supplemented with an Environmental Management Plan (EMP) to guide the proponent towards environmental improvements.
- *Risk assessment:* Inventory analysis and hazard probability and index also form part of EIA procedures.

2. Environmental Audit

On 27 January 1994, the Union Ministry of Environment, Forests & Climate Change (MoEF&CC), Government of India, under the Environmental (Protection) Act 1986, promulgated an EIA notification making Environmental Clearance (EC) mandatory for expansion or modernization of any activity or for setting up new projects listed in Schedule 1 of the notification.

The MoEF&CC notified new EIA legislation in September 2006. Unlike the EIA Notification of 1994, the new legislation has put the onus of clearing projects on the state government depending on the size/capacity of the project.

Environment Impact Assessment Notification of 2006 has decentralized the environmental clearance projects by categorizing the developmental projects in two categories, i.e., Category A (national level appraisal) and Category B (state level appraisal).

Category A projects are appraised at national level by Impact Assessment Agency (IAA) and the Expert Appraisal Committee (EAC) and Category B projects are apprised at state level. The State Level Environment Impact Assessment Authority (SEIAA) and State Level Expert Appraisal Committee (SEAC) are constituted to provide clearance to Category B process.

Four stages of EIA Cycle

After 2006 Amendment, the EIA cycle comprises of four stages:

1. Screening,
2. Scoping,
3. Public hearing (also called public consultation),
4. Appraisal

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3. Energy Audit

Energy audit is verification, monitoring and analysis of use of energy with a view to reduce energy consumption per unit of product output and thereby to reduce operating cost and environmental effects.

An ‘Energy Audit’ is an in-depth study of a facility to:

- determine how and where energy is being used or converted from one form to another, and
- identify opportunities to reduce energy usage and prevent energy losses.

It is a technique to establish the current status of energy efficiency of a system.

There are actually 3 basic questions, which should be answered in an energy audit:

1. How much energy is being used and where is it utilised?
2. How much energy should be used with the present operating conditions?
3. How much energy could be used with improved operating conditions?

The Energy Conservation Act, 2001 defines Energy Audit as "the verification, monitoring and analysis of use of energy including submission of technical report containing recommendations for improving energy efficiency with cost benefit analysis and an action plan to reduce energy consumption".

The Act also provides for a biennial energy audit of Designated Consumers in various industrial sectors consuming more energy per year than the threshold defined by Bureau of Energy Efficiency (BEE), Ministry of Power, Government of India. As prescribed in the Act, the Bureau of Energy Efficiency (BEE) is responsible for:

- maintaining a list of accredited energy auditors as may be specified by regulations.
- specifying qualifications for the accredited energy auditors.
- specifying the manner and intervals of time in which the energy audit shall be conducted.

Several State Governments (Gujarat, Maharashtra, Orissa etc.) have enacted laws making Energy Audit to be mandatorily conducted once in 3 years for all consumers of electrical power exceeding the defined threshold.

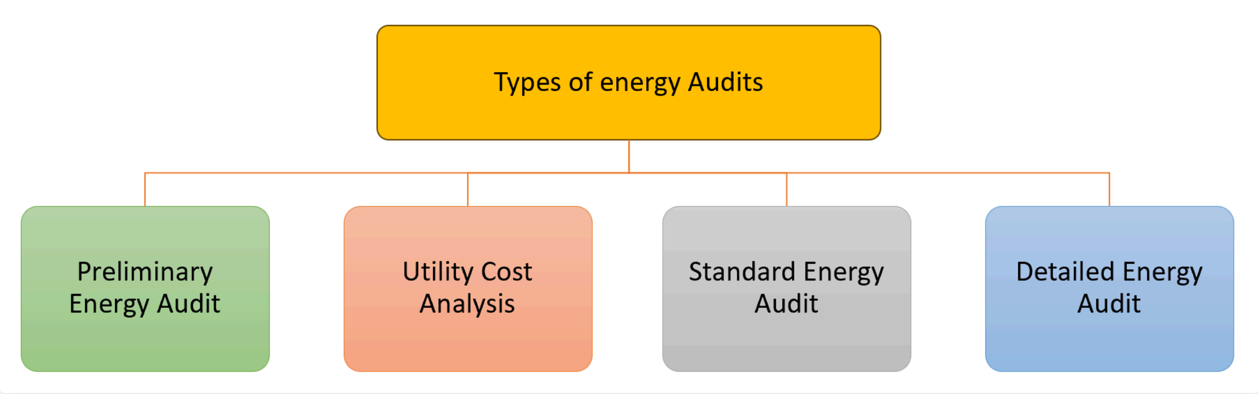
Steps for Energy Audit

The steps in the methodology for conducting a detailed energy audit may be outlined as follows:

1. Gathering and collating information in a specially designed, “Energy Systems Questionnaire” format, for the industry under study.
2. Inter- and intra-industry comparison of the collected data.
3. Assessment of present efficiency index for energy consumption in the industry/process.
4. In-depth study of plant operations, equipment and systems for a general review of the energy systems to assess the operational efficiency and potential for economising.
5. Evaluation of the detailed recommendations for energy saving/conservation,
6. Formulation of detailed action plans/strategies in consultation with plant management for implementation of the identified energy saving measures.
7. Training operating personnel in the specifics of energy conservation to enable them to implement the recommendations and also to monitor the progress on a periodic basis.

3. Energy Audit

Energy audits vary in scope and complexity, ranging from basic evaluations to detailed analyses:



1. **Preliminary Energy Audit: Simplest and quickest**

Purpose:

- Establish baseline energy consumption.
- Identify no-cost/low-cost energy-saving opportunities.
- Highlight areas needing detailed studies.

Method:

Uses existing data, brief site visit, minimal interviews, and facility walk-through.

2. **Utility Cost Analysis: Focuses on operating costs and potential retrofits**

Purpose:

- Analyze utility bills and historical energy usage.
- Identify patterns like peak demand and weather effects.
- Calculate energy savings potential and incremental energy costs.

Method:

- Combines utility data review with a preliminary audit for facility insights.

3. **Standard Energy Audit: Comprehensive evaluation**

Purpose:

- Establish baseline energy usage.
- Assess energy-saving measures and cost-effectiveness.

Method:

- Off-site review of drawings, schedules, and codes.
- On-site inventory of energy-consuming equipment.
- Metering equipment to verify consumption.
- Create baseline energy models and evaluate payback periods for energy-saving measures.

4. **Detailed Energy Audit: Most extensive and detailed**

Purpose:

- Collect in-depth operational data.
- Perform a thorough evaluation of energy conservation measures.
- Provide detailed financial analysis and project justification.

Method:

- Employ computer simulation tools and detailed metering.
- Analyze interactions of multiple retrofits (e.g., lighting, HVAC).
- Justify projects with site-specific savings and implementation cost estimates.

The findings of an energy audit should be reported in the form of an energy audit report, which should contain Preface, Executive Summary, Background and Plant Description, Findings and Recommendations.

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4. Systems Audit

An Information System Audit (IS Audit) is a comprehensive evaluation of an organization's information systems, including its IT infrastructure, policies, operations, and controls. The primary goal of an IS audit is to ensure that the systems are functioning effectively, securely, and in alignment with organizational objectives and compliance requirements.

