

# **RAGHAV ACADEMY**

**Specialised Coaching for CMA**

## **CMA INTER GR-II**

# **AUDITING**

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**COMPLETE COURSE DIVIDED IN**

**90**

**CONCEPTS**

**BY**

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# INDEX

S.NO.	PARTICULAR	PG. NO.
1	CONCEPT 1. ORIGIN OF WORD AUDIT	1
2	CONCEPT 2. DEFINITIONS OF AUDIT	1
3	CONCEPT 3. BASIC MEANING OF AUDITING	2
4	CONCEPT 4. ESSENTIAL FEATURES OF AUDITING	2
5	CONCEPT 5. NATURE OF AUDITING	3
6	CONCEPT 6. SCOPE OF AUDITING	4
7	CONCEPT 7. RELATIONSHIP AND DISTINCTION BETWEEN ACCOUNTING & AUDITING	5
8	CONCEPT 8. AUDITOR	6
9	CONCEPT 9. AUDIT AND INVESTIGATION	8
10	CONCEPT 10. ASPECTS TO BE COVERED IN AUDIT	9
11	CONCEPT 11. OBJECTIVES OF AUDITING	10
12	CONCEPT 12. BASIC PRINCIPLES GOVERNING AN AUDIT	10
13	CONCEPT 13. SIGNIFICANCE OF AUDIT	11
14	CONCEPT 14. ADVANTAGES OF AUDIT	13
15	CONCEPT 15. INHERENT LIMITATIONS OF AN AUDIT	13
16	CONCEPT 16. AUDITOR'S ENGAGEMENT	14
17	CONCEPT 17. FUNCTIONAL CLASSIFICATION OF AUDIT – COMPARISON BETWEEN EXTERNAL AND INTERNAL AUDIT	15
18	CONCEPT 18. TYPES OF AUDIT	16
19	CONCEPT 19. CONCEPT OF TRUE AND FAIR	17
20	CONCEPT 20. CONCEPT OF MATERIALITY IN PLANNING AND PERFORMING THE AUDIT	18
21	CONCEPT 21. DISCLOSURE OF ACCOUNTING POLICIES	19
22	CONCEPT 22. VARIOUS TYPES OF AUDIT	21
23	CONCEPT 23. AUDIT ENGAGEMENT	34
24	CONCEPT 24. AUDIT PROGRAMME	35
25	CONCEPT 25. AUDIT WORKING PAPERS	37
26	CONCEPT 26. AUDIT NOTE BOOK	38
27	CONCEPT 27. AUDIT RISK	39
28	CONCEPT 28. SURPRISE CHECK	40
29	CONCEPT 29. AUDIT EVIDENCE	40
30	CONCEPT 30. AUDIT REPORT	43
31	CONCEPT 31. INTERNAL CHECK	46
32	CONCEPT 32. DISTINCTION BETWEEN INTERNAL AUDIT, INTERNAL CONTROL AND INTERNAL CHECK	50
33	CONCEPT 33. CUT OFF PROCEDURES	51
34	CONCEPT 34. EXAMINATION IN DEPTH/AUDITING IN DEPTH/WALK THROUGH TEST	52
35	CONCEPT 35. DIFFERENCE BETWEEN TEST CHECKING AND STATISTICAL SAMPLING	52
36	CONCEPT 36. INTERNAL CONTROL	52
37	CONCEPT 37. INTERNAL AUDIT – INDUSTRY SPECIFIC	60
38	CONCEPT 38. VOUCHING	64
39	CONCEPT 39. AUDIT OF RECEIPTS	66
40	CONCEPT 40. AUDIT OF EXPENDITURE	66
41	CONCEPT 41. VERIFICATION OF ASSETS AND LIABILITIES	67

42	CONCEPT 42. INTRODUCTION TO COMPANY AUDIT	72
43	CONCEPT 43. APPOINTMENT OF AUDITORS [SECTION 139]	72
44	CONCEPT 44. REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE [SECTION 140]	77
45	CONCEPT 45. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS [SECTION 141]	79
46	CONCEPT 46. REMUNERATION OF AUDITORS [SECTION 142]	81
47	CONCEPT 47. POWERS AND DUTIES OF AUDITORS [SECTION 143]	81
48	CONCEPT 48. AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]	87
49	CONCEPT 49. AUDITOR TO SIGN AUDIT REPORTS ETC. [SECTION 145]	88
50	CONCEPT 50. AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]	88
51	CONCEPT 51. PUNISHMENT FOR CONTRAVENTION [SECTION 147]	89
52	CONCEPT 52. AUDIT COMMITTEE [SECTION 177]	90
53	CONCEPT 53. COST AUDIT [SECTION 148]	91
54	CONCEPT 54. SECRETARIAL AUDIT	97
55	CONCEPT 55. SCOPE, BASIC ELEMENTS AND SIGNIFICANCE OF AUDIT REPORT	98
56	CONCEPT 56. CARO 2020	106
57	CONCEPT 57. ASPECTS TO BE CONSIDERED IN QUALIFYING A REPORT	112
58	CONCEPT 58. DISCLAIMER OF OPINION	113
59	CONCEPT 59. PIECEMEAL OPINION	114
60	CONCEPT 60. ADVERSE OR NEGATIVE REPORT	114
61	CONCEPT 61. DISTINGUISH BETWEEN EXPLANATORY NOTES AND QUALIFICATORY NOTES	115
62	CONCEPT 62. DISTINGUISH BETWEEN QUALIFIED REPORT AND ADVERSE REPORT	115
63	CONCEPT 63. DISTINGUISH BETWEEN CLEAN AUDIT REPORT AND QUALIFIED AUDIT REPORT	116
64	CONCEPT 64. DATE OF THE AUDIT REPORT	116
65	CONCEPT 65. SIGNIFICANCE OF THE PHASE "TO THE BEST OF OUR INFORMATION AND ACCORDING TO THE EXPLANATIONS GIVEN TO US" WHICH IS GENERALLY FOUND IN THE AUDITORS' REPORTS.	117
66	CONCEPT 66. SIGNIFICANCE OF OBTAINING INFORMATION AND EXPLANATIONS FROM THE MANAGEMENT.	118
67	CONCEPT 67. AUDITOR'S REPORT ON REVISED ACCOUNTS OF COMPANIES BEFORE CIRCULATION TO SHAREHOLDERS	121
68	CONCEPT 68. REVISION/ RECTIFICATION OF FINANCIAL STATEMENTS	121
69	CONCEPT 69. REVISION OF THE AUDIT REPORT	122
70	CONCEPT 70. AUDIT OF ABRIDGED FINANCIAL STATEMENTS	123
71	CONCEPT 71: PROVISION FOR PROPOSED DIVIDEND	123
72	CONCEPT 72: ACCOUNTS OF LIQUIDATORS / REPORT U/S 348 OF COMPANIES ACT, 2013	124
73	CONCEPT 73: SECTION 182 OF THE COMPANIES ACT AND AUDITOR	124
74	CONCEPT 74: AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS (CFS)	126
75	CONCEPT 75: AUDIT CERTIFICATE	127
76	CONCEPT 76: DIFFERENCE BETWEEN AUDIT REPORT AND AUDIT CERTIFICATE	128
77	CONCEPT 77: BRANCH AUDIT	129
78	CONCEPT 78: JOINT AUDIT	130
79	CONCEPT 79: AUDIT OF SHARES	131
80	CONCEPT 80: AUDIT OF DEBENTURES	136
81	CONCEPT 81: AUDIT OF DIVISIBLE PROFITS AND DIVIDEND	137
82	CONCEPT 82: STATUTORY AUDITOR VS INTERNAL AUDITOR	142
83	CONCEPT 83: AUDITING AND ASSURANCE STANDARDS RELATING TO AUDIT OF INVENTORIES	142

<b>84</b>	<b>CONCEPT 84: AUDITING AND ASSURANCE STANDARDS RELATING TO AUDIT OF FIXED ASSETS</b>	<b>143</b>
<b>85</b>	<b>CONCEPT 85: EDUCATIONAL INSTITUTION</b>	<b>144</b>
<b>86</b>	<b>CONCEPT 86: AUDIT OF HOSPITAL</b>	<b>145</b>
<b>87</b>	<b>CONCEPT 87: CO-OPERATIVE SOCIETIES</b>	<b>146</b>
<b>88</b>	<b>CONCEPT 88: BANK AUDIT</b>	<b>149</b>
<b>89</b>	<b>CONCEPT 89: AUDIT OF TRUSTS</b>	<b>154</b>
<b>90</b>	<b>CONCEPT 90: AUDIT OF MUNICIPALITIES AND PANCHAYATS (LOCAL BODIES)</b>	<b>155</b>

# Study Note 6

## AUDITING CONCEPTS

### CONCEPT 1. ORIGIN OF WORD AUDIT

<b>What is the origin of word Auditing?</b>	<ul style="list-style-type: none"> <li>✓ The term “audit” has been derived from the Latin words “audire”</li> <li>✓ which means to listen.</li> <li>✓ In those ancient days,</li> <li>✓ the person appointed to check the accounts,</li> <li>✓ used to hear the explanations</li> <li>✓ required from responsible officers and that’s why,</li> <li>✓ the person who heard the explanations was called as an “auditor”.</li> </ul>
<b>What has changed so far?</b>	<ul style="list-style-type: none"> <li>✓ However, now a days,</li> <li>✓ due to drastic changes</li> <li>✓ in business, accounting systems, size and the provisions of different laws,</li> <li>✓ this “hearing” concept of auditing is considerably changed and</li> <li>✓ become more exhaustive and therefore,</li> <li>✓ different authors have defined “auditing” differently.</li> </ul>

### CONCEPT 2. Definitions of Audit

<b>Taylor and Perry -</b>	“Audit is defined as an investigation of some statements of figures involving examination of certain evidence, so as to enable an auditor to make a report on the statement.
<b>F.R.M De Paula</b>	“An audit denotes the examination of Balance Sheet and Profit and Loss Account prepared by others together with the books of accounts and vouchers relating there to in such a manner that the auditor may be able to satisfy himself and honestly report that, in his opinion, such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the particular concern according to the information and explanations given to him and as shown by the books”.
<b>Prof. Montgomerly</b>	“Auditing is a systematic examination of the books and records of business or other organization, in order to ascertain or verify and to report upon the facts regarding its financial operations and the result thereof.
<b>M. L. Shandilya</b>	“Auditing may be defined as inspecting, comparing, checking, reviewing, vouching, ascertaining, scrutinizing, examining and verifying the books of accounts of a business concern with a view to have a correct and true idea of its financial state of affairs

<b>Spicer &amp; Pegler</b>	"Audit such an examination of the books of accounts and vouchers of a business, as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business, and whether the profit and loss account gives a true and fair view of the profit or loss for the financial period according to the best of his information and explanations given to him and as shown by the books, and if not, in what respect he is not satisfied".
<b>ICAI-CA</b>	"A systematic and independent examination of data, statement, records, operation and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the proposition before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report".
<b>SA 200 on- "Basic Principles Governing an Audit"</b>	<ul style="list-style-type: none"> <li>✓ <i>An audit is independent examination</i></li> <li>✓ <i>of financial information</i></li> <li>✓ <i>of any entity,</i></li> <li>✓ <i>whether profit oriented or not,</i></li> <li>✓ <i>and irrespective of its size or legal form,</i></li> <li>✓ <i>when such examination is conducted</i></li> <li>✓ <i>with a view to expressing an opinion thereon.</i></li> </ul>

**CONCEPT 3. BASIC MEANING OF AUDITING**

<b>The meaning of an Audit contains</b>	<p>(i) An <b>intelligent and critical examination</b> of the books of accounts of business.</p> <p>(ii) It is done by an <b>independent qualified person</b>.</p> <p>(iii) It is done with the <b>help of vouchers</b>, documents, information and explanations received from the clients.</p> <p>(iv) The <b>auditor satisfies himself with the authenticity</b> of the financial accounts prepared for a particular period.</p> <p>(v) The auditor <b>reports that-</b></p> <p>(a) The <b>Balance Sheet exhibits a true and fair view</b> of the state of affairs of the concern.</p> <p>(b) The <b>profit and loss account reveals the true and fair view</b> of the profit or loss for the financial period.</p> <p>(c) The <b>accounts have been prepared in conformity</b> with the concerned law.</p> <p>(d) If he is not satisfied then <b>reports</b> in what respect <b>he is not satisfied</b>.</p>
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**CONCEPT 4. ESSENTIAL FEATURES OF AUDITING**

<b>Features of Auditing</b>	(i) It involves <b>evaluation &amp; verification</b> of the relevance, reliability and adequacy of evidence in support of verifiable information such as
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	vouchers, documents, explanations.
(ii)	It is <b>analytical, critical and investigative</b> review of systems of Accounting & Internal Controls.
(iii)	The information audited <b>may be financial or non-financial</b> . In case of non financial the information is such that it effects financial figures.
(iv)	There should be <b>standards or criteria for evaluation</b> of the information in a systematic & scientific manner.
(v)	The auditor should be <b>competent and independent, qualified</b> & possessing prescribed qualification & certificate of practice.
(vi)	It <b>ensures reliability of information and authenticity of assertions</b> made in the financial statements relating to enterprises, whether profit-oriented or not and whether it is required by law or not, to enable the auditor to form his opinion on these statements with regard to true and fair view of state of affairs of Business and of profit or loss made during financial period disclosed there in.