Obejctives of Information System Audit

The objectives of an Information System Audit are as following:

- Assess System Security: Evaluate measures to protect systems against unauthorized access, cyberattacks, and data breaches.
- Verify Data Integrity: Ensure that the data within the systems is accurate, reliable, and protected from corruption.
- Evaluate Operational Efficiency: Review IT processes, applications, and infrastructure to ensure optimal performance and resource utilization.
- Ensure Compliance: Verify that the organization adheres to applicable regulations, standards, and policies, such as GDPR, HIPAA, or ISO 27001.
- Assess Risk Management: Identify and mitigate risks related to IT operations, such as system failures, downtime, or security vulnerabilities.

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4. Systems Audit

An IS audit may cover the following areas:

- IT Governance: Evaluate whether IT aligns with organizational goals and contributes to achieving business objectives.
- Network and Infrastructure Security: Assess firewalls, intrusion detection systems, and access controls.
- Application Controls: Verify the accuracy, reliability, and security of software applications.
- Data Management: Ensure proper data storage, backup, recovery, and confidentiality measures are in place.
- Change Management: Review processes for managing system updates, patches, and changes.
- Disaster Recovery and Business Continuity: Examine plans and mechanisms to ensure uninterrupted operations during disruptions.
- Compliance Audits: Check adherence to industry-specific or organizational IT standards and regulations.

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4. Systems Audit

Established by the Information Systems and Audit Control Association (ISACA), the Control Objectives for Information and Related Technologies (COBIT) framework provides a framework for organizing enterprise IT management. Initially founded in 1969, ISACA creates globally recognized IT certifications and develops auditing control guidance.

First released in 1996, COBIT (Control Objectives for Information and Related Technologies) was initially designed as a set of IT control objectives to help the financial audit community better navigate the growth of IT environments. In 1998, the ISACA released version 2, and in 2000, it released COBIT 3. The COBIT 4 was released in 2005, followed by COBIT 5 in 2012.

The ISACA announced an updated version of COBIT in 2018, ditching the version number and naming it COBIT 2019. This updated version of COBIT is designed to constantly evolve with “more frequent and fluid updates,” according to the ISACA. COBIT 2019 was introduced to build governance strategies that are more flexible, collaborative and address new and changing technology.

4. Systems Audit

An Information System (IS) Audit involves systematic steps to evaluate and ensure the reliability, security, and efficiency of IT systems. The process includes:

1. **Planning Phase**

- Define Scope and Objectives: Identify the purpose of the audit (e.g., compliance, performance evaluation) and the systems to be audited.
- Risk Assessment: Determine critical risk areas in IT operations and prioritize them.
- Audit Program Development: Create a detailed plan including methodology, team responsibilities, and timelines.

2. **Pre-Audit Activities**

- Data Collection: Gather information about IT policies, procedures, and system configurations.
- Preliminary Analysis: Review previous audits, Understand organizational workflows and infrastructure.
- Coordination: Assign tasks to the audit team and schedule interviews and walkthroughs.

3. **Fieldwork or Audit Execution**

- System Inspection: Examine IT infrastructure (hardware, software, and networks).
- Review: Review physical and logical security controls.
- Control Testing: Evaluate general controls (e.g., access, backups) and application-specific controls (e.g., input validation).
- Vulnerability Assessment: Perform security scans to identify weaknesses, Test system defenses against potential cyber threats.

4. **Reporting**

- Findings Evaluation: Compare audit results with predefined criteria, Categorize risks based on their severity (high, medium, low).
- Draft Report: Summarize objectives, findings, and actionable recommendations.
- Management Review: Share the draft report for feedback and validation.
- Final Audit Report: Submit a comprehensive document with key findings and improvement steps.

5. **Follow-Up**

- Implementation Monitoring: Ensure corrective actions are taken and controls are effective.
- Post-Audit Review: Conduct follow-up audits to confirm ongoing compliance and document residual risks.

4. Systems Audit

The Key deliverables of systems are as follows:

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5. Safety Audit

A **Safety Audit** is a systematic evaluation of an organization's safety practices, policies, procedures, and systems. Its primary goal is to ensure that workplace environments, operations, and equipment comply with safety standards, minimize risks, and promote a safe and healthy workplace for employees and stakeholders.

Objectives of a Safety Audit

- *Identify Hazards:* Recognize potential safety risks in the workplace or operational procedures.
- *Ensure Compliance:* Verify adherence to safety regulations, laws, and organizational policies.
- *Assess Risk Control Measures:* Evaluate the effectiveness of existing safety controls and equipment.
- *Promote Continuous Improvement:* Provide recommendations to enhance workplace safety and reduce future risks.
- *Prevent Accidents:* Identify and mitigate factors that could lead to injuries, illnesses, or environmental harm.

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5. Safety Audit

A safety audit typically covers:

- *Workplace Conditions:* Lighting, ventilation, noise, and ergonomics.
- *Operational Processes:* Safety procedures during machine operation or material handling.
- *Equipment and Tools:* Inspection of tools, machines, and personal protective equipment (PPE).
- *Emergency Preparedness:* Availability and functionality of fire extinguishers, evacuation plans, and first-aid kits.
- *Training Programs:* Adequacy of employee training in safety practices.
- *Incident Reporting Systems:* Mechanisms for tracking and analyzing workplace accidents.

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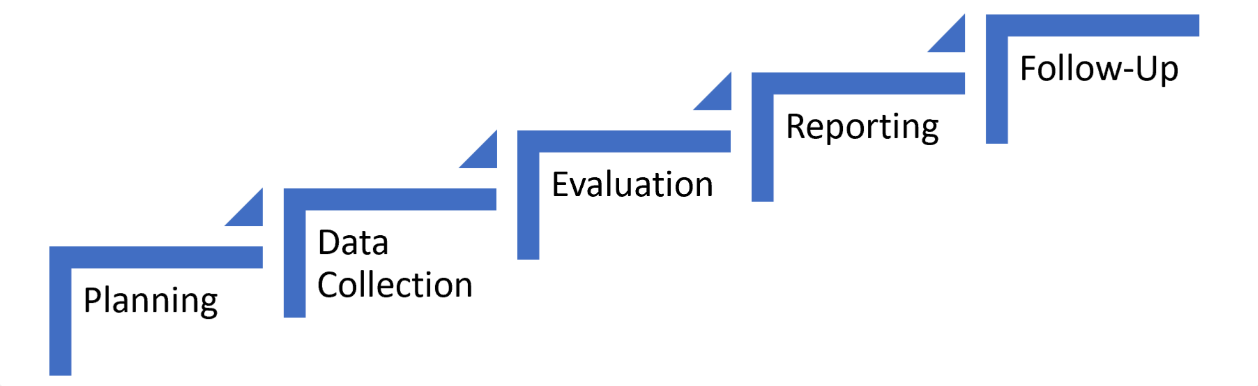
5. Safety Audit

Steps in a Safety Audit are listed below:



1. **Planning**

- Define objectives and scope.
- Identify the audit team and prepare checklists.

2. **Data Collection**

- Conduct on-site inspections, interviews, and document reviews.
- Collect evidence through observations and measurements.

3. **Evaluation**

- Compare current practices against established safety standards.
- Identify gaps, risks, and non-compliance issues.

4. **Reporting**

- Summarize findings, categorize risks, and propose recommendations.
- Submit a detailed report to management.

5. **Follow-Up**

- Monitor the implementation of corrective actions.
- Conduct periodic reviews to ensure ongoing compliance and improvement.

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6. Management Audit

A Management Audit is a systematic evaluation of an organization's management processes, policies, and practices to ensure they are efficient, effective, and aligned with the organization's objectives. Unlike financial or operational audits, a management audit focuses on assessing the overall performance of the management team and its ability to achieve organizational goals.

Objectives of Management Audit

The objectives of Management Audit are as follows:

- *Evaluate Efficiency:* Assess how well resources (human, financial, and material) are being utilized.
- *Review Decision-Making Processes:* Analyze the quality and effectiveness of strategic and operational decisions.
- *Ensure Goal Alignment:* Check if the organization's policies, strategies, and actions align with its mission and objectives.
- *Identify Weaknesses:* Highlight inefficiencies, gaps, or bottlenecks in management practices.
- *Recommend Improvements:* Provide actionable insights to enhance management effectiveness and organizational performance.

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6. Management Audit

A management audit typically covers:

- *Organizational Structure:* Evaluates the clarity and functionality of reporting lines, roles, and responsibilities.
- *Strategic Planning:* Reviews the development, communication, and implementation of long-term goals.
- *Decision-Making:* Assesses the timeliness, quality, and impact of decisions at all management levels.
- *Resource Allocation:* Analyzes the allocation and utilization of financial, human, and material resources.
- *Performance Measurement:* Evaluates metrics and tools used to monitor progress and success.
- *Human Resource Management:* Reviews recruitment, training, performance appraisal, and employee relations practices.
- *Risk Management:* Examines the management's approach to identifying and mitigating risks.
- *Compliance and Governance:* Ensures adherence to regulatory, ethical, and governance standards.

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6. Management Audit

The process of a Management Audit is listed below:

1. **Planning**

- Define the audit objectives and scope.
- Identify key management areas to be reviewed and develop an audit plan.

2. **Data Collection**

- Review organizational documents (policies, reports, meeting minutes).
- Conduct interviews with managers, staff, and stakeholders.
- Observe management practices and workflows.

3. **Analysis**

- Evaluate the effectiveness of management systems and processes.
- Compare practices against industry benchmarks and best practices.

4. **Reporting**

- Present findings in a detailed report, categorizing strengths and weaknesses.
- Include actionable recommendations for improvement.

5. **Follow-Up**

- Monitor the implementation of recommendations.
- Conduct periodic reviews to track progress and ensure continuous improvement.

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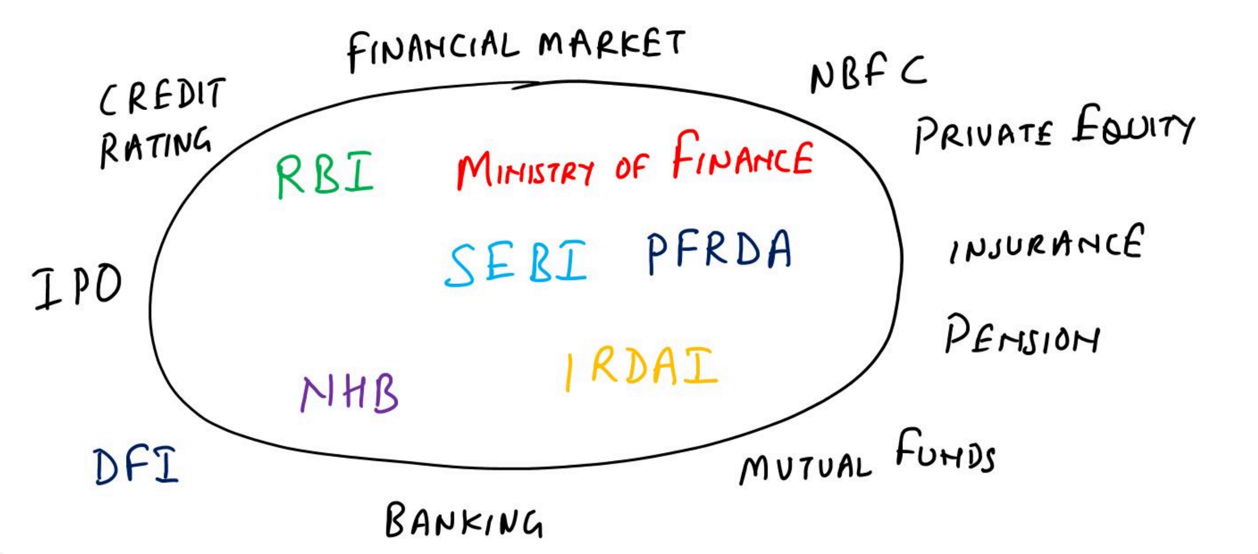
1. Indian Financial System



A financial system typically comprises of institutions (banks, non-banking financial companies, insurance companies, mutual funds etc.), financial markets (money, Government securities, foreign exchange markets, equity, corporate debt, etc.) and financial market infrastructure ably supported by the legal and institutional framework.

The regulation and supervision of the financial system in India is carried out by different regulatory authorities. The Reserve Bank of India RBI regulates and supervises the major part of the financial system.

Role of RBI

The supervisory role of the Reserve Bank of India (RBI) covers:

- Commercial Banks
- Urban Co-operative Banks (UCBs)
- Financial Institutions (FIs)
- Non-Banking Financial Companies (NBFCs)

Some of the Financial Institutions, in turn, regulate and/or supervise other institutions in the financial sector. Regional Rural Banks (RRBs), State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) are supervised by the National Bank for Agriculture and Rural Development (NABARD). While RBI/NABARD is concerned with the banking function of the Co-operatives, the Management control rests with the State/Central Governments.

Earlier, the Registrar of Co-operative Societies (RCS) of respective states in case of single state co-operative banks and the Central Registrar of Co-operative Societies (CRCS) in the case of multi-state co-operative banks were joint regulators with the RBI for Urban Co-operative Banks and with the NABARD for Rural co-operatives.

In 2020, the Urban Co-operative Banks and multi-state cooperative banks were brought under supervisory powers of Reserve Bank of India (RBI). Please note that this “duality of jurisdiction” has been abolished only for Urban Co-operative Banks (UCBs) and multi-state cooperative banks. Rural co-operatives are still under dual control.