#### CONCEPT 5. NATURE OF AUDITING

<b>What IASSB Says?</b>	<p>International Auditing and Assurance Standard Board (IAASB) defines the term 'audit' as</p> <p>"The objective of an audit of financial statements is to enable the auditor to express an opinion <b>whether the financial statements are prepared</b>, in all material respects, in accordance with an identified financial reporting framework".</p>
<b>What Mautz Says.</b>	<p>Mautz defines auditing as being "concerned with the <b>verification of accounting data</b>, with determining the accuracy and reliability of accounting statements and reports."</p> <p>The emphasis is clearly on verification of accounting data with a view to reporting on the reliability of the accounting statements.</p>
<b>What has changed so far?</b>	<p>Developments in the last few decades have extended the scope of auditing.</p> <p><b>Auditing today is no longer concerned only with financial accounting records</b>, it may also involve a review of compliance with law, costing records, operations and performances.</p> <p>Therefore, a more comprehensive definition is required to describe modern auditing.</p>

<b>How ICAI Defines Auditing now?</b>	<p>ICAI (CA) has defined auditing as “a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose.</p> <p>“This definition does not confine auditing to accounting records. It recognizes that auditing can extend to such areas as managerial performances, cost data and operations.</p>
<b>Arens, Elder and Beasley’s opinion</b>	<p>According to them, “auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria. Auditing should be done by a competent independent person.”</p> <p>This definition emphasises the following points.</p> <ul style="list-style-type: none"> <li>(i) The information under audit need not necessarily be accounting information. However, information must be in a verifiable form.</li> <li>(ii) There should be standards or criteria for evaluation of the information.</li> <li>(iii) The auditor should not only be a competent person but he should also have an independent mental attitude.</li> </ul>

#### CONCEPT 6. SCOPE OF AUDITING

<b>What Schlosser says?</b>	<p>Development in the last two decades has extended the scope of auditing.</p> <p>Therefore, a more comprehensive definition of auditing given by Schlosser may also be considered.</p> <p>According to him, auditing is a “systematic examination of financial statements, records and related operation to determine adherence to generally accepted accounting principles, management policies of stated requirements”.</p> <p>The earlier definition of auditing by Mautz emphasizes the verification of accounting statements. While retaining that emphasis, Scholsser’s definition extends the scope of auditing by including in it an examination of allied operations.</p> <p>Similarly the purpose of auditing has been extended to examination of allied operations to ‘management policies or stated requirements’. This, where as the previous definition mainly covers Mautz independent professional audit, Schlosser’s definition also covers cost audit, internal audit, Government audit, management audit, operational audit and the like.</p> <p>The auditor is not supposed to perform the duties which are beyond the scope of his competence. However he is expected to exercise due diligence and professional care in his work as expected of him.</p>
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<b>Auditing begins where accounting ends.</b>	<p>Accounting is concerned with the recording of the transaction and preparation of statements of account but auditing involves a detailed and critical examination of accounts prepared by others.</p> <p>In fact, auditing begins where accounting ends. Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in the report. Qualified opinion or disclaimer of opinion should be expressed as appropriate.</p> <p>According to Schlosser, audit now also covers Cost Audit, Management Audit, Internal Audit, Energy Audit, Excise Audit, VAT audit and Government audit too. Today audit is not confined to the business houses only, but also to non-business organizations. Auditor is in the nature of a watch-dog and a trustee of the nation's finances.</p>
<b>What SA 200A says?</b>	<p>As per SA-200A on "Objectives and Scope of Audit of Financial Statements" the scope of an audit of financial statements will be determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislations and pronouncement of the Institute of Chartered Accountants of India.</p>

#### CONCEPT 7. RELATIONSHIP AND DISTINCTION BETWEEN ACCOUNTING & AUDITING

<b>The relationship between accounting and auditing has been explained by Kell and Ziegler in "Modern Auditing" as follows:</b>	<b>Accounting</b>	<b>Auditing</b>
	1. Analyze events and transactions	1. Review client's internal control system
	2. Record and summarize data in accounting records	2. Obtain and evaluate evidence on statement assertions
	3. Make financial statement assertions	3. Determine fairness of statements in conformity with recognized accounting principles
	4. Prepare financial statements as per recognized accounting principles and applicable regulations	4. Prepare audit report on finding
	5. Distribute Financial statements and Auditor's report to shareholders	5. Deliver audit report to client
	6. Accounting is first & after it is done auditing starts	6. Auditing starts where accounting ends

<b>DISTINCTION between the two:</b>  <b>[MTP June 17 Q.7a 9 Marks]</b>	<b>Accounting</b>	<b>Auditing</b>
	1. It is the collection, classification and summarization of data for preparation of books of accounts, and to make financial statements.	1. Auditing is an analytical and critical examination of books of accounts, financial records and the financial statements prepared thereon.
	2. It is the recording of transactions at the time of occurrence.	2. It is the post mortem examination of recorded transactions.
	3. It measures the business events in monetary terms, records them, and communicates the financial results through Financial Statements.	3. Auditing reviews financial records to form an opinion on the authenticity of Financial Statements.
	4. The primary responsibility is of the management towards the shareholders/ owners, to maintain the Financial records in such a manner that Financial Statements can be prepared from the records.	4. The auditor is an independent person appointed by the business entity to review the Financial Statements and to give his opinion thereon.
	5. An accountant is not expected to review/ report on the Financial Statement but to report the compilation of records to the management.	5. An auditor is required to submit a report with his opinion on 'true and fair' assertions made in the Financial Statements to the owners.
	6. An accountant works for/ under the management.	6. The auditor is an independent person answerable/ liable to the owners/ shareholders and not just to the management
	7. No such liability; liable to its management for improper accounts	7. In certain circumstances, the auditor could be held liable to third parties also.
	8. Maintenance of accounts may not be mandatory for small individuals or partnership firms, e. g. under section 44AA of the Income Tax Act, but could be mandatory under other laws, e. g. for companies under the Companies Act.	8. Audit could be exempt for various individuals or small partnerships, e. g. under section 44AB of the Income tax Act, and even in case where maintaining books of accounts is a statutory requirement under section 44AA, but may be mandatory under other laws e. g. for Companies under the companies Act.
	9. Accounting is done as per the principles set by Indian Accounting standards (Ind AS)	9. Auditing is done as per the principal set in standards on auditing.

**CONCEPT 8. AUDITOR**

<b>Who is Auditor?</b>	<p>The person conducting the audit is known as the Auditor.</p> <p>To be an auditor, the person should be professionally qualified.</p> <p>For example, under the Companies Act, 2013, only Chartered Accountants who are professionally qualified and possess certificate of practice which is valid and are allowed to conduct the audit of the accounts of the companies.</p>
<b>Qualities of a Successful Auditor</b>	<p>(i) An auditor should have a sound knowledge of various disciplines associated with the audit such as accountancy, economics, mathematics etc.</p> <p>(ii) As per SA-200 on Basic Principles Governing an Audit issued by ICAI (CA) an auditor must possess the integrity and be objective and independent in his approach to the audit work.</p> <p>(iii) The auditor must have the knowledge of the general principles of the Law governing the auditee enterprise. For example, while auditing a company the knowledge of the Companies Act, 2013 is necessary. If an enterprise is governed by some special statute as in case of Banking Companies, the knowledge of that special statute (Banking Regulation Act in case of Banking Companies) is also imperative.</p> <p>(iv) An auditor should also have an understanding of the special features which are peculiar to a particular business. SA 300 (Revised) and SA 310 issued by ICAI (CA) lay down principles in this regard.</p> <p>(v) Though technical knowledge is necessary to conduct an audit, only those persons whose technical knowledge is backed by basic human qualities can prove to be successful auditors.</p> <p>(vi) In the case of London &amp; General Bank, Lord Justice Lindley said that "an auditor must be honest, that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true.</p>

**CONCEPT 9. AUDIT AND INVESTIGATION**

Differences	BASIS	AUDIT	INVESTIGATION
<p>[MTP December 2019 Q.7a 7 Marks]</p> <p>[MTP June 2019 Q.7b 7 Marks]</p>	1. Meaning	Auditing is an independent and systematic examination of the evidence underlying the accounting or other data in accordance with the generally accepted auditing practices to ascertain the true and fair view of the financial statements of an enterprise.	An investigation may be defined as an examination of accounts and records with a view to ascertain any fact for some special purpose which varies from assignment to assignment. Considered to a negative word.
	2. Scope	The audit has a wide scope. In statutory audit, the scope is determined by the relevant law and in case of a private audit (e.g. management audit) by a client.	The scope of investigations, on the other hand, is limited as regards the period or areas to be covered.
	3. Objective	In audit, the accounts and records are verified as to their truth and fairness. It is general in nature.	Investigation is for special purpose (e.g. investigation on the behalf of incoming partner). It is specific in nature.
	4. Audit Procedure	The audit is conducted in accordance with the generally accepted auditing principle.	Investigations involve an extended auditing procedure.
	5. Evidence	An auditor will evaluate the accounting records predominantly based on persuasive evidence.	An investigator can draw his conclusions only on the basis of substantial or sometimes conclusive evidence.
	6. Approach	Auditor is sceptical and not suspicious.	Whereas an investigator starts with suspicion and collects evidence to either confirm or dispel that suspicion.
	7. Periodicity	Auditing is a routine exercise (normally conducted annually).	Investigation may spread over a gap period longer than one year.
	8. Requirement	Mandatory	Not mandatory

**CONCEPT 10. ASPECTS TO BE COVERED IN AUDIT**

**“The principal aspects to be covered in an audit concerning the final statements of accounts are as follows:**

<b>Accounting and Internal Control System</b>	<p>The auditor should develop an understanding of the accounting and the internal control system operating in the enterprise.</p> <p>Such an understanding will enable the auditor to ascertain the degree to which reliance can be placed on the information obtained during the audit.</p> <p>Further, the auditor should review the system from time to time to ascertain its adequacy and comprehensiveness.</p>
<b>Examination of books, records etc</b>	<p>The auditor should check the arithmetical accuracy of the books of accounts as well as the authenticity and the validity of transactions entered into the books of accounts.</p> <p>He should ensure that the entries in the books of accounts are adequately supported by underlying papers, documents and other evidence.</p> <p>Further, none of the entries in the books of accounts has been omitted in the process of compilation and nothing which is not in the books of accounts has found place in the financial statements.</p>
<b>Compliance with the Generally Accepted Accounting Standards and Applicable Statutory Regulations</b>	<p>The financial statements should be prepared in accordance with the requirements of applicable laws and should comply with the relevant Indian Accounting Standards, guidance notes issued by ICAI (CA) etc.</p> <p>For example, a proper distinction should be made between the items of capital and revenue nature, in case a company declares dividend it should comply with the requirements of the Companies Act and the relevant Rules made there under</p>
<b>Reporting</b>	<p>Once the audit is carried out, the audit findings need be communicated to the appropriate personal body (e.g. shareholders in case of company).</p> <p>An audit report states the opinion of the auditor as to the true and fair view of the financial position and operating results of the enterprise.</p>

**CONCEPT 11. OBJECTIVES OF AUDITING**

According to SA 200 overall objective of the Independent auditor and the conduct of an audit in accordance with SAs, in conducting an audit of financial statements, the overall objectives of the auditor are:

<b>First</b>	(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
<b>Second</b>	(b) To report on the financial statements, and communicates as required by the SAs, in accordance with the auditor's findings''.

**An audit is conducted with two main objectives:**

<b>Primary Objective:</b>	The main objective of an audit is to determine whether the financial statements presents a "true & fair view" of the financial position and financial performance of a business during the period.
<b>Secondary Objective:</b>	<p>The auditor is also responsible for detecting frauds and errors in the books of accounts and financial records of the client's business. Such detection of frauds and errors is called the secondary objective of audit because the primary responsibility for safeguarding the business assets rests with the management.</p> <p>If the auditor suspects the presence of material misstatements or defalcations in the records of the business, he is expected to look into the matter with greater detail by applying various audit procedures to satisfy himself about their existence or non-existence.</p>

**CONCEPT 12. BASIC PRINCIPLES GOVERNING AN AUDIT**

[Q.7a 6 Marks December 2019]

[MTP June 19 Q.7a 7 Marks]

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

<b>(i) Integrity, objectivity and independence:-</b>	The auditor should be straight-forward, honest, sincere and free from any influence on his audit work. He should maintain impartiality and be free of any interest
<b>(ii) Confidentiality: -</b>	He should not disclose the client's information to anybody without the client's permission or under any regulatory requirement.

<b>(iii) Skills and competence:-</b>	The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.
<b>(iv) Work performed by others:-</b>	The auditor should carefully supervise the work performed by others (such as his subordinates, other auditors, experts etc.) as remains responsible for the work delegated by him to his assistants, other auditors or experts.
<b>(v) Documentation: -</b>	Proper working papers should be maintained by the auditor to evidence the audit work. Working paper which is maintained is to demonstrate that the audit is in adherence to the basic principles.
<b>(vi) Planning: -</b>	The auditor should obtain the knowledge about client's business to determine the nature, timing and the extent of the audit procedures.
<b>(vii) Audit evidence: -</b>	The auditor should obtain sufficient appropriate audit evidence through performing the compliance and substantive procedures
<b>(viii) Accounting system and internal controls:</b>	An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures.
<b>(ix) Audit conclusions and reporting: -</b>	On the basis of conclusions drawn from the audit evidence obtained the auditor should give unqualified report or qualified report or adverse report or the disclaimer report.