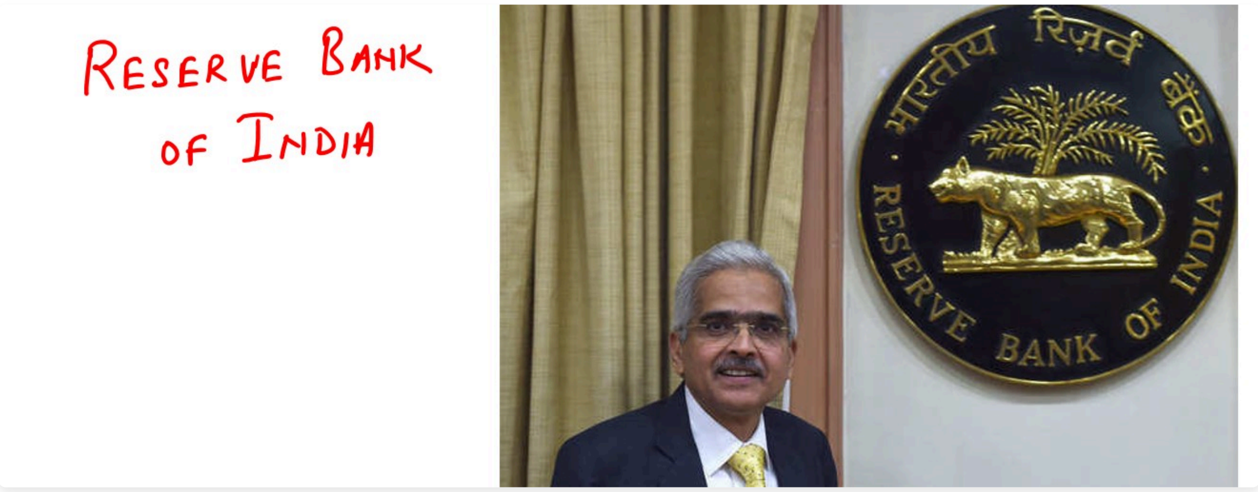
The Housing Finance Companies (HFCs) are supervised by National Housing Bank (NHB).

The Ministry of Company Affairs (MCA), regulates deposit taking activities of companies, other than NBFCs, registered under the Companies Act.

The Insurance Regulatory and Development Authority (IRDA) regulates the insurance sector.

The capital market, credit rating agencies etc., are regulated by Securities and Exchange Board of India (SEBI).

2. Background of RBI



The Reserve Bank of India was **established on April 1, 1935** in accordance with the provisions of the Reserve Bank of India Act, 1934. The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937.

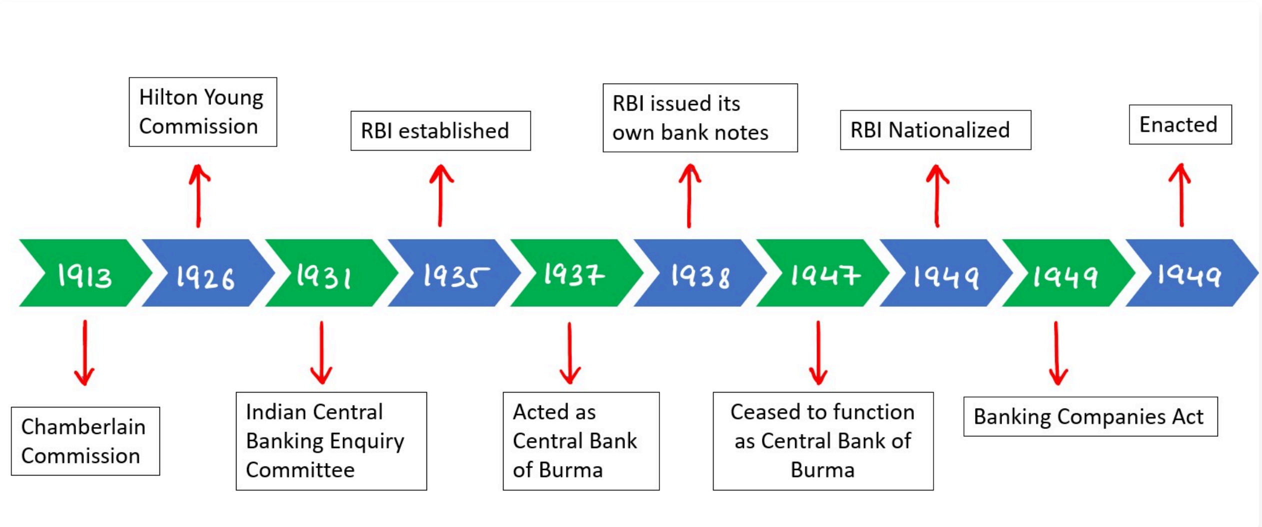
In 1913, the Royal Commission on Indian Finance and Currency (Chamberlain Commission) underlined the need for a central bank for India.

Then in 1926, Hilton Young Commission recommended the establishment of a central bank in India, to be named as Reserve Bank of India. Subsequently, in January 1927, the government introduced a bill "The Gold Standard and Reserve Bank of India" in the legislature, but it was not passed.

In 1931, the report of the Indian Central Banking Enquiry Committee released, strongly recommending the establishment of the Reserve Bank.

Then in September 1933, the Reserve Bank of India Bill, drafted on the basis of London Committee recommendations, was introduced in the Legislative Assembly. It was **passed in December 1933.**

In March 1934, Reserve Bank of India Bill received the assent of the Governor-General.



Sir Osborne Smith was appointed the **first Governor of the Reserve Bank of India**.

In March 1937, the Reserve Bank acted as banker to the Government of Burma and was also responsible for note issue in Burma as per the Burma Monetary Arrangements Order.

In January 1938, the Reserve Bank issued its own bank notes. In January 1946, High Denomination Bank Notes of Rs 500, Rs 1,000 and Rs 10,000 were demonetized to curb unaccounted money.

In March 1947, the Reserve Bank ceased to function as Central Bank of Burma. In June 1948, the Reserve Bank ceased to function as Central Bank of Pakistan.

In January 1949, the Reserve Bank was nationalised.

In March 1949, the Banking Companies Act, 1949 came into force, replacing the earlier interim arrangements. This formed the statutory basis of bank supervision and regulation in India.