### CONCEPT 13. SIGNIFICANCE OF AUDIT

<b>Problem with Management Reports to Owners</b>	<p>The problem that has always existed when the manager report to owners is the credibility of the report.</p> <p>The report may —</p> <ul style="list-style-type: none"> <li>(a) contain errors,</li> <li>(b) not disclose frauds,</li> <li>(c) be inadvertently misleading,</li> <li>(d) be deliberately misleading,</li> <li>(e) fail to disclose relevant information,</li> <li>(f) fail to conform to regulations.</li> </ul> <p>The solution to this problem of credibility in reports and accounts lies in appointing an independent person called an auditor to investigate the report and submit his findings.</p>
<b>Increasing Complexity of Business &amp; Industry</b>	A further point is that modern companies can be very large with multi-national activities. The preparation of the accounts of such groups is a very complex operation involving the bringing together and summarizing of accounts of subsidiaries with different conventions, legal systems and accounting and control systems. The verification of such accounts by independent experts trained in the

	assessment of financial information is beneficial to those who control and operate such organizations as well as to owners and outsiders.
<b>Compliance with Company Law</b>	Many financial statements must conform to statutory and other requirements. The most notable thing is that all company accounts have to conform to the requirements of the Companies Act 2013.
<b>Compliance with AS</b>	In addition, all accounts should conform to the requirements of Indian Accounting Standards (Ind AS). It is essential that an audit should be carried out on financial statements to ensure that they conform to these requirements.
<b>Significance from Legal Point of view:</b>	<p>(i) <b>Filing of Income Tax Return</b> — Income Tax authorities generally accept the profit and loss account that has been prepared by a qualified auditor and they do not go into details of the accounts.</p> <p>(ii) <b>Borrowing of money from external sources</b> — Money can be borrowed easily on the basis of audited balance sheet from the external sources. Most of the financial institution sanctions various loans on the basis of audited financial statements.</p> <p>(iii) <b>Statement of Insurance Claim</b> — In case of flood, fire, other natural calamities and the like unexpected happenings the insurance company may settle the claim for loss or damages on the basis of audited accounts of the previous year.</p> <p>(iv) <b>Sales tax payments</b> — The audited books of accounts may generally be accepted by the sales tax authorities.</p> <p>(v) <b>Action against bankruptcy</b> — The audited accounts serve as a basis to determine action in bankruptcy and insolvency cases.</p>
<b>From Internal Control Point of View</b>	<p>(i) <b>Quick discovery of errors and frauds</b> — Errors and frauds are located at an early date, so that in future no attempt is made to commit such frauds as one is rather careful not to commit an error or a fraud as the accounts are subject to regular audit.</p> <p>(ii) <b>Moral check on the employees</b> — The auditing of the accounts keeps the accounts clerks and the accountants regular and vigilant as they know that the auditor would complain against them if the accounts are not prepared upto date or if there is any irregularity.</p> <p>(iii) <b>Advice to the management</b> — It may happen that the management may consult the auditor and seek advice on certain technical points although it is not the duty of the auditor to give advice.</p> <p>(iv) <b>Uniformity in accounts</b> — If the accounts have been prepared on an uniform basis, accounts of one year can be compared with other years and if there is any discrepancy, the cause may be enquired into.</p>



<b>From External Affairs Point of View</b>	<p>(i) <b>Settlement of accounts</b> — The audited accounts would facilitate the settlement of accounts of a deceased partner.</p> <p>(ii) <b>Valuation of assets and goodwill</b> — If the business is to be sold as a going concern basis, there may not be much difficulty regarding the valuation of assets and goodwill as the accounts have already been audited by an independent person.</p> <p>(iii) <b>Future trend of the business</b> — From the audited books of accounts, the future trend of the business can be assessed easily with certainty.</p>
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**CONCEPT 14. ADVANTAGES OF AUDIT**

<b>Advantages</b>	<p>(i) Audit is a tool, which different stakeholders can use to protect their interests in the enterprise. Auditors are called as 'eyes &amp; ears' of the shareholders.</p> <p>(ii) Audit is not only a corrective measure but has a deterrent effect. It serves as a moral check on the employees from committing defalcations or embezzlements.</p> <p>(iii) The employees of the organisation remain alert and vigilant as regards the updating of books of accounts and other records.</p> <p>(iv) Audited accounts are considered more reliable by different cadres of Government. For example, the tax audit report filed with the Taxation authorities.</p> <p>(v) It facilitates detection of wastages and losses and helps in instituting corrective actions.</p> <p>(vi) Audited accounts are taken to be more reliable and useful during corporate restructuring exercises, valuations etc.</p> <p>(vii) Banks, Financial Institutions and Government require audited accounts before granting any financial assistance to the enterprise.</p> <p>(viii) Audited accounts are taken to be more helpful in the settlement of accounts between the partners and thus avoiding any dispute amongst them.</p>
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**CONCEPT 15. INHERENT LIMITATIONS OF AN AUDIT**

<b>Responsibility of Auditor and Management</b>	<p>While the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the enterprise.</p> <p>Management's responsibility includes the maintenance of adequate accounting records and internal controls, selection and application of accounting policies and safeguarding the assets of the enterprise.</p> <p>The audit of financial statements does not relieve the management of its</p>
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	responsibilities.
<b>Inherent Limitations</b>	<p><b>(i) An audit does not guarantee that all the material misstatements will be detected because of the following inherent limitations of audit:</b></p> <p>(a) <u>Test nature of the audit</u>; where volume is large, sample tests are carried out.</p> <p>(b) The <u>audit evidence available to the auditor is persuasive</u> rather than conclusive in nature;</p> <p>(c) <u>Inherent limitations of internal control</u>, e.g. certain levels of management may be in a position to override controls.</p> <p><b>(ii) Professional skepticism</b> — <u>Professional skepticism means an approach that would ensure that if something is wrong it is detected</u>. This behavior of auditor helps him in identifying and evaluating</p> <p>(a) matters that increase the risk of material misstatements resulting from fraud or error,</p> <p>(b) circumstances that make the auditor to suspect material misstatements,</p> <p>(c) the question of management's representations reliability. The auditor is entitled to accept the records and documents as genuine unless there is some evidence to the contrary.</p> <p><b>(iii) Materiality is one of basic fundamental concepts in process of Auditing as well as Accounting.</b></p> <p>Auditor has to constantly &amp; continuously judge whether transaction is material or not. It is used by him in his Audit Planning. Materiality means important cost wise, profit wise, effect wise, value wise; which influences economic decision of user. What is material in one circumstance, may not be material in another circumstances. Therefore, changes need to be done accordingly.</p>

#### CONCEPT 16. AUDITOR'S ENGAGEMENT

<b>Requirement of Engagement Letter</b>	<p>In case of a statutory audit the objective and scope of an audit is clearly described in the relevant law.</p> <p>However, in a non-statutory audit it has to be stated with absolute clarity so as to avoid any kind of ambiguity as to the objective and scope of audit. A misunderstanding may arise about the exact scope of the work.</p> <p>For example, the client may be under an impression that while the auditor is preparing the accounts, the audit is also being carried out. Therefore, in order to <u>avoid any kind of misunderstanding or dispute it is in the interests of both the auditor as well as the client to exactly define the scope of the engagement</u> and reduce the same in writing by way of audit engagement letter.</p>
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<b>Significance of Engagement Letter</b>	An auditor's engagement letter signifies the confirmation by the auditor of his acceptance of appointment as auditor, the documentation of the objective and scope of audit or other work, and the extent of his responsibilities to the client and the form of any reports.
<b>Major References of Engagement Letter</b>  <b>[Q.7a 8 Marks June 2017]</b>  <b>[MTP JUNE 2020 Q.7a 8 Marks]</b>	<p>Although the form and content of the engagement letter differs from client to client but in general the following references should be made in audit engagement letter:</p> <ul style="list-style-type: none"> <li>(i) The objective and the scope of the engagement.</li> <li>(ii) Management's responsibility for the financial statements.</li> <li>(iii) The existence of inherent limitations of audit and resulting material misstatements that may remain undiscovered,</li> <li>(iv) The need for use of services of internal auditors and/ or other experts that may arise during the course of the engagement.</li> <li>(v) The requirement of management confirmation letter as regards representations made by them concerning audit.</li> <li>(vi) Restriction of the auditor's liability, if any.</li> <li>(vii) Basis for computation of audit fees and billing arrangements.</li> <li>(viii) The form of reports or other communication of results of the engagement.</li> </ul>
<b>Importance of Audit Engagement Letter</b>	<p>The importance of audit engagement letter was highlighted in the case of <u>Leech v Stokes</u>.</p> <p>In this case the auditors were instructed to prepare the annual profit and loss account of a firm of solicitors for submission to the tax authorities. The evidence showed that proper books of account were not maintained and though the firm collected large sums by way of rent on behalf of its clients, no proper cash book and client's ledger were maintained.</p> <p>On the basis of record of bills against clients as well as summary of firm's expenses, the profit and loss account was prepared. Subsequently, it was found that there was misappropriation of the rents collected and the auditors were sued for negligence in their work. <u>The judgment, given purely on the basis of facts, held the auditors not guilty, as in their letter they had clearly indicated the restricted nature of their engagement.</u></p>

**CONCEPT 17. FUNCTIONAL CLASSIFICATION OF AUDIT – COMPARISON BETWEEN EXTERNAL AND INTERNAL AUDIT [MTP Dec 2018 Q. 7a 7 Marks]**

<b>Appointment</b>	<p>(i) The <u>external auditors are appointed by the owners</u> of the organisation, e.g., shareholders in case of a company. When external auditors are appointed under a particular statute, they are called as statutory auditors.</p> <p>But <u>internal auditors are appointed by the management of the organisation</u>. The</p>
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	internal auditors may be appointed on contractual basis or any employees of the organisation may be asked to take up the assignment.
<b>Scope of Work</b>	(ii) The scope of work of an external auditor is determined by the particular statute under which they are appointed but the internal auditors have to work within the scope defined by the management which generally includes review and appraisal of accounting, financial and administrative controls.
<b>Main Concern</b>	(iii) The main concern for an external auditor is to collect the adequate and reliable evidence to support his opinion as to the truth and fairness of the representations made in the financial statements. The internal auditors, on the other hand, are concerned with the compliance of various policies, rules and procedures of the enterprise, compliance with applicable laws and generally accepted accounting principles.
<b>Responsibility</b>	(iv) The external auditors are directly responsible to the owners and in some cases to the third parties but the internal auditors do not have any freedom to report to the outsiders. Internal Auditors report to Management so that they can take corrective action, if required.
<b>Independence</b>	It may be noted that unlike external auditors, internal auditors are generally not considered as independent of the management. But one of the basic philosophies of audit is that the auditor must be independent. Thus, in order to derive benefit from audit in its right earnest even internal auditor must be independent to the extent practicable.

#### CONCEPT 18. TYPES OF AUDIT

<b>Depending on independence and interference of the client</b>	<p><b>(a) Statutory Special Audit by auditors (investigators)</b> appointed by the Government to report to the respective government authorities on specific issues. This has the least interference of the client. The auditor is generally supposed to submit a report to the appropriate authorities on matters and in the form specified to him, within a specified timeframe. This audit may relate to one or more financial years.</p> <p><b>(b) Statutory Audit, or Cost Audit, or Tax Audit</b> by independent auditors appointed by the Company, or Board of Directors, or the client. This has high degree of independence. However the level of independence is specified in the governing statutes. The manner, content, time for submission of the audit report and the person to whom it is to be reported are governed by the respective statutes.</p> <p><b>(c) Internal audit by an auditor</b>, who may or may not be an independent auditor, appointed by the management depending on the nature and scope defined and mutually decided in the terms of engagement.</p>
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<b>Depending on functional classification</b>	(a) Statutory Audit of a Company or a LLP (b) Statutory cost audit

**CONCEPT 19. CONCEPT OF TRUE AND FAIR**

<b>Fundamental Concept of True and Fair</b>	<p>The concept of true and fair is a fundamental concept in auditing.</p> <p>This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amounts which are in accordance with accounting principles and policies which are relevant and no material amount, item or transaction has been omitted.</p>
<b>What constitutes True and Fair</b>	<p>What constitutes “true and fair”, however, has not been defined in any legislation.</p> <p>In the context of audit of a company, however, section 129 of the Companies Act 2013 provides that the accounts of a company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Schedule III to the Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements.</p> <p>It must be noted that the disclosure requirements as laid down by the law are the minimum requirements. If certain information is vital for showing a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so.</p> <p>Thus, what constitutes a ‘true and- fair view is a matter of an auditor’s judgment in the particular circumstances of a case.</p>
<b>Auditor’s Duty</b>	<p>In more specific terms, to ensure true and fair view, an auditor has to see the following;</p> <ul style="list-style-type: none"> <li>(i) That the assets are neither undervalued or overvalued, according to the applicable accounting principles;</li> <li>(ii) No material asset is omitted,</li> <li>(iii) The charge, if any, on assets are disclosed,</li> <li>(iv) Material liability should not be omitted,</li> <li>(v) The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with part I of Schedule III,</li> <li>(vi) All unusual, exception or non- recurring items have been disclosed separately.</li> </ul>

**CONCEPT 20. CONCEPT OF MATERIALITY IN PLANNING AND PERFORMING THE AUDIT**

<b>Materiality : A Fundamental Concept</b>	Materiality is one of the basic fundamental concepts in the process of Accounting and Auditing. It is a continuous process and covers in its ambit all the stages from recording to classification and presentation. <u>An auditor has to constantly judge whether a particular item or transaction is material or not.</u>
<b>What SA 320 Says?</b>	SA 320 on Materiality in Planning and Performing an Audit lays down that "The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements."  It lays down a Standard on Auditing (SA) on the concept of audit materiality in relationship with the audit risk affecting the planning and procedures of the auditors.
<b>Materiality of an item may influence the economic decision of the user:</b>	<u>It is a relative term</u> , the knowledge of which may influence the economic decision of the users of the Financial Statements. It requires that the auditor should consider materiality and its relationship with audit risk while conducting an audit and therefore an auditor requires more reliable evidence to support material items.  <u>No item is material in all circumstances, what may be material in one circumstance may not be material in another.</u>  It may be a statement, silence (or omission) or a misstatement in the Financial Statements, materially affected if such statement is erroneously stated or omitted to be stated therein and economic decision of the users taken on the basis of such information is influenced by such misstatement or omission.
<b>The main factors to be considered for determining materiality of an item are:</b>  [MTP Dec 19 Q.7a 6 Marks]  [MTP June 18 Q.7b 7 Marks]  [MTP June 17 Q.7b 7 Marks]	<b>(i) Individually:</b> It may be determined individually. E.g., a payment of ` 1000 may be material in a small business, but even ` 1 lac could be immaterial for a big business entity.  <b>(ii) Aggregate:</b> It may be determined in aggregate. E.g., total income from investment in mutual funds could be more material than looking into each individual investment.  <b>(iii) Legal Considerations:</b> It depends on the statutory or legal considerations. E.g., where the terms of appointment of a whole time director are not according to law, the remuneration paid to him is a material item even if the financial implication is not much.  <b>(iv) Legal Definition:</b> It may be defined or described in law itself. E.g., Schedule III requires separate disclosure of items of all expenses exceeding 1% of turnover or

	<p>to write off capital assets purchased for less than ₹ 5000.</p> <p><b>(v) Relative overall impact:</b> It may depend on the relative degree of relevance to the overall accounts or the group, or class of transactions to which it pertains. E.g., short recoveries from debtors.</p> <p><b>(vi) Qualitative:</b> It may be qualitative and not often reckoned with respect to quantitative details alone. E.g., improper disclosure of an accounting policy in the Notes to the Annual Financial Statements may affect economic decisions.</p> <p><b>(vii) Insignificant quantity but special context:</b> It may be of an insignificant quantity otherwise, but material in special circumstances. E.g., rounding off to the nearest rupee the fraction of 0.666 as 0.67 in computer software. It may be material in future due to cumulative effect even if insignificant now.</p>
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#### CONCEPT 21. DISCLOSURE OF ACCOUNTING POLICIES

<b>What are Accounting Policies?</b>	<p>Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of the financial statements.</p> <p>The view presented in the financial statements of an enterprise as to its state of affairs and operating results may be significantly affected by following different accounting policies in the preparation of financial statements.</p> <p>Thus, <u>an adequate disclosure of accounting policies is very necessary so that the view presented in the financial statements can be apprehended by the users of the financial statements.</u></p>
<b>AS-1</b>	<p>The Institute of Chartered Accountants of India (ICAI-CA) has issued AS-1 on Disclosure of Accounting Policies in this regard. The purpose of this Accounting Standard is to promote better understanding of the financial statements by laying down the principles as to the manner of disclosure of accounting policies.</p>
<b>Fundamental Accounting Assumptions</b>	<p>It is generally assumed that the financial statements are prepared on the basis of fundamental accounting assumptions.</p> <p><b>AS-1 on Disclosure of Accounting Policies lists the following three fundamental accounting assumptions:</b></p> <p><b>(i) Going Concern</b> - It means that the enterprise has an intention to carry on its operations for the foreseeable future (i.e. coming 1 or 2 years). There is no intention on the part of the enterprise to discontinue the business nor has any need arisen as to the liquidation of the organisation. It is because of this fundamental assumption that depreciation etc. is provided in the books of</p>

	<p>accounts.</p> <p><b>(ii) Consistency</b> - Accounting policies are followed on consistent basis from one period to another. For example, ABC Ltd. values its inventory on FIFO basis. The same basis of valuation is adopted in subsequent year also as per the Principle of consistency.</p> <p><b>(iii) Accrual</b> - Revenues and cost are accrued, i.e., they are recognised when they are earned or incurred. Actual receipt or payment is not necessary. In other words, the accounts are maintained on 'mercantile system' only.</p>
<b>Factors determining selection of accounting policies</b>	<p>The accounting policies should be selected in such a manner that when financial statements are prepared on the basis of such policies, they reflect a true and fair view of the state of affairs and the operating results of the enterprise. The accounting policies are selected on the basis of following factors which are enunciated below;</p> <p><b>(i) Prudence</b> - It states to 'provide for all losses and anticipate no profits.' At the time of preparation of financial statements the preparer may face various uncertainties, for example, as to recoverability of receivables, warranty claims etc. Thus, estimates are made for uncertainties and provided for in the books of accounts. For example, provision for bad and doubtful debts.</p> <p><b>(ii) Substance over Form</b> - The transaction should be accounted for in accordance with its actual happening and the economic reliability. The legal form is not relevant. For example, in case of hire purchase transaction, the assets purchased under hire purchase are shown under the asset side of the balance sheet of the hire purchaser even though he is not the legal owner. The reason being the ultimately the legal ownership of the asset would be transferred to the hire purchaser.</p> <p><b>(iii) Materiality</b> - Financial statements should disclose all the items and facts which are sufficient enough to influence the decisions of the user of the financial statements.</p>
<b>IND AS 1</b>	<p>Ind AS-1 further states that any change in accounting policy which has a material effect should be disclosed.</p> <p>The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable and if it is not ascertainable, either wholly or in part, the fact should be indicated.</p> <p>If a change is made in accounting policy(s) which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in subsequent periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.</p>



<b>Some of the areas where different accounting policies may be followed</b>	(i) Valuation of inventories - First In First Out (FIFO), Weighted Average, Last In First Out (LIFO) method (ii) Methods of providing depreciation -Straight Line, WDV, (iii) Conversion of foreign currency items -Average rate, TT rate, (iv) Treatment of retirement benefits, (v) Expenditure during the construction period, (vi) Government grants, etc.
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**CONCEPT 22. VARIOUS TYPES OF AUDIT**

<b>(i) Organisational Structure</b>	(a) Voluntary Audit/ Private Audit (Non mandatory) - Sole Proprietorship - Partnership Firm - LLP/ NGOs (b) Statutory Audit (Mandatory through statute) (c) Government Audit - Audit by CAG
<b>(ii) Objective</b>	(a) Independent Financial Audit (b) Internal Audit (c) Cost Audit (d) Management Audit (e) Tax Audit (f) Secretarial Audit (g) Forensic Audit (h) Information Security Audit (i) Social Audit (j) Environment Audit (k) Performance Audit (l) Propriety Audit (m) Operational Audit
<b>(iii) Timing</b>	(a) Continuous Audit (b) Annual Audit (c) Interim Audit (d) Balance Sheet Audit
<b>(iv) Scope</b>	(a) Complete Audit (b) Partial Audit (c) Detailed audit (d) Special Audit - to know about a special transaction
<b>Interlocking</b>	The above broad classification is sometimes inter-locked

	<p>E.g:</p> <p>(a) Tax Audit and Cost Audit are statutory audits.</p> <p>(b) Balance Sheet Audit has defined scope.</p> <p>(c) Scope of Audits may be decided by the terms of engagement or by the statute governing the Audit.</p>
<p><b>Broad Classification of Audit</b></p> <p><b>[MTP Dec 17 Q.7a 5 Marks]</b></p>	<p>Broadly there are two classifications of audits:</p> <p>(i) Statutory Audit</p> <p>(ii) Voluntary Audit or Private Audit</p> <p><b>(A)</b> Statutory audits are mandatory in nature. Audit of companies is mandatory under the provisions of the Companies Act, 2013. Audit of insurance companies, banking companies and cooperative societies are also compulsory under the specific statutes, as applicable.</p> <p><b>(B)</b> Voluntary audits are non-statutory audits. There is no statutory requirement for audits of sole trader, partnership firm (except for a statutory tax audit u/s 44AB required as per the Income Tax Act, 1961, e.g. when such an entity exceeds the turnover of certain limit). The sole proprietors and partnership firms may get their accounts audited voluntarily on their own because of certain advantages.</p>
<p><b>ADVANTAGES OF AUDITING FOR SOLE PROPRIETORS</b></p> <p><b>[MTP June 17 Q.7b 3 Marks]</b></p>	<p>(i) It evaluates the internal control system and strengthens it by removing weaknesses, if any.</p> <p>(ii) It increases the reliability and authenticity of Financial Statements.</p> <p>(iii) It helps in timely finalization of Annual Financial Statements and tax assessments.</p> <p>(iv) It keeps a moral check on the working of employees.</p> <p>(v) It helps them in obtaining funds easily from financial institutions, based on more reliable Financial Statements available to the banks and financial institutions.</p> <p>(vi) It helps in settling:</p> <ul style="list-style-type: none"> <li>- Trade disputes</li> <li>- Labour disputes</li> <li>- Insurance claims</li> </ul>
<p><b>ADVANTAGES OF AUDITING FOR PARTNERSHIP FIRMS &amp; OTHERS</b></p>	<p>The added advantages besides other advantages are enumerated below;</p> <p>(i) It helps in settlement of accounts among the partners on the basis of more reliable accounting records.</p> <p>(ii) It protects the interest of minors, sleeping partners/partners who are not involved in day to day operations, and keeps a check on persons who are working on behalf of others.</p> <p>(iii) It helps in partnership firms for settlement of goodwill at the time of admission, retirement and death of partners.</p> <p>(iv) It enables firm to get loans from banks, financial institutions as they rely on audited accounts of firm.</p>

<b>STATUTORY AUDIT</b>	<p>Statutory audit is the checking of accounts as required by law. A statute or law may require having an annual audit of financial records of a company or any other entity. The law may require the audit to be conducted in the specified manner. The manner of reporting, contents of the report and the authority to which the report of auditors should be presented are all specified by the statute. Statutory audits are mandatory in nature. The statutory auditor is generally the principal auditor in an organization.</p> <p>i. In the case of companies, the Companies Act, 2013 governs the audit of accounts, its reporting, and manner of preparing the audit report.</p> <p>ii. In the case of audit of a government body, the scope and audit programmes are set by the Comptroller and Auditor General (CAG) of India and the Companies Act, 2013.</p> <p>iii. In the case of audit of an insurance company or a nationalized bank, the audit is governed by specific statutes and IRDAI/RBI (Insurance regulatory &amp; Development Authority of India &amp; Reserve Bank of India) guidelines. Co-operative banks are also governed by the Co-operative Societies Act, 1912.</p> <p>The statutory auditor of a company is appointed by the board/shareholders in the General Meeting and shareholders cannot delegate this power to directors even by passing a special resolution.</p> <p>A statutory auditor can be appointed by the Central Government if shareholders fail to appoint an auditor. A statutory audit should be performed by a qualified Chartered Accountant holding a valid Certificate of Practice (COP) and not by any other person.</p>
<b>Advantages of Statutory Audit</b>  <b>[MTP Dec 17 Q.7a 8 Marks]</b>	<p>The auditor expresses his independent opinion after following relevant audit procedures and checking the external and internal evidences necessary for the conduct of audit. He comments on the truthfulness and fairness of statement of affairs of the organization as on certain date and also about the fact that no misstatement or misrepresentation has been made in the Financial Statements under report.</p> <p>Such an independent opinion by the auditor increases the reliability, authenticity and credibility of the Financial Statements which may further be used by different users for various purposes such as:</p> <p>(i) The members/shareholders/stakeholders, for their economic decisions and for exercising their voting rights.</p> <p>(ii) For timely tax assessments.</p> <p>(iii) For determining the purchase or sale consideration in case of ongoing concern.</p> <p>(iv) Settlement of partners' accounts in case of admission, retirement or death of partner on account of goodwill or otherwise.</p> <p>(v) Before the court, in case of settlement of disputes with employees, creditors or debtors.</p> <p>(vi) For determining the actual value of business or shares in case of merger,</p>

	<p>acquisition, etc.</p> <p>(vii) For getting financial assistance from financial institutions, banks or investors.</p> <p>(viii) In case of non-profit organizations, for getting government grants and availing tax exemptions.</p> <p>(ix) Evaluation of the internal control systems and strengthening it by removing the inherent weaknesses, and checking the efficacy of the internal checks.</p> <p>(x) For checking the integrity of the management which manages the funds and affairs on behalf of the real owners or shareholders.</p> <p>(xi) For other users of financial statements like creditors, investors and government agencies, it ensures that any assertions in the Financial Statements are neither overstated/understated nor misrepresented.</p> <p>(xii) For the proper distribution of profits by way of payment of wages and other benefits.</p> <p>(xiii) For ensuring of proper distribution of profits as dividends.</p> <p>(xiv) For ensuring that all legal requirements are fulfilled and statutory compliances are adhered.</p> <p>(xv) For settlement of insurance claims or other recoveries from government bodies or otherwise.</p>
<p><b>GOVERNMENT AUDIT</b></p> <p><b>[MTP Dec 2018 Q.7b 5 Marks]</b></p>	<p><b>Meaning:</b> United Nations (UN) Handbook on Government Auditing in Developing Countries states that "Government auditing is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity for the purpose of evaluating and verifying them, presenting a report containing comments, conclusions, recommendations and expressing the appropriate professional opinion in respect of financial statements."</p> <p><b>Authorization:</b> The Comptroller &amp; Auditor General (CAG) of India is the Supreme Audit Institution.</p> <p><b>Types of Government Audit</b></p> <p><b>(a) Transaction audit</b></p> <p>i. Expenditure Audit</p> <p>ii. Receipts Audit</p> <p><b>(b) Efficiency cum Performance Audit</b></p> <p><b>Expenditure Audit:</b> The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. Some standards are briefly explained below;</p> <p><b>i. Audit against Rules &amp; Orders:</b> It is also known as Regularity Audit. Under this, the auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and orders framed by the competent authority.</p>

	<p><b>ii. Audit of Sanctions:</b> The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorizing such expenditure. In case expenditure exceeds the sanctioned limit, objection is raised.</p> <p><b>iii. Audit against Provision of Funds:</b> It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the sanctioned amount as well as examine whether the money has been spent for the specified purpose.</p> <p><b>iv. Audit of financial propriety:</b> The auditor has to ensure that the expenditure incurred are with respect to the recognized standards of financial propriety i.e. quantity, quality, morality and ethics.</p>																								
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<b>INDEPENDENT FINANCIAL AUDIT</b>	<p>An independent financial audit may be conducted by a qualified auditor at the request of a client, which may be a sole-proprietorship, partnership, non-profit organization or any other entity. Its objective is to comment on the truthfulness and fairness of the Financial Statements, and it may be compulsory under some Acts which govern the entity.</p>																								

<b>INTERNAL AUDIT</b>	<p>ICAI describes Internal Audit as “an independent management function, which involves a continuous and critical appraisal of the functioning of entity with a view to suggest improvements thereto and to add value and strengthen the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system. Internal Audit, therefore, provides assurance that there is transparency in reporting, a part of good governance”.</p> <p>Internal Audit being an independent appraisal function ensures objectivity and consultation which enhances the value and improves an organization’s operations. It not only includes matters related to finance but also critical appraisal of the policies and procedures of the company. Internal Audit is based on principle of “early detection &amp; prevention of further damage”. It points out irregularities, non compliances timely and not after year end as in case of Statutory Audit. It believes that “prevention is better than cure”.</p>
<b>FORENSIC AUDIT</b>	<p>Forensic audit involves examination of legalities by blending the techniques of propriety audit, regularity, investigative and financial audits. The objective is to find out whether or not true business value has been reflected in the Financial Statements and in the course of examination to find whether any fraud has taken place.</p> <p>Major accounting scandals involving Enron, Worldtel, Parmalat and Satyam have been widely reported. In all these cases, the methods and purpose of manipulations in the Financial Statements were peculiar to the motives of such manipulations.</p> <p>The Companies (Auditors’ Report) Order, 2016, requires auditors to report, amongst others, “whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved are to be indicated”. In this background, the techniques of forensic auditing have gained importance.</p>
<b>SOCIAL AUDIT</b>  <b>[MTP June 19 Q.7b 5 Marks]</b>	<p>Organizations, these days, focus on attaining economic growth through performing processes that ensure social and environmental development simultaneously. A social audit is a way of measuring, understanding, reporting and improving an organization’s performance towards meeting its social and ethical objectives. With introduction of mandatory CSR, social audit has gained importance.</p> <p><b>Objectives of Social Audit</b></p> <ul style="list-style-type: none"> <li>i) Assessing the needs of the society and resources available for fulfilling them.</li> <li>ii) Spreading awareness among beneficiaries about the business’ efforts towards attaining social objectives.</li> <li>iii) Increasing efficacy and effectiveness of the organization’s Corporate Social Responsibility (CSR) programmes.</li> </ul>