Thus, originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

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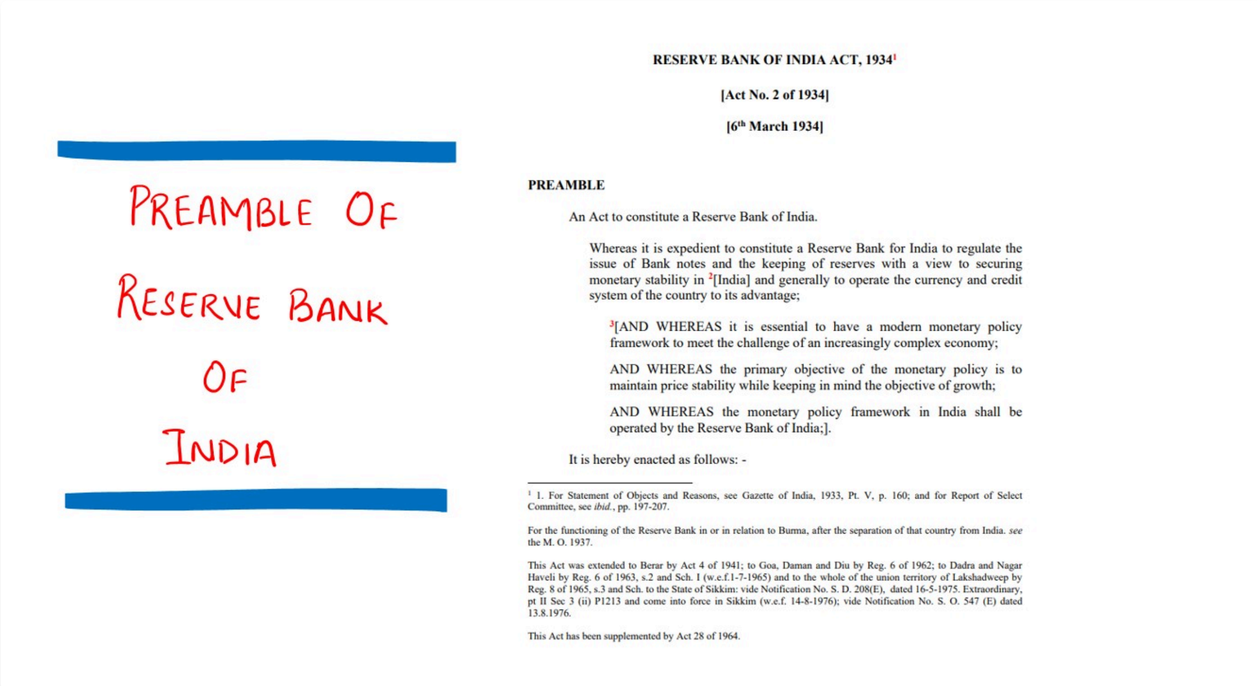
2. Background of RBI



RESERVE BANK OF INDIA ACT, 1934[1]

[Act No. 2 of 1934]

[6th March 1934]

PREAMBLE

An Act to constitute a Reserve Bank of India.

Whereas it is expedient to constitute a Reserve Bank for India to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in [2][India] and generally to operate the currency and credit system of the country to its advantage;

[3][AND WHEREAS it is essential to have a modern monetary policy framework to meet the challenge of an increasingly complex economy;

AND WHEREAS the primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth;

AND WHEREAS the monetary policy framework in India shall be operated by the Reserve Bank of India;].

It is hereby enacted as follows: -

[1] 1. For Statement of Objects and Reasons, see Gazette of India, 1933, Pt. V, p. 160; and for Report of Select Committee, see *ibid.*, pp. 197-207.

For the functioning of the Reserve Bank in or in relation to Burma, after the separation of that country from India. *see* the M. O. 1937.

This Act was extended to Berar by Act 4 of 1941; to Goa, Daman and Diu by Reg. 6 of 1962; to Dadra and Nagar Haveli by Reg. 6 of 1963, s.2 and Sch. I (w.e.f.1-7-1965) and to the whole of the union territory of Lakshadweep by Reg. 8 of 1965, s.3 and Sch. to the State of Sikkim: vide Notification No. S. D. 208(E), dated 16-5-1975. Extraordinary, pt II Sec 3 (ii) P1213 and come into force in Sikkim (w.e.f. 14-8-1976); vide Notification No. S. O. 547 (E) dated 13.8.1976.

This Act has been supplemented by Act 28 of 1964.

The Preamble of the Reserve Bank of India describes its basic functions -

- regulates the issue of Bank notes,
- maintains reserves with a view to secure monetary stability in India,
- operate the currency and credit system of the country to its advantage,
- have a modern monetary policy framework to meet the challenge of an increasingly complex economy,
- maintain price stability while keeping in mind the objective of growth.

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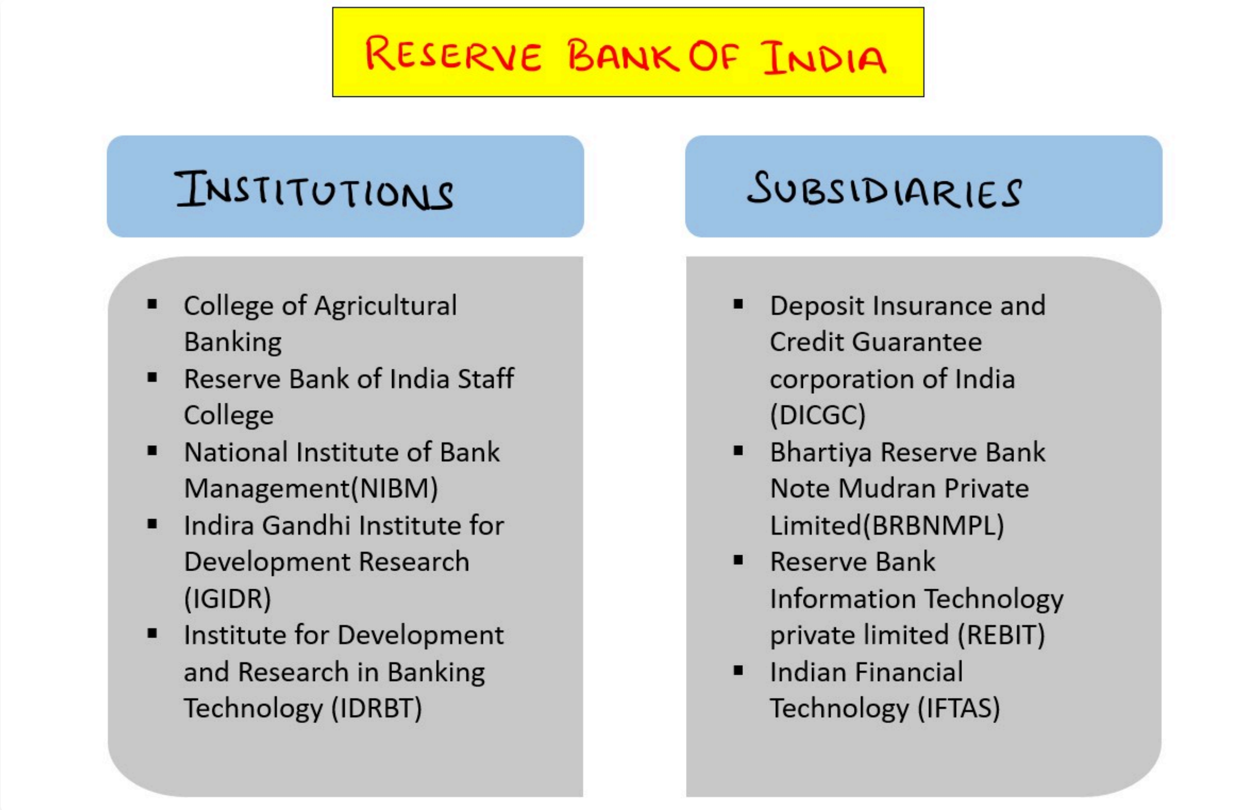
3. Institutes and Subsidiaries



The RBI has 5 training establishments.

- 2 are, College of Agricultural Banking and Reserve Bank of India Staff College, which are part of the Reserve Bank.
- Remaining 3 are autonomous, namely, National Institute for Bank Management (NIBM), Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT).