	<p>iv) Scrutiny of policy decisions, keeping in view the interests of stakeholders.</p> <p><b>Advantages of Social Audit</b></p> <ul style="list-style-type: none"> <li>i) Encourages community participation among different business entities.</li> <li>ii) Ensures continuous efforts towards environmental protection and use of environment friendly production processes.</li> <li>iii) Builds customer satisfaction and trust through ethical business practices.</li> <li>iv) Promotes collective decision making and sharing responsibilities.</li> <li>v) Develops human resources by working towards improvement of workers' and the underprivileged persons' working/ living conditions.</li> </ul>
<b>ENVIRONMENTAL AUDIT</b>	<p><b>Definition and Meaning</b></p> <p>According to the United States Environmental Protection Agency (USEPA), environmental audit may be defined as a systematic, documented, periodic and objective review by a regulated entity of facility operations and practices related to meeting environmental requirements.</p> <p>It protects environment from pollution of Air, Water, Earth etc. With corporate houses being involved in sustainable development, this area has become important. One of specialised audit is "energy audit" where the use of energy resources are audited.</p> <p>The Confederation of British Industry has defined environmental auditing as "the systematic examination of the interactions between any business operation and its surroundings."</p> <p><b>Scope and Object</b></p> <ul style="list-style-type: none"> <li>i. All emissions to air, land and water</li> <li>ii. Legal constraints</li> <li>iii. The effects on the neighboring community, landscape and ecology</li> <li>iv. The public's perception of the operating company in the local area</li> <li>v. It provides expert opinion on hazards in the environment</li> <li>vi. Associated risks</li> <li>vii. The measures that may need to be taken for the management and control of risks.</li> </ul> <p><b>Different steps of an Environment Audit</b></p> <p>The International Chamber of Commerce presents the different steps of an environmental audit as follows:</p> <p><b>1. Pre-audit activities:</b></p> <ul style="list-style-type: none"> <li>i. Selection and scheduling of facility to audit.</li> <li>ii. Selection of audit team.</li> <li>iii. Contact with facility.</li> <li>iv. Planning of the audit.</li> </ul> <p><b>2. Site activities:</b></p>

	<p>i. Understanding of internal controls.  ii. Assessment of internal controls.  iii. Gathering of audit evidence.  iv. Evaluation of audit findings.  v. Report of findings to facility.</p> <p><b>3. Post audit activities:</b>  i. Production of a draft report.  ii. Production of a final report.  iii. Preparation and implementation of an action plan.</p> <p>ISO 14001 is a voluntary international standard for Environmental Management Systems (EMS). It provides the requirements for an EMS and gives general guidelines for its maintenance. An EMS meeting the requirements of ISO 14001:2004 is a management tool enabling an organization of any size or type to:</p> <p>i. Identify and control the environmental impact of its activities, products or services.  ii. Improve its environmental performance continually.  iii. Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.</p>	
<b>EFFICIENCY – CUM-PERFORMANCE AUDIT</b>	It is an examination of the financial and operational performance of an entity. It includes identification of opportunities of greater economy as well as removal of weaknesses after evaluation. Actual performance is compared with the standards set by the entity. If the auditor at the time of evaluation comes across any deviations with respect to the pre-determined standards, it is further investigated.	
<b>Scope of EPA</b>	<b>i. Economy Audit</b>	It ensures that entity has acquired the financial, human and physical resources economically. It implies that resources have been procured in appropriate quantity, quality and at minimum cost.
	<b>ii. Efficiency Audit</b>	It ensures the economical execution of various schemes and policies. It refers to the relationship between inputs and output i.e. the goods and services produced and resources used to produce them, yielding the expected results.
	<b>iii. Effectiveness</b>	It is an appraisal of the performance of schemes and projects with reference to the overall targeted objectives as well as efficiency of the ways and methods adopted for the attainment of objectives.
<b>Approach of EPA</b>	Various steps undertaken by the auditor while conducting EPA are identification of topic, obtain necessary information, preliminary study, planning and execution of	



	audit, reviewing internal control system and reporting.
<b>PROPRIETY AUDIT</b>	<p>A propriety audit is not just concerned with the truthfulness and fairness of the Financial Statements and books of accounts of the client, but also ensures that the transactions entered into by the client, business practices and activities undertaken are not against public interest. Its objective is to see that the business lives upto standards of proper conduct. Legal, economic and financial are all equally important aspects that require to be looked into during the course of the audit.</p> <p>It is an essential element of a Government Audit. The Comptroller and Auditor General (CAG) examines the propriety of all government expenditures to ensure that they have been incurred in the interest of the general public, and are not influenced by personal interests of the government authorities sanctioning it.</p> <p>Section 143 of the Companies Act, 2013 requires the auditor to look into some specified matters to ensure that the Directors of the company do not engage in misappropriation and siphoning of funds. One of the concept of propriety audit is that the Auditor should audit assuming himself as the proprietor of the business organisation.</p>
<b>OPERATIONAL AUDIT</b>	<p>Operational Audit involves examination of all the operations and activities of the entity under audit.</p> <p><b>Objective</b> The objects of operational audit include the following:</p> <ul style="list-style-type: none"> <li>✓ The examination of the control structure of the entity. The relation of department controls to general policies and its relation with control of other departments.</li> <li>✓ It provides an appraisal of whether the department is operating in conformity with prescribed standards and procedures laid down by the management.</li> <li>✓ It checks whether standards of efficiency and economy are maintained. It is concerned with formulation of plans and checking of the implementation of systems and controls in respect of other departments of the entity.</li> <li>✓ It checks whether capacity utilization in production department and achievement of short term targets in marketing departments and other activities are so economically performed to achieve the preset overall goals of the entity.</li> </ul> <p><b>Scope</b> Operational audit, in its initial stages, was developed as a branch of internal auditing. Internal audit focuses on accounting operations of the entity but operational audit has a wider scope of working and covers all other operations, such as production and marketing too.</p> <p><b>Advantages</b> Operational audit is one of the management tools to get first hand information. It is</p>

	<p>more useful in an entity where the management is at a distance from actual operations. It is very useful in large organizations where management cannot control the actual operations due to layers of delegation of responsibility. The management information system has various tools like routine performance report from department heads, internal audit reports, surprise checks, periodic inspections and investigation to control the managers responsible for their departments.</p> <p>The operational audit is also one of the tools used in large or geographically vast entities to control the operation at first stage and to fill up the gaps of information provided by department heads through periodic reports.</p>
<p><b>CONTINUOUS AUDIT</b></p> <p><b>[MTP June 18 Q. 7a 5 Marks]</b></p> <p><b>[MTP June 17 Q. 7a 5 Marks]</b></p>	<p><b>Definition:</b> According to the The Institute of Internal Auditors, USA, continuous auditing is “a method used to perform control and risk assessments automatically on a more frequent basis. Continuous auditing changes the audit paradigm from periodic reviews of a sample of transactions to ongoing audit testing of 100 percent of transactions. It becomes an integral part of modern auditing at many levels..... technology is a key to enabling such an approach.”</p> <p>Continuous audit may be defined as the examination and verification of a firm’s financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.</p> <p>A continuous audit driven system generates alarm triggers that provide advance notice about anomalies and errors detected by the system. It is performed usually by the firm’s internal auditors to eliminate the year-end workload.</p> <p><b>The Basic Features of Continuous Audit</b></p> <ol style="list-style-type: none"> <li>It is a process conducted throughout the year.</li> <li>It is conducted at regular or irregular intervals.</li> <li>It focuses on testing 100% of transactions.</li> <li>Technology is important to enable it.</li> <li>It provides advance notice about errors and irregularities detected.</li> <li>Surprise visits by the auditor are involved.</li> </ol> <p><b>Necessary of Continuous Audit</b></p> <p>Continuous audit is necessary where:</p> <ol style="list-style-type: none"> <li>Internal controls are inadequate.</li> <li>The transactions run in large numbers.</li> <li>The management is interested in getting statements of accounts audited periodically for enabling better management of resources.</li> <li>Where failure of a transaction would amount to substantial loss.</li> </ol> <p><b>The Advantages of Continuous Audit</b></p> <ol style="list-style-type: none"> <li><b>Early location of errors and frauds:</b> It helps in detecting errors and frauds immediately on their occurrence, and not at the year end when it would become difficult to install corrective control mechanisms.</li> <li><b>Quick rectification:</b> rectification of errors at an early stage is possible.</li> </ol>

	<p>iii. <b>Guidance:</b> Continuous guidance to client.</p> <p>iv. <b>Finalizations of accounts completion in time:</b> Just at the end of the accounting period.</p> <p>v. <b>Moral check:</b> Make employees of the client alert and more efficient in conducting their work.</p> <p>vi. <b>Improves statutory auditor's focus:</b> It relieves statutory auditors of routine testing and allows them to focus efforts on more valuable activities.</p> <p><b>Some Apparent Demerits of Continuous Audit</b></p> <p>i. The records and figures in the books of accounts, which have already been checked by the auditor, may be altered after the audit is over.</p> <p>ii. Frequent visits made by the auditor may cause inconvenience at times inconvenient at work.</p> <p>iii. The client may suffer due to the clash of duties between his staff and that of the auditor clash of work.</p> <p>iv. It is more expensive because the auditor has to devote more time to this audit.</p> <p>v. The work of audit becomes too mechanical and repetitive work.</p>
<p><b>INFORMATION SYSTEMS AUDIT</b></p> <p>[Q. 10b 4 Marks December 2019]</p> <p>[MTP December 2018 Q. 10b 4 Marks]</p> <p>[MTP June 2017 Q. 10a 4 Marks]</p>	<p>According to Ron Weber, "Information systems auditing is an organizational function that evaluates asset safeguarding, data integrity, system effectiveness, and system efficiency in computer based information systems". It has arisen for seven major reasons:</p> <p>i. The consequences of losing the data resource;</p> <p>ii. The possibility of misallocating resources because of decision based on incorrect data or decision rules;</p> <p>iii. The possibility of computer abuse if computer systems are not controlled;</p> <p>iv. The high value of computer hardware, software, and personnel;</p> <p>v. The high costs of computer error;</p> <p>vi. The need to maintain the privacy of individual persons; and</p> <p>vii. The need to control the evolutionary use of computers.</p>
<b>FINAL AUDIT</b>	<p><b>Meaning:</b> Final Audit is conducted at the end of the accounting year, after the books of accounts have been closed.</p> <p><b>Procedure</b></p> <p>It does not interrupt with the regular functioning of the client's accounting or operations functions and ensures completion of work in one session due to continuity. The auditor may use statistical sampling methods and techniques which lead to time effectiveness. The possibility of tampering with the books of accounts during the audit is considerably reduced as the audit work starts only after the books are closed.</p> <p><b>Limitations and precautions</b></p> <p>A major disadvantage of annual audit is that all the errors and frauds are found at the end of the accounting year, which makes it very difficult to fix responsibility for</p>

	defalcations. It delays the presentation of Audited Financial Statements to the shareholders and to prevent the delay, the auditor uses sample testing, which also reduces the possibility of detection of frauds and errors.
<b>INTERIM AUDIT</b> [MTP Dec 17 Q.10a 4 Marks]	<p><b>Meaning:</b> Interim audit is an audit conducted between two annual audits. It may be conducted for a specific period, such as a quarter or half year, with an interim object of declaration of interim dividend or valuation of shares on a certain date, in case of mergers.</p> <p>It is carried out by professionals, but has no legal status as the figures may be altered subsequently.</p> <p><b>Use of Interim Audit</b></p> <p><b>It is useful for:</b></p> <ol style="list-style-type: none"> <li>Early detection and rectification of errors &amp; frauds,</li> <li>Publishing of interim results in some cases,</li> <li>Timely completion of records and final audit,</li> <li>Moral checks on employees.</li> </ol>
<b>BALANCE SHEET AUDIT</b>	<p><b>Meaning:</b> Balance sheet audit is generally synonymous with statutory audit. In a Balance Sheet audit, the auditor reviews and critically examines the Financial Statements, which include the Balance Sheet and Profit &amp; Loss Account prepared by the management. He verifies each assertion in the Financial Statements, working backwards and checking through original entries made in the books of accounts and evidences to support the entries recorded.</p> <p><b>Objective</b></p> <p>While conducting a balance sheet audit, the auditor can rely upon the system of internal controls and internal checks and also on the reports of the internal auditor. Wherever internal controls and checks are sound, he can reduce the extent of routine checking of vouching, posting, casting and other routine tests. However, he should increase the extent of checking to obtain audit assurance if he finds that there are weaknesses in the internal control systems.</p> <p><b>Need</b></p> <p>With the development of industries and computerization of accounts, the need for balance sheet audit has increased. Now, the statutory auditor can reduce the extent of routine checking and concentrate more on critical examination of the Balance Sheet due to the computerized recording of large number of transactions and adoption of EDP system controls in data processing.</p> <p><b>Procedure</b></p> <p>As per the guidelines of national and international accounting bodies, the auditor should follow carefully planned audit procedures:</p> <ol style="list-style-type: none"> <li>For identification of areas where sample testing is sufficient.</li> </ol>