The RBI has following Subsidiaries -

- Reserve Bank Innovation Hub (RBIH) set up in 2022
- Deposit Insurance and Credit Guarantee Corporation of India (DICGC) set up in 1978
- Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL) set up in 1995
- Reserve Bank Information Technology Private Limited (ReBIT) set up in 2016
- Indian Financial Technology and Allied Services (IFTAS) set up in 2014.

Note that, National Housing Bank (NHB), set up in 1987, was a subsidiary of RBI but since May 2019 it has been taken over by the Central Government.

Their description are given below.

Reserve Bank Innovation Hub (RBIH)

The Reserve Bank Innovation Hub (RBIH) was established in 2022 by the Reserve Bank of India as a Section 8 company under the Companies Act, 2013. It was launched to support financial innovation in a structured and sustainable manner. The primary objective of RBIH is to build an ecosystem that enhances access to financial products and services, especially for the low-income segments of the population. This aligns with RBIH's broader vision of bringing world-class innovation to India's financial sector while maintaining a strong focus on financial inclusion.

Deposit Insurance and Credit Guarantee Corporation

The Deposit Insurance and Credit Guarantee Corporation (DICGC) was established in 1978 under the Deposit Insurance and Credit Guarantee Corporation Act, 1961 for the purpose of providing insurance of deposits and guaranteeing of credit facilities. The DICGC insures all bank deposits, such as saving, fixed, current, recurring deposit for up to the limit of Rs 5 Lakhs of each deposit in a bank (before 2019, this limit was Rs 1 lakh). As per Aug 2021 amendment, time limit is within 90 days of the RBI imposing moratorium on their banks.

Bharatiya Reserve Bank Note Mudran Private Limited

It was established to augment the production of bank notes in India to enable the RBI to bridge the gap between the supply and demand for bank notes in the country.

Reserve Bank Information Technology Private Limited (ReBIT)

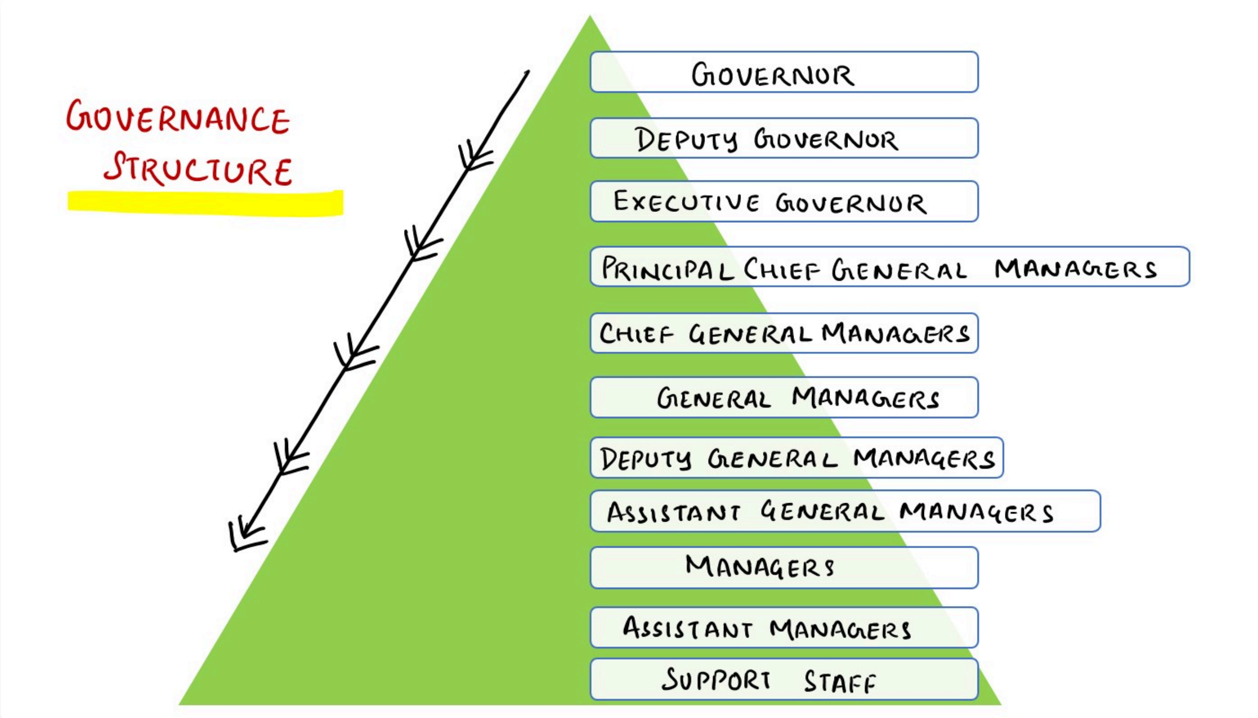
It has been set up to serve its IT and cybersecurity needs and to improve the cyber resilience of the Indian banking industry.

Indian Financial Technology and Allied Services (IFTAS)

Indian Financial Technology & Allied Services (IFTAS) designs, deploys & provides the essential IT-related services, required by the RBI, banks, and financial institutions. It is responsible for -

- Indian Financial Network (INFINET), a closed user group MPLS network for banking and financial sector.
- Structured Financial Messaging System (SFMS), a messaging system facilitating RTGS, NEFT, Government payments and receipts, etc.
- Indian Banking Community Cloud (IBCC), providing CBS and other software applications such as SFMS, mobile banking, etc. as web service/s.
- Global Interchange for Financial Transactions (GIFT), an integrated payment & settlement system based on open source technology stack.

4. Governance structure



The RBI has following Governance structure from the top to the bottom (in this order) -

- Governor
- Deputy Governor
- Executive Governor
- Principal Chief General Managers
- Chief General Managers
- General Managers
- Deputy General Managers
- Assistant General Managers
- Managers
- Assistant Managers
- Support Staff

Central Board

The Reserve Bank's affairs are governed by a Central Board of Directors. The board is appointed by the Government of India in accordance with the Reserve Bank of India Act. The board is appointed for a period of 4 years.

Official Directors - There is provision for a Governor with not more than 4 Deputy Governors, who are appointed full time. The current Governor of the Reserve Bank of India (RBI) is Sanjay Malhotra, who assumed the role on December 11, 2024.

Non-Official Directors - The Government also appoints 10 Directors from various fields and 2 Government Officials.

Committees and Sub-Committees

The Central Board is assisted by 3 Committees -

1. Committee of the Central Board (CCB)
2. Board for Financial Supervision (BFS)
3. Payments Regulatory Board (PRB) (*it has replaced Board for Regulation and Supervision of Payment and Settlement Systems*)

These committees are chaired by the Governor.

In addition, the Central Board has 4 sub-committees -

1. Audit and Risk Management Sub-Committee (ARMS)
2. Human Resource Management Sub-Committee (HRM-SC)
3. Building Sub-Committee (BSC)
4. Information Technology Sub-Committee (IT-SC)

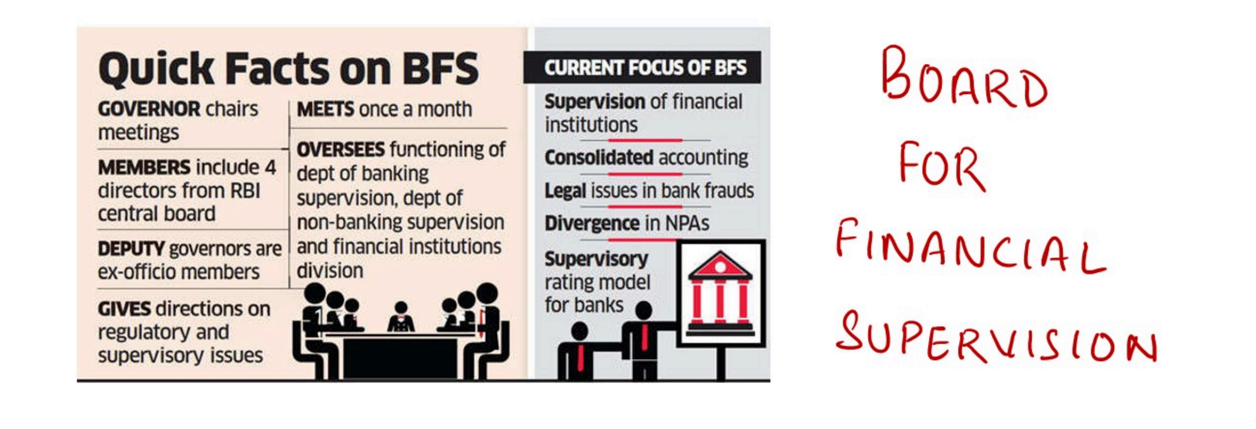
These sub-committees are headed by an External Director.

Local Boards

There are also provisions for 4 Local Boards, one each for 4 regions of the country in Mumbai, Calcutta, Chennai and New Delhi. Each Local Board consists of 5 members, which are appointed by the Central Government for a term of 4 years. The functions of Local Board is to advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time to time.

The functions of Board for Financial Supervision (BFS) and Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) are discussed next.

4. Governance structure



The Reserve Bank of India performs the supervisory function under the guidance of the Board for Financial Supervision (BFS). The Board was constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India under the Reserve Bank of India (Board for Financial Supervision) Regulations, 1994.

Objective
The primary objective of BFS is to undertake consolidated supervision of the financial sector comprising Scheduled Commercial and Co-operative Banks, All India Financial Institutions, Local Area Banks, Small Finance Banks, Payments Banks, Credit Information Companies, Non-Banking Finance Companies and Primary Dealers.

Composition
The Board is constituted by co-opting 4 Directors from the Central Board as Members and is chaired by the Governor. The Deputy Governors of the Reserve Bank are ex-officio members. One Deputy Governor, traditionally, the Deputy Governor in charge of supervision, is nominated as the Vice-Chairman of the Board.

Meetings
The Board is required to meet normally once every month. It deliberates on inspection reports, periodic reviews related to banking and non-banking sectors and policy matters arising out of or having relevance to the supervisory functions of the Reserve Bank.

Function
The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Department of Co-operative Bank Supervision (DCBS) and gives directions on regulatory and supervisory issues.

Initiatives

Some of the initiatives taken by the BFS include -

- Fine-tuning the supervisory processes adopted by the Bank for regulated entities;
- Introduction of off-site surveillance system to complement the on-site supervision of regulated entities;
- Strengthening the statutory audit processes of banks and enlarging the role of auditors in the supervisory process;
- Strengthening the internal defenses within supervised institutions such as corporate governance, internal control and audit functions, management information and risk control systems, review of housekeeping in banks;
- Introduction of supervisory rating system for banks and financial institutions;
- Supervision of overseas operations of Indian banks, consolidated supervision of banks;
- Technical assistance programme for cooperative banks;
- Introduction of scheme of Prompt Corrective Action Framework for weak banks;
- Guidance regarding fraud risk management framework in banks;
- Introduction of risk based supervision of banks;
- Introduction of an enforcement framework in respect of banks;
- Establishment of a credit registry in respect of large borrowers of supervised institutions; and
- Setting up a subsidiary of RBI to take care of the IT requirements, including the cyber security needs of the Reserve Bank and its regulated entities, etc.

4. Governance structure

The Reserve Bank of India (RBI) has notified the Payments Regulatory Board Regulations, 2025 (w.e.f 20th May 2025), under the Payment and Settlement Systems Act, 2007. These regulations replace the earlier Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) Regulations, 2008. Accordingly, in October 2025, the Reserve Bank of India (RBI) established a 6-member Payments Regulatory Board (PRB).

The **Payment Regulatory Board (PRB)** serves as the apex body responsible for regulation, supervision, and oversight of payment and settlement systems in India. It ensures the safety, efficiency, and stability of the country's digital and electronic payment ecosystem. Chairperson of the PRB is the Governor of the Reserve Bank of India. It has 6 members.

Composition

It is chaired by the RBI Governor and comprises 2 additional RBI representatives along with 3 Central Government nominees.

- RBI Members include Deputy Governor and Executive Director in charge of Payment and Settlement Systems.
- RBI's principal legal adviser is a permanent invitee to PRB meetings.

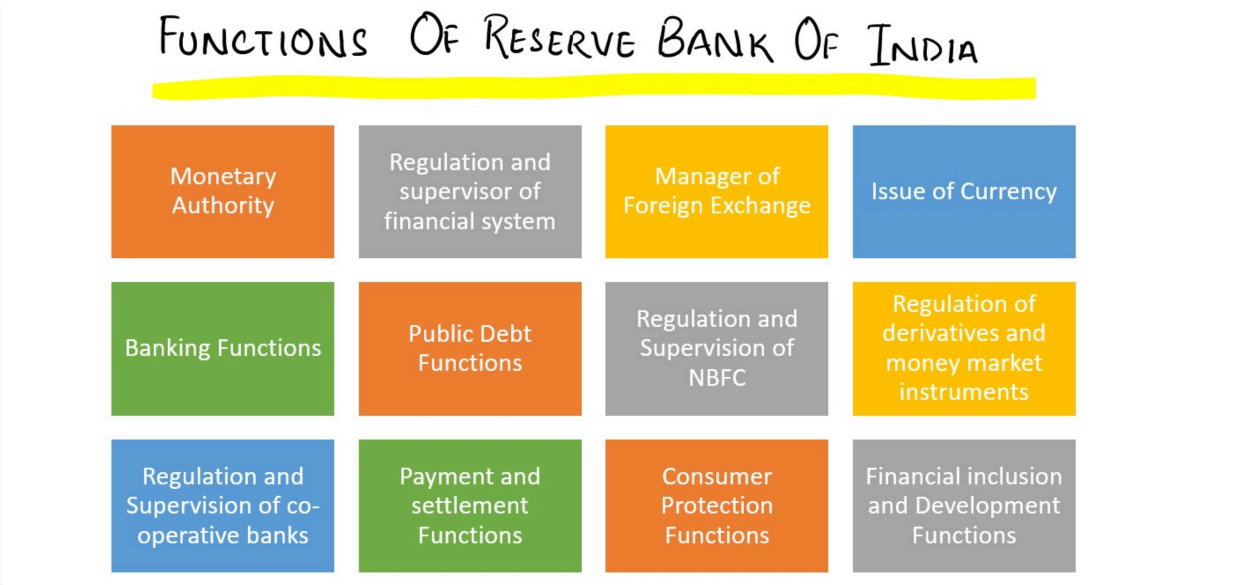
Legal Authority

PRB derives powers from the Payment and Settlement Systems Act, 2007. The RBI's Department of Payment and Settlement Systems (DPSS) reports directly to the PRB.