	<p>ii. For performance of certain compliance procedures and substantive procedures in some areas.</p> <p>iii. For analytical review of Financial Statements.</p> <p>iv. For verification of assets and liabilities stated in the Financial Statements.</p> <p>v. For scrutiny of books of accounts to check whether Financial Statements are in conformity with the records.</p> <p>vi. For evaluation of the internal control system and critical examination of the assertions made in the Financial Statements.</p> <p>vii. For ensuring the compliance of all legal requirements relating to adequate disclosure of material facts in the Financial Statements.</p> <p><b>Advantages of Balance Sheet Audit</b></p> <p>i. Balance sheet audit commences after the completion of books of accounts. The management prepares the Balance Sheet, therefore changes in the accounts is not possible once the verification process is started.</p> <p>ii. No interruption in the accounts department. Checking can be done smoothly without any breaks in between.</p> <p>iii. No loose links because audit is conducted in a continuous flow, which reduces the chances of missing the verification of any aspect.</p> <p>iv. Sample tests reduce the time involved for routine checking. The saving on account of time results in cost effectiveness.</p>
<b>COMPLETE, PARTIAL AND DETAILED (IN DEPTH) AUDIT</b>	<p><b>A complete audit</b> is an audit where the scope of audit is not confined to specific limits, which may be set by the management or any other authority. The auditor is required to check all the possible aspects of a business, including manufacturing operations, data flow processes, accounting records and procedures, etc. In general business practices, it is not feasible to get a complete audit conducted.</p> <p><b>A partial audit</b> is a non statutory audit, which restricts the scope of the auditor to checking of certain specific aspects only. The auditor's powers to enquiry are restricted by his terms of engagement. He may not be allowed to obtain information which falls outside the purview of the scope defined for him. E.g. an auditor may be appointed to check the accuracy of recording of transactions relating to cash sales, or he may be appointed to conduct an audit for the month of Diwali only.</p> <p><b>Detailed audit</b> is also known as audit-in-depth. It involves checking of transactions from the time of their recording till their final effect on the Financial Statements. Every stage that a transaction goes through in the accounting process is closely examined by the auditor using various audit evidences.</p>
<b>STATUTORY AUDIT REPORT</b>	<p>Statutory Audit of a public company implies the audit of the transactions of the company which are the subject-matter of the report under section 143. The auditor, however, has to certify as correct only as much of the Statutory Report as relates to the shares allotted by the company, cash received in respect of such shares and</p>

	<p>other receipts and payments of the company. The auditor, therefore, must:</p> <p>(a) Examine the internal check with regard to the control over amounts collected. And</p> <p>(b) Study the Memorandum, Articles of Association and the Prospectus for ascertaining the amount of authorized capital, its composition, terms of issue, particulars of any underwriting contract entered in to, the rate of underwriting commission, shares agreed to be issued for consideration other than cash and particulars of important agreements entered into by the company.</p> <p>In addition he should carry out an audit of the issue of shares. The under mentioned steps are also necessary:</p> <ol style="list-style-type: none"> <li>Vouch the payment of the underwriting commission.</li> <li>Vouch the brokerage paid on issue of share by examining the application and confirming that they bear the stamps of the brokers or agents to whom brokerage has been paid. Refer to minutes of the Directors authorizing the payment of such brokerage. Also see that the provisions of section 40 have not been contravened.</li> <li>Vouch the payment of preliminary Expenses and see that the amount paid does not exceed the amount fixed by the Articles or the prospectus.</li> <li>Vouch all other receipts and payments of the company up to date within seven days of the report; pay special attention to receipts and payments on capital account, e.g., sale proceeds of assets acquired from the vendor of the business, payments made to him, purchase of fixed assets, etc.</li> </ol> <p>Check in detail amounts deposited in the bank and withdrawals thereof with the entries in the bank Pass Book. Obtain a certificate from the Bank as to the bank balance as at the date up to which the statutory report has been prepared. Verify that the amounts receivable and payable which have been adjusted in the books of account but have been excluded from the balance of receipts and payments.</p> <p>The statutory audit culminates in the preparation of the statutory report. Its main content, with which the audit is concerned, is the abstract of Receipts and Payments made up to a date within 7 days of the report, exhibiting under distinctive heads, receipts of the company from shares, debentures and other sources, payment made and balance left in hand. The Statutory Report is required to be certified by the auditors of the company, in so far as the report relates to shares allotted by the company, cash received in respect of which the checking of accounts, as per details given above, has been carried out.</p>
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**CONCEPT 23. AUDIT ENGAGEMENT**

<b>AUDIT ENGAGEMENT</b>	<p>The engagement letter is one firm's contract with your client. It is the starting point, and often times the ending point, for the relationship. Most Chartered Accountants firms receive a signed engagement letter and file it away.</p>
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	<p>An audit engagement refers to an audit that an auditor performs. More specifically, it refers only to the initial stage of an audit during which the auditor notifies the client he has accepted the audit work and clarifies his understanding of the audit's purpose and scope.</p> <p>The Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India is issuing various illustrative formats for engagement letter for audit of Financial Statements under the Companies Act, 2013 and the Rules there under.</p> <p>Audit Engagement letter is given by Auditor to Company, explaining scope of work duties &amp; responsibilities of Auditor and that of management of Company. It specifies limits of Liability of Auditor. It avoids mis-under standing confusion, dispute between client &amp; Auditor at a later stage. Audit engagement letter confirms acceptance of Audit by Auditor, documentation objective &amp; scope of Audit &amp; Other work and the extent of his responsibilities to client the forms of report to be given by him;</p> <p>Every engagement letter as per ICAI should cover following points: -</p> <ul style="list-style-type: none"> <li>(a) Objective &amp; scope of engagement</li> <li>(b) Management responsibility</li> <li>(c) Existence of inherent limitations</li> <li>(d) Need for use of Internal Auditor</li> <li>(e) Management confirmation letter</li> <li>(f) Restrictions &amp; limitations of Auditor liabilities</li> <li>(g) Basis of computation of Audit fees</li> <li>(h) Billing arrangement</li> <li>(i) Form of report &amp; Other communications of engagement</li> <li>(j) Validity of report</li> <li>(k) Limits on submission of report to other authorities</li> </ul>
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**CONCEPT 24. AUDIT PROGRAMME**  
**[Q. 7a 6 Marks, June 2019]**

<b>Audit Programme</b>	<p>An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required.</p> <p>To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.</p> <p>As per SA 300, the auditor should prepare a written audit programme setting forth</p>
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	<p>the procedures that are needed to be implemented while carrying out the audit plan. He may take into account the reliance to be placed on internal controls. The auditor has some flexibility in deciding when to perform audit procedures. But, sometimes he may have no discretion as to timing, such as, observing the stock taking by the client's personnel. The audit programme should consider previous year's audit programmes and these may be modified, if necessary.</p> <p>An audit programme may be classified into two categories:</p> <ol style="list-style-type: none"> <li>Programme common to all types of audit. For example, checking of books of accounts; and</li> <li>Special programme containing the work relating to a particular audit. For example, the audit programme for a partnership firm would be different from that of a company.</li> </ol>
<b>(a) Advantages of audit programme</b>	<p>The main advantages of an audit programme are enumerated below;</p> <ol style="list-style-type: none"> <li>It serves as a ready check list of audit procedures to be performed.</li> <li>The audit work can be properly allocated to the audit assistants or the article clerks.</li> <li>The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.</li> <li>Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.</li> <li>A uniformity of the work can be attained as the same programme would be followed from time to time.</li> <li>It is a useful basis for planning the programme for the following year it is useful in selection of team members &amp; delegation of responsibilities to them.</li> <li>It may be used as evidence by the auditor in the event when any charge is brought against him.</li> <li>It is useful in selection of Team members and delegation of responsibilities to them.</li> </ol> <p>He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.</p>
<b>(b) Disadvantages of Audit Programme</b>	<p>The main disadvantages of an audit programme are enumerated below;</p> <ol style="list-style-type: none"> <li>The auditor's task becomes mechanical and the auditors may lose interest and initiative.</li> <li>Drawing up of an audit programme may be unnecessary for a small concern.</li> <li>Though audit programme helps in fixing responsibilities but inefficient staff may defend themselves by stating that the matter was not contained in the audit programme.</li> <li>Rigid programmes cannot be laid down for each type of business.</li> </ol> <p>There are many large multi unit, diversified companies where high level of coordination is required. Unless the audit programme is properly made in advance, completing the audit will be a problem.</p>



**CONCEPT 25. AUDIT WORKING PAPERS**

<b>AUDIT WORKING PAPERS</b>	<p>Audit working papers are the record of the planning and execution of the audit engagement. Auditors retain a set of working papers for each audit engagement for each year. The audit working papers for the current year are referred to as the current working papers. Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers. The audit working papers (current and permanent) for a client audit engagement are sufficiently detailed to enable another appropriately experienced and competent auditor that is not familiar with the client to obtain an overall understanding of the engagement.</p> <p>SA 230 on 'Documentation' issued by ICAI (CA) deals with the 'working papers'. As per this Standards an Audit documentation refers to the working papers prepared or obtained and retained by the auditors for his audit work. Working papers (or documentation) serve three purposes</p> <ul style="list-style-type: none"> <li>(i) aid in planning and performance of the audit;</li> <li>(ii) aid in supervision and review of the audit work; and</li> <li>(iii) these papers serve as an evidence of the audit work performed by the auditor to support his opinion.</li> </ul> <p>Further, as per SA 230, working papers are the momentous records of the auditor which help in establishing that the reasonably logical and verifiable conclusions were reached on the basis of relevant audit evidence. These working papers also facilitate audit planning and supervision of the audit work. The form and content of working papers vary from audits to audits, but they are affected by the following matters:</p> <ul style="list-style-type: none"> <li>(a) nature of engagement;</li> <li>(b) form of audit report;</li> <li>(c) nature and complexity of client's business;</li> <li>(d) nature and condition of client's records</li> <li>(e) degree of reliance of internal controls;</li> <li>(f) supervision of work performed by assistants.</li> </ul>
<b>Types of working paper files</b>  <b>[Q.7a 6 Marks June 2018]</b>	<p>In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files: while the former is updated with the Information of continuing importance, the latter contains information relating to audit of a single period. The contents of these files are given below:</p>

	<table> <tr> <th>Permanent Audit File</th><th>Current Audit File</th></tr> <tr> <td>(a) Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company.</td><td>(a) Correspondence relating to acceptance of annual reappointment.</td></tr> <tr> <td>(b) Extracts or copies of legal documents, agreements and minutes relevant to the audit.</td><td>(b) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.</td></tr> <tr> <td>(c) A record of study and evaluation of internal controls.</td><td>(c) Copies of management letters.</td></tr> <tr> <td>(d) Analysis of significant ratios &amp; trends.</td><td>(d) Analysis of transactions and balances.</td></tr> <tr> <td>(e) Copies of the audited financial statements of previous year(s).</td><td>(e) Copies of communication with other auditors, experts and third parties.</td></tr> <tr> <td>(f) Notes regarding significant accounting policies.</td><td>(f) Audit programme.</td></tr> <tr> <td>(g) Significant audit observations of the earlier years.</td><td>(g) Conclusions reached on significant aspects of audit.</td></tr> </table>	Permanent Audit File	Current Audit File	(a) Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company.	(a) Correspondence relating to acceptance of annual reappointment.	(b) Extracts or copies of legal documents, agreements and minutes relevant to the audit.	(b) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.	(c) A record of study and evaluation of internal controls.	(c) Copies of management letters.	(d) Analysis of significant ratios & trends.	(d) Analysis of transactions and balances.	(e) Copies of the audited financial statements of previous year(s).	(e) Copies of communication with other auditors, experts and third parties.	(f) Notes regarding significant accounting policies.	(f) Audit programme.	(g) Significant audit observations of the earlier years.	(g) Conclusions reached on significant aspects of audit.
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(f) Notes regarding significant accounting policies.	(f) Audit programme.																
(g) Significant audit observations of the earlier years.	(g) Conclusions reached on significant aspects of audit.																
<b>Working Papers to be property of Auditor</b>	<p>Working papers are the property of the auditor, the portions or extracts of which can be had at his discretion. These working papers should be kept in safe custody and in confidential manner for such time as is sufficient to meet the requirements of his practice or to satisfy any related legal or professional requirement of record retention. However, if required by some legislation, the auditor has to make working papers available to the regulatory authority(s). In case of Chantry Martin &amp; Co, it was held that the audit working papers are the property of the auditor and he is entitled to retain them.</p> <p>ICAI has prescribed that the members have to retain the working papers for a period of 7 years (as per SQC 1), otherwise, the member is guilty of professional misconduct.</p>																

**CONCEPT 26. AUDIT NOTE BOOK**

<b>Audit Note Book</b>	<p>An audit book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. The audit note book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. The audit note book should be maintained clearly, completely and systematically. An audit note book is a great evidential tool available as a defence with the auditors in the event of any charge brought against them. In case of City Equitable Fire Insurance Company, the auditors were relieved because they have maintained record of the audit work performed at each stage.</p>
<b>Contents of Audit Note Book</b>	<ul style="list-style-type: none"> <li>i. Name of the business enterprise.</li> <li>ii. Organisation structure.</li> <li>iii. Important provisions of Memorandum of Association (MOA) and Articles of Association.</li> </ul>

	<p>Association (AOA).</p> <p>iv. Communication with the previous auditor, if any.</p> <p>v. Management representations and instructions.</p> <p>vi. List of books of accounts maintained by the enterprise.</p> <p>vii. Accounting methods, internal control systems followed by the enterprise, applicable laws etc.</p> <p>viii. Key managerial personnel.</p> <p>ix. Errors and fraud discovered.</p> <p>x. Matters requiring explanations or clarifications.</p> <p>xi. Special points that need attention in the audit report.</p>
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**CONCEPT 27. AUDIT RISK**

<b>AUDIT RISK</b>	<p>In very broad terms, audit risk is the risk of a material misstatement of a financial statement item that is or should be included in the audited financial statements of an entity.</p> <p>In theory, audit risk ranges anywhere from zero, where there is complete certainty of no material misstatement, to one, where there is complete certainty of a material misstatement. In practice, however, audit risk is always greater than zero.</p> <p>There is always some risk of material misstatement as it is not possible, (except for the audit of the simplest of financial statements), due to the limitations inherent in both accounting and auditing, to be absolutely certain that a material misstatement will not exist.</p> <p>“Audit risk” is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Such misstatements can result from either fraud or error.</p> <p><b>i. Inherent risk</b> – It is the susceptibility of a account balance or class of transaction to misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls.</p> <p><b>ii. Control risk</b>- It is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or when taken together with misstatements in other balances or classes, will not be prevented/detected/corrected on timely basis by the accounting and internal control systems.</p> <p><b>iii. Detection risk</b> -It is the risk that an auditor’s substantive procedures (the procedures designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system) will not detect a misstatement that exists in account balance or class of transactions that could be</p>
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	material, either individually or when taken together with misstatements in other balances or classes.
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**CONCEPT 28. SURPRISE CHECK**

<b>SURPRISE CHECK</b>  <b>[MTP Dec 18 Q. 7a 7 Marks]</b>  <b>[MTP June 17 Q. 10d 4 Marks]</b>	<p>Auditor and his staff have to visit the client's place for carrying out the audit. Normally, the visit is given to understand the accounting system, to evaluate the system of internal controls, stock taking etc. It is well accepted that the audit constitutes a moral check on the employees of the client and thus have a deterrent effect. But at the same time, if the auditor or his staff visits at regular intervals, the client or his staff may get time to be well prepared in advance for the audit queries. This may impair the deterrent effect. Thus, there is a need of element of surprise.</p> <p>An element of surprise can significantly improve the effectiveness of an audit and therefore, wherever practicable, an element of surprise should be incorporated into the audit programme. The Council of ICAI has made the following recommendations in this regard:</p> <ol style="list-style-type: none"> <li>Surprise checks should be considered as a desirable part of each audit.</li> <li>The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include: <ul style="list-style-type: none"> <li>• Verification of cash and investments.</li> <li>• Test verification of stores and stocks and the records relating thereto.</li> <li>• Verification of books of prime entry and statutory registers normally required to be examined for the purposes of audit.</li> </ul> </li> <li>The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.</li> <li>The results of the surprise checks should be communicated to the management if they reveal weakness in the internal control system or the existence of fraud or error.</li> <li>The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.</li> <li>The results of surprise checks should be included in the audit report if they are material and affect the true and fair view of the accounts on which the reporting is done.</li> </ol>
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**CONCEPT 29. AUDIT EVIDENCE**

<b>AUDIT EVIDENCE</b>	<p>While auditing, the auditor come across various assertions of the management. The auditor has to evaluate these assertions so that he would be able to express his opinion on the financial statements. This evaluation can be made in the light of some facts and reasons. These facts and reasons are called Audit Evidence'. The auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn there from. It is to be noted</p>
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	<p>that sufficiency and appropriateness are interrelated and apply to evidence obtained from both substantive and compliance procedures. Sufficiency refers to the quantum of audit evidence obtained and appropriateness relates to its relevance and reliability. The following factors influence auditor's judgement while obtaining audit evidence:</p> <ul style="list-style-type: none"> <li>(a) the nature of the item;</li> <li>(b) the adequacy of internal controls;</li> <li>(c) the nature and size of the business carried on by the entity;</li> <li>(d) Situations which may exert an unusual influence on the management;</li> <li>(e) The financial position of the entity;</li> <li>(f) The materiality of the item;</li> <li>(g) The experience gained during the previous audits;</li> <li>(h) The results of auditing procedures, including fraud or error which may have been found;</li> <li>(i) The type of information available;</li> <li>(j) The trend indicated by accounting ratios and analysis.</li> </ul>
<b>Need for Audit Evidence</b>	<p>Audit evidence provides the auditor a reasonable assurance in respect of the assertions made by the management. While obtaining evidence through substantive procedures, the different assertions made by the management can be as follows:</p> <ul style="list-style-type: none"> <li><b>(a) Existence</b> – that an asset or a liability exists at a given date;</li> <li><b>(b) Rights and Obligations</b> - that an asset is a right of the entity and a liability is an obligation of the entity at a given date;</li> <li><b>(c) Occurrence</b> -that a transaction or event took place which pertains to the entity during the relevant period;</li> <li><b>(d) Valuation</b> - that an asset or liability is recorded at an appropriate carrying value;</li> <li><b>(e) Measurement</b> -that a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period;</li> <li><b>(f) Presentation and Disclosure</b> - an item is disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory requirements, if any.</li> </ul> <p>While obtaining evidence through compliance procedures, the different assertions made by the management can be as follows:</p> <ul style="list-style-type: none"> <li><b>(i) Existence</b> -that the internal controls exist;</li> <li><b>(ii) Effectiveness</b> - that the internal controls are operating effectively;</li> <li><b>(iii) Continuity</b> - that the internal controls have been so operated throughout the period of intended reliance.</li> </ul>
<b>Reliability of Audit Evidence</b>  <b>[Q.7a 8 Marks, December 2017]</b>	<p>The reliability of audit evidence depends on its source - internal or external and on its nature - visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalizations may be useful in assessing the reliability of audit evidence:</p> <ul style="list-style-type: none"> <li>(a) External evidence (e.g. confirmation received from a third party) is generally more reliable than internal evidence;</li> </ul>

	<p>(b) Internal evidence is more reliable when related internal control is satisfactory;</p> <p>(c) Evidence in the form of documents and written representation is usually more reliable than oral representations;</p> <p>(d) Evidence obtained by the auditor himself is more reliable than that obtained through the entity.</p>
<p><b>Methods to Obtain Audit Evidence</b></p> <p><b>[Q.7a 6 Marks, December 2018]</b></p> <p><b>[Q.7a 8 Marks, December 2017]</b></p> <p><b>[MTP June 2020 Q.7a 5 Marks]</b></p>	<p>Auditor obtains evidence in performing <b>compliance</b> and <b>substantive procedures</b> by any one or more of the following methods –</p> <p><b>(a) Inspection</b> - It consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature, source and the effectiveness of internal controls over their processing.</p> <p><b>(b) Observation</b> - It consists of witnessing a process or procedure being performed by others.</p> <p><b>(c) Inquiry and Confirmation</b> - Inquiry consists of seeking appropriate information from a knowledgeable person inside or outside the entity, Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records. Sometimes information from one source is crosschecked with other source.</p> <p><b>(d) Computation</b> - It consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.</p> <p><b>(e) Analytical Review</b> - It consists of studying significant ratios and trends and investigating unusual fluctuations and items.</p>
<p><b>Compliance procedures or Tests of controls</b></p>	<p>Tests of control are those activities performed by the auditor during the control testing stage that gather evidence as to the operational effectiveness of internal control procedures upon which the auditor has planned reliance.</p> <p>Management impliedly asserts that internal control procedures are effective as to both their design and operation. If controls are effective, then the auditor can plan reliance on the controls and reduce the time spent in gathering audit evidence. This is because the objective of an audit is similar in many respects to the objectives of internal control procedures. One of the primary objectives of a financial statement audit is to gather evidence as to whether account balances and classes of transaction are materially complete, valid and accurate. This is very similar to the primary objective of internal control procedures - to provide management with assurance that account balances and classes of transaction are complete, valid and accurate. Thus, if controls are effective, the auditor can plan reliance on the controls and reduce the amount of evidence that he would otherwise gather as to the completeness, validity and accuracy of account balances and classes of transaction.</p> <p>In the audit planning stage, the auditor gathers evidence as to the effectiveness of design of control procedures and decides which control procedure, if any, upon which he will plan reliance. In the control testing stage, the auditor gathers evidence as to the effectiveness of operation of those controls upon which the</p>

	<p>auditor has planned reliance. The activities that the auditor employs to gather this evidence are referred to collectively as tests of control (sometimes referred to as compliance tests or compliance procedures).</p> <p>Tests of control include observation of an internal control procedure being performed, inspection of evidence that the control procedure was performed (and performed at the appropriate time), and inquiry about how and when the procedure was performed. Where the information system is computerized, evidence may also be gathered using CAATs (Computer Assisted Audit Technique) such as a generalized audit software or an embedded audit module.</p>
<b>Substantive procedures</b>	<p>Substantive procedures (or substantive tests) are those activities which are performed by the auditor during the substantive testing stage of the audit that gather evidence as to the completeness, validity and/ or accuracy of account balances and underlying classes of transactions.</p> <p>Management impliedly asserts that account balances and underlying classes of transaction do not contain any material misstatements. In other words, that they are materially complete, valid and accurate. Auditors gather evidence about these assertions by undertaking activities referred to as substantive procedures.</p> <p><b>For example, an auditor may:</b></p> <ul style="list-style-type: none"> <li>(i) physically examine inventory on balance date as evidence that inventory shown in the accounting records actually exists (validity assertion);</li> <li>(ii) arrange for suppliers to confirm in writing the details of the amount owing at balance date as evidence that accounts payable is complete (completeness assertion); and</li> <li>(iii) make inquiries of management about the collectibility of customers' accounts as evidence that trade debtors is accurate as to its valuation (accuracy assertion).</li> </ul> <p>Evidence that an account balance or class of transaction is not complete, valid or accurate is evidence of a substantive misstatement.</p> <p>There are two categories of substantive procedures - analytical procedures and tests of detail. Analytical procedures generally provide less reliable evidence than the tests of detail. It may be noted that analytical procedures are applied in several different audit stages, whereas tests of detail are only applied in the substantive testing stage.</p>

**CONCEPT 30. AUDIT REPORT**

<b>While conducting every audit auditor has to go</b>	<ul style="list-style-type: none"> <li>(a) Preliminary work for audit.</li> <li>(b) Conduct of actual audit, and</li> <li>(c) Conclusion of audit, which means submission of Audit Report.</li> </ul>
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<p>through three phases</p>	<p>Therefore, Audit Report is called as the ultimate and final product of every audit.</p> <p>The meaning of Audit Report can be well understood from the following selected definitions</p> <p><b>Lancaster</b> – “A Report is a statement of collected &amp; considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report.”</p> <p><b>J. B. Ray</b> - “The Report shall either contain as expression of opinion regarding the financial statements, taken as a whole or an assertion to the effect that an opinion cannot be expressed when an overall opinion cannot be expressed, the reason therefore should be stated. In all cases, where auditor’s name is associated with financial statements the report should contain a clear cut indication of the character of the auditor’s examination, if any, and the degree of responsibility he is taking.”</p> <p>In short, the Audit Report is nothing but a statement of observation gathered &amp; considered while proving conclusive evidence of company’s financial position. It is a medium through which an auditors expresses his opinion on the financial statement under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.</p>
<p><b>Importance of Audit Report</b></p>	<ul style="list-style-type: none"> <li>i. An Audit report is the end product of the auditing and concluding part of the audit process.</li> <li>ii. Audit report gives the auditor’s opinion on the accounts &amp; record of the company, as examined by him.</li> <li>iii. Audit Report reflects the work done by the auditor.</li> <li>iv. Audit report is the instrument which, measures the auditors responsibility in regard to the true &amp; fair view on the financial statement of the company.</li> <li>v. Audit Report indicates the real position of the financial status of the company. It is used by different people as a reliable document.</li> </ul>
<p><b>The Basic Elements of the Auditors’ Report are –</b></p> <p><b>[Q.9b 8 Marks, December 2017]</b></p>	<ul style="list-style-type: none"> <li>i. <b>Title:</b> The Auditor’s Report should have an appropriate title i.e. “Auditor’s Report”. It should be distinguished from other Reports, e.g. reports of officers of the entity, Board of Directors.</li> <li>ii. <b>Addressee:</b> The Auditor’s Report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the Auditor’s Report is addressed to the authority appointing the Auditor.</li> <li>iii. <b>Opening or Introductory Paragraph:</b> <ul style="list-style-type: none"> <li>(a) The Auditor’s Report should identify the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial</li> </ul> </li> </ul>



	<p>Statements.</p> <p>(b) The Report should include a Statement that the Financial Statements are the responsibility of the entity's management and a Statement that the responsibility of the Auditor is to express an opinion on the Financial Statements based on the audit.</p> <p><b>iv. Scope Paragraph:</b></p> <p>(a) The Auditor's Report should describe the scope of the audit by stating that the audit was conducted in accordance with auditing Standards generally accepted in India.</p> <p>(b) The Report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the Financial Statements are free of material misstatement.</p> <p>(c) The Auditor's Report should describe the Audit as including examining, on a test basis, evidence to support the amounts and disclosures in Financial Statements, assessing the accounting principles used in the preparation of the Financial Statements, assessing significant estimates made by management, in the preparation of Financial Statements, &amp; evaluating the overall position of Financial Statements.</p> <p>(d) The Report should include a statement by the Auditor that the audit provides a reasonable basis for his opinion.</p> <p><b>v. Opinion Paragraph:</b> The Opinion paragraph of the Report should indicate the Financial Reporting framework used to prepare the Financial Statements. It should state the Auditor's opinion as to whether the Financial Statements give a true and fair view in accordance with the financial reporting framework and, where appropriate, whether the Financial Statements comply with the statutory requirements.</p> <p><b>vi. Date of the Report:</b> The date of an Auditor's Report is the date on which the Auditor signs the Report expressing an opinion on the Financial Statements. The Auditor should not date the Report earlier than the date on which the Financial Statements are signed or approved by Management.</p> <p><b>vii. Place of Signature:</b> The Report should name the specific location, which is ordinarily the city where the Audit Report is signed.</p> <p><b>viii. Auditor's Signature:</b> The Report should be signed by the Auditor in his personal name. Where a Firm is appointed as the Auditor, the Report should be signed in the personal name of the Auditor and in the name of the Audit Firm. The Partner / Proprietor signing the Report should mention his ICAI Membership Number.</p> <p><b>Note:</b> Where the governing statute requires the Auditor to include certain matters in his Report or prescribe the form in which the Auditor should issue his Report, such additional matters should be included in addition to the requirements of SA 700.</p>
<b>A. Significance of Opening Paragraph:</b>	<p>(a) The Opening or Introductory Paragraph identifies the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.</p> <p>(b) The 'Opening Paragraph' seeks to bring to the notice of the Users of Financial Statements, that preparation of the accounts is the responsibility of the Management of the enterprise, whereas the responsibility of the Auditor is to</p>

	express an opinion on the said accounts based on the audit carried out by him. (c) Through the Opening Paragraph, the Auditor communicates the basic message that the preparation of Financial Statements requires Management to make significant accounting estimates and judgements, as well as to determine the appropriate accounting principles and methods used in preparation of the said Financial Statements.
<b>B. Significance of Scope Paragraph:</b>	<p>(a) The 'Scope Paragraph' seeks to inform the Users about the practices and procedures followed in the conduct of audit by the Auditor.</p> <p>(b) In the Scope Paragraph, the Auditor states that the audit was planned and performed in accordance with Auditing Standards generally accepted in India, and also that the audit provides a reasonable basis for his opinion.</p> <p>(c) The significance of the Scope Paragraph lies in the fact that the Auditor intends to convey to the readers of his report, about the scope of audit by highlighting the nature and progress of audit. The test check approach of audit adopted by the Auditor in performing his audit work as also the significant aspect of evaluation of accounting principles and accounting estimates is also clarified.</p> <p>(d) The basic objective of auditing that the Auditor provides only "reasonable assurance" is emphasized in the Scope Paragraph. Thus, this paragraph signifies the inherent limitations of audit.</p>

**CONCEPT 31. INTERNAL CHECK****[Q. 7b 6 Marks December 2019]**

<b>INTERNAL CHECK</b>	<p>The accounting of transactions has a number of steps such as posting to the concerned books of accounts, recording receipts and payments of cash etc. These processes involve a various number of staffs. Thus in an internal check system, practically a continuous internal audit is carried on by the staff itself. The work of one individual is checked by the other in the staff. Internal check is a valuable part of the internal control.</p> <p>According to Spicer and Pegler, internal check is an arrangement of staff duties where none is allowed to carry through and record every aspect of a transaction so that, without collusion between any two or more persons, fraud is prevented and at the same time the possibilities of errors and frauds are reduced to the minimum.</p> <p>For example, <i>at the time of cashing a cheque at any bank, the cheque is produced at the counter from where customers get a token. The token number is entered into the token book as well as at the back of the cheque by the attending clerk. The cheque is then passed on to the ledger clerk who verifies the credit balance in the customer's account and makes a debit entry. The cheque is then sent for verifying the signature of the customer and then it is passed for payment to the customer. The cashier makes the payment to the cashier. The cashier makes the payment against the token and records it in the cash register.</i></p>

**Auditor's Duty In  
Regard to Internal  
Check System**

In the case of a big concern where there is a good internal check system the auditor may, to a great extent, presume the accuracy of the accounting. But he must not be negligent. He should apply a few test checks, i.e. he should check a few transactions here and there at random or check fully the accounts for a few months, and carry out a thorough check of the whole of a certain class of transactions taking place during that particular period, e.g. cash sales, or cash received or credit purchases during that period. In selecting certain transactions are representative and true specimens the auditor should see that such sample transactions are representative and true specimens of such entries throughout the year.