Decision-Making

Decisions are by majority vote of members present. In case of a tie, the chairperson or deputy governor has a second or casting vote.

5. Functions of RBI



The functions of RBI are not confined only within the provisions of the RBI Act, but extend to various areas, such as, regulation and supervision of banks, consumer protection, management of foreign exchange, management of government securities, regulation and supervision of payment systems.

The list of Acts administrated by the RBI are:

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944/Government Securities Act, 2006
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Chapter II)
- Credit Information Companies (Regulation) Act, 2005
- Payment and Settlement Systems Act, 2007
- Factoring Regulation Act, 2011

The key functions of RBI are discussed next.

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5. Functions of RBI

The RBI formulates implements and monitors the monetary policy. The objective is to maintain price stability while keeping in mind the objective of growth.

Monetary policy refers to the actions and strategies that a country's central bank (RBI in India) undertakes to control and regulate the money supply and interest rates in the economy. The primary objectives of monetary policy typically include maintaining price stability, achieving full employment, and supporting sustainable economic growth.

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5. Functions of RBI

The RBI prescribes broad parameters of banking operations within which the country's banking and financial system functions. The objective is:

- to maintain public confidence in the system,
- to protect depositors' interest and
- to provide cost-effective banking services to the public.

March 2020: RBI took control of Yes Bank under the Banking Regulation Act, 1949

- Imposed a moratorium on Yes Bank under section 45 of the Banking Regulation Act, 1949.
- Proposed 'Yes Bank Ltd. Reconstruction Scheme, 2020' under section 45 of the Banking Regulation Act, 1949.
- Gave directions to halt all banking operations to the Yes Bank under the Section 35A of the Banking Regulation Act, 1949.
- Superseded the Board of Directors of Yes Bank Ltd under 36ACA of the Banking Regulation Act 1949.

Powers under Banking Regulations Act 1949

The power to regulate and supervise banks has been provided under the provisions of the Banking Regulation Act, 1949 (BR Act, 1949).

- RBI is empowered under Section 10BB of the Banking Regulation (BR) Act, 1949 to appoint a Chairman or Managing Director of a banking company for specified reasons.
- Under Section 36-AB of the BR Act, 1949, RBI has the power to appoint additional directors on the boards of banking companies as part of its control over management.
- RBI also has the power to remove managerial persons under Section 36-AA of the BR Act, 1949.
- RBI is empowered under the BR Act, 1949 to supersede the board of banking companies.
- Under Section 22 of the BR Act, 1949, RBI has the authority to issue licenses to banking companies and also to cancel such licenses.
- Under Section 35-A of the BR Act, 1949, RBI can issue directions to banking companies:
  - in the public interest,
  - in the interest of banking policy,
  - to prevent banking affairs from harming depositors,
  - to issue directions for resolution of stressed assets.

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5. Functions of RBI

The powers and responsibilities with respect to external trades and payments, development and maintenance of foreign exchange market in India are conferred on the RBI under the provisions of the Foreign Exchange Management Act, 1999 (FEMA).

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5. Functions of RBI

As per the RBI Act 1934, the RBI has the sole right to issue bank notes in India. The issue of bank notes is done by the Issue Department of the RBI, which is separated and kept wholly distinct from the Banking Department. The RBI Act enables the RBI to recommend the Central Government regarding the denomination of bank notes.

The RBI has sole right to issue currency notes of various denominations except One Rupee notes. The One Rupee note is issued by Ministry of Finance and it bears the signatures of Finance Secretary, while other notes bear the signature of Governor RBI. As per the RBI Act 1934, the RBI can print notes of Rs 2, 5, 10, 20, 50, 100, 500, 1000, 5000 and 10000 (or any other value as advised by the Central Board of RBI). As on date, the notes in circulation are of Rs 10, Rs 20, Rs 50, Rs 100, Rs 200, Rs 500 and Rs 2000.

The RBI receives notes from 4 currency note printing presses. Two of the currency note printing presses are owned by the Government of India and two are owned by the Reserve Bank, through its wholly owned subsidiary, the Bharatiya Reserve Bank Note Mudran Ltd. (BRBNML). The government owned presses are at Nasik (Western India) and Dewas (Central India). The other two presses are at Mysore (Southern India) and Salboni (Eastern India).

The Government of India has introduced new 1 Rupee note from 7 February 2020 (it was discontinued in 2015-16). The note contains the words 'Bharat Sarkar', above the words 'Government of India'. The new one rupee notes will have the bilingual signature of the Secretary, Ministry of Finance.

The Government of India has the sole right to mint coins (and not RBI), as per Coinage Act 1906. The responsibility for coinage vests with the Government of India in terms of the Coinage Act, 1906 as amended from time to time.

The designing and minting of coins in various denominations is also the responsibility of the Government of India. Coins are minted at the 4 India Government Mints at Mumbai, Alipore (Kolkata), Saifabad (Hyderabad), Cherlapally (Hyderabad) and NOIDA (UP). Currently, coins of 50 paise, Re 1, Rs 2, Rs 5, Rs 10 and Rs 20 denomination of various sizes, theme and design are in circulation.

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5. Functions of RBI

The RBI is a Banker to the Government. It performs merchant banking function for the Central and the State Governments and thus acts as their banker. The RBI is also **Banker to Banks** and thus maintains banking accounts of all scheduled banks.

Section 17 of the RBI Act 1934 enables RBI to do banking business, such as accepting deposits, without interest, from any person. Similarly, Section 18 facilitates the RBI to act as **Lender of Last Resort** whereas Section 19 states the list of businesses in which the RBI may not transact. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of the bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

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5. Functions of RBI

The Parliament of India enacted the Government Securities Act, 2006 (GS Act) with an objective to consolidate and amend the law relating to Government securities and its management by the RBI. The GS Act applies to Government securities created and issued by the Central Government or a State Government.

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5. Functions of RBI

The RBI Act mandates every Non-Banking Financial Company, NBFC to obtain a certificate of registration from the RBI and to maintain net owned fund (Rs 2 Crore as in 2022) as may be specified by the RBI, before commencing such non-banking financial business. Further, as a part of regulation and supervision of non-banks, the RBI has been conferred with the statutory powers to regulate or prohibit issue of prospectus or advertisements soliciting deposits of money by non-banking financial companies, power to determine policy and issue directions to the non-banking financial companies, etc.

Thus, it may be noted that, the power of the RBI to regulate and supervise banking companies emanates from the provisions of the Banking Regulations Act 1949 whereas the powers to regulate and supervise non-banks has the source from the RBI Act 1934.