If he finds that there is no mistake and there is nothing to arouse his suspicion, he may presume that the accounts are correct. It must be remembered that in such a case, the auditor is not relieved of his responsibility. Therefore, it would be better for him to probe the matter thoroughly if there is the slightest suspicion. If later on, it is found that a fraud had been committed which the auditor failed to detect as he had not checked all the transactions, he would be held liable.

**The existence of a good internal check system reduces to a great extent the work of the auditor but does not reduce his liability.** To what extent an auditor should depend upon the internal check system will depend upon his tact, skill, experience and judgment.

The internal check is said to have the following fundamental aims:

- i. To pin down to definite persons responsibility for particular acts, default or omission, by the segregation of tasks.
- ii. To obtain confirmation of facts and entries, physical and financial, by the creation and preservation of necessary records.
- iii. To facilitate the "breakdown" of routine procedures so as to avoid bottlenecks and to establish an even flow of work.
- iv. To reduce to a minimum the possibility of fraud and error.

The evaluation of internal check system in an organization is of great concern both to the statutory auditor as well as to the internal auditor. The guiding factor for audit operation by the statutory auditor depends to a great extent on the soundness or otherwise of the internal controls in business. Due to the limitation of time a statutory auditor can spend on a company's audit, he has to decide the extent of in-depth audit of many areas, particularly the checking and verification of routine aspects of financial transactions.

The evaluation of the internal check system including internal accounting control gives an opportunity to the statutory auditor to have a clearer insight into the operational systems and an overall view of the organization Workings to spot weakness in the systems and procedure both in respect of financial and operational areas of the business.

Check list is usually a questionnaire set, designed to draw attention to important aspects of the system of internal check. The question should be phased in such a way that an affirmative answer would normally reveal a satisfactory position. If the

	<p>answer is negative, enquiry should be made to see if there is a satisfactory substitute for the procedure referred to in the questionnaire.</p> <p>A negative answer always merits further examination. All the items on the questionnaire cannot be of the same importance and an unhealthy position might be revealed either by a single negative answer or by a number of such answers.</p> <p>No questionnaire for the appraisal of a system of internal check can ever be considered to be complete. Although every effort should be made to make such a questionnaire as comprehensive as possible, it is primarily stimulation to thinking along recognized channels.</p>
<b>Internal Control Questionnaires</b>	<p>The internal check system questionnaire is a list of systematically and logically prepared questions designed to find out and evaluate the effectiveness of the internal check system regarding various aspects and accounting transactions of an organization. The questionnaire are to be as comprehensive as possible in nature to make sure that all aspects and accounting transactions are covered which are to be replied by the official of the department or division concerned.</p> <p>During the course of the audit statutory auditor will submit to the organization a complete questionnaire for reply by concerned official which will help the former to form an opinion as to the adequacy and reasonableness of the internal check system. Sometimes questions are also asked on piecemeal basis. In both the cases, whether it is big or small, the language used is "audit query".</p> <p>The statutory auditor during the course of his audit may make test checks or in-depth checking depending on the circumstances to make sure that the replies to the questionnaire are accurate and complete. In respect of many of the replies, the statutory auditor may have to make sure that the internal check system are really in operation through proper verification. In respect of negative replies, he may have to qualify his audit report depending on the seriousness of the situation.</p> <p>The internal auditor in their pre-audit i.e. before taking up real internal audit operations may require the officials concerned to reply to the questionnaire. This will help the internal auditor in shaping his programming.</p> <p>The department or divisional heads should also make use of such questionnaire, solely on their own initiative, by directing the personnel to prepare replies to such a questionnaire for the benefit of the department itself. This procedure will enable the department head to evaluate the existing internal control system and thereby to suggest management to review the said systems to further strengthen the organizational controls.</p>
<b>(A) Internal Control</b>	Is inward mail opened by persons not connected with handling cash or the Accounts Department?

<b>Questionnaire for Cash and Bank Receipts</b>	<ol style="list-style-type: none"> <li>1. Is the inward mail date stamped?</li> <li>2. Is there a detailed record of receipts prepared?</li> <li>3. Are all cheques specially crossed by employees opening mail?</li> <li>4. Are bank deposits prepared and made by someone other than those responsible for cash receipts and/ or personal ledger. Are duplicate (or counterfoils of) receipted deposit slips received from the bank?</li> <li>5. Is there any comparison of items listed on the duplicate (or counterfoils of) deposit slips with the amounts of cheques recorded in the cash receipts records?</li> <li>6. Are receipts given for over-the counter collections?</li> <li>7. Is there reconciliation of such proofs of collection with amounts banked?</li> <li>8. Are collections of branch offices and sales offices deposited in special bank accounts subject to withdrawal only by the head office?</li> <li>9. If collections are made by representatives of the company in cash, have serially numbered been issued to them?</li> <li>10. Is there a system of issuing permanent receipts in lieu of the temporary/provisional receipts issued by bill collections etc.</li> <li>11. Are such collections promptly received and banked? Are the receipts forms : <ol style="list-style-type: none"> <li>a. Serially numbered?</li> <li>b. Kept in safe custody?</li> <li>c. Controlled by register?</li> <li>d. Unused stocks checked regularly?</li> <li>e. Made out by one employee and dispatched by another?</li> <li>f. Accounted for, including those cancelled in respect of partially used receipts, books not intended to be used, cancelled. Are cancelled receipts preserved?</li> </ol> </li> <li>12. Is the opening of bank accounts authorized by the Board of Directors (BOD)?</li> <li>13. Are sundry items, such as, dividends, interest, rent, commissions etc. regularly checked by responsible official to satisfy that correct amount are received?</li> <li>14. Is there a procedure to ensure that Hundi borrowing as only by cheques crossed "Account Payee"?</li> <li>15. Is the cash balance verified frequently (incoming money orders. VPP receipts etc.).</li> <li>16. Are they listed immediately?</li> <li>17. Are such lists compared with the Cash Book regularly?</li> <li>18. Is there an arrangement with the postal authorities to receive cheques instead of cash?</li> <li>19. Are the cashier's duties taken over for a few days, by someone else, occasionally?</li> <li>20. If rough cash book is maintained: <ol style="list-style-type: none"> <li>(a) Is a fair cash book written up promptly?</li> <li>(b) Is the fair cash book checked with the rough cash book, by a person other than the cashier?</li> </ol> </li> </ol>
<b>DIFFERENCE BETWEEN A CHECKLIST AND INTERNAL</b>	

<b>CONTROL QUESTIONNAIRE</b>  <b>[Q.7b 4 Marks June 2017]</b>  <b>[MTP Dec 2017 Q.7b 4 Marks]</b>	Sl. No	Basis	Check List	Internal Control Questionnaire
	i.	Point of Time	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
	ii.	Issued To	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
	iii.	Contents	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
	iv.	Objective	It works as a guideline for audit staff so that no major issues remains unchecked.	This is used to collect the information to know about the internal control system and to evaluate the weaknesses therein.

**CONCEPT 32. DISTINCTION BETWEEN INTERNAL AUDIT, INTERNAL CONTROL AND INTERNAL CHECK [Q.7b 6 Marks December 2018]**

<b>Internal Audit:</b>	It is a continuous critical review of financial and operating activities by the auditor or his representative.		
<b>Internal Control:</b>	It consists of all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business. It includes internal checks and internal audit.		
<b>Internal Check:</b>	A system of allocation of responsibility, division of work, and methods of recording transactions, whereby the work of an employee is checked continuously by another.		
	<pre> graph TD     A[Internal Control (Total System)] --&gt; B[Internal Check (Sub-System)]     A --&gt; C[Internal Audit (Sub-System)] </pre>		
<b>Basis</b>	<b>Internal Audit</b>	<b>Internal Control</b>	<b>Internal Check</b>
<b>Way of Checking</b>	In an internal audit system, each component of work is checked.	In internal controls systems, work of one person is automatically checked by another.	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same
<b>Objective</b>	Its objective is to evaluate the internal control system and to detect	Its objective is to ensure adherence to management policies,	Its objective is to ensure that no one employee has exclusive control over any

	frauds and errors.	safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	transaction or group of transactions and their recording in the books
<b>Point of Time</b>	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
<b>Thrust of System</b>	The thrust of internal system is to detect errors and frauds.	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
<b>Cost Involvement</b>	In an internal audit system, work is checked specially; therefore cost is involved in addition to accounting	The system proves to be costly in case of small businesses because more number of employees are engaged	It is a part of internal control and a method of division of work, therefore does not add to the cost.
<b>Report</b>	The internal auditor submits his report to the management	Internal Controls provide for built in MIS reports	The summary of day to day transactions work as report for the senior.

**CONCEPT 33. CUT OFF PROCEDURES**

<b>i) Definition</b>	Periods usually coincide with calendar months, which lead to the need for specific demarcation between transactions forming the part of one period from those included in the following period. Thus, cut-off procedures are adopted to allocate revenues and costs to the proper accounting period.
<b>ii) Areas of concern</b>	Close attention should be paid to the accounts payable and accounts receivable functions. These two functions are the most susceptible to recording of transactions in the wrong accounting period.
<b>iii) Cut-of points</b>	Serially numbered documents like invoice for sales or purchase bills are allocated to the respective accounting periods by establishing cut-off points based on the serial



	numbers.
<b>iv) Importance</b>	Cut-off procedures require detailed testing by the auditor so as to ensure proper accounting of assets and liabilities, which may arise without the corresponding physical delivery of goods taking place.
<b>v) Example</b>	The purchase procedure involves a number of steps, like issuing purchase requisitions, inviting quotations, selecting sellers and defining the terms of purchase, entering agreement, receipt of goods, storage of goods, payment, etc. All the documents and vouchers that substantiate the proof of authentication of these transactions are serially numbered. It is the auditor's duty to examine the cut-off points and ensure that the transaction has been recorded in the period in which the title in goods is transferred, irrespective of the period of physical delivery of goods and to ensure compliance of the Indian Accounting Standards and the relevant Statute.

**CONCEPT 34. EXAMINATION IN DEPTH/AUDITING IN DEPTH/WALK THROUGH TEST**

<b>AUDITING IN DEPTH</b>	<p>The process of examination in depth explains its meaning and importance. It is stated as under:</p> <ul style="list-style-type: none"> <li>i. Fixation of the maximum tolerable error limit/desired confidence level.</li> <li>ii. Selecting a few transactions in each area of audit to be checked.</li> <li>iii. Verification of those selected transactions- 100% by verifying the accounting aspects, internal control aspects, documentation and audit trail.</li> <li>iv. Audit trail refers to the documents, records, books and files, which enable an auditor to trace a transaction from its source till it is summed up, recorded and presented in an accounting report.</li> <li>v. Analysis of the results with the maximum tolerable error limit.</li> </ul>
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**CONCEPT 35. DIFFERENCE BETWEEN TEST CHECKING AND STATISTICAL SAMPLING**

<b>DIFFERENCE</b>	<b>Sl. No.</b>	<b>Basis</b>	<b>Test Checking</b>	<b>Statistical Sampling</b>
	i.	<b>Selection</b>	Selective transactions are verified.	Drawing a sample from a Large number of transactions.
	ii.	<b>Technique</b>	No specific technique is used.	Statistical technique used is: Selection on random basis.
	iii.	<b>Subjective</b>	It is subjective and depends upon the choice of the auditor.	It depends upon the statistical technique applied.
	iv.	<b>Risk &amp; Method</b>	It involves more risk as there are no specific methods for test check.	It carries lesser risk and various statistical methods can be used at different times.

**CONCEPT 36. INTERNAL CONTROL**



<b>INTERNAL CONTROL</b>	<p>The internal control system comprises all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business, ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, and checking the accuracy and completeness of the accounting records. Internal checks and internal audit are integral parts of the overall internal control system.</p> <p>Internal control refers to a process that is designed for helping the organization to accomplish goals and objectives through people of the organization and IT (information Technology) systems, whereas internal check is a part of internal control. It refers to the accounting procedure that acts as a safeguard against frauds and losses. On the other hand, internal Auditing is an activity that devises ways for organizations for better achievement of objectives.</p>
<b>Essentials of an Internal Control System</b>  <b>[MTP Dec 18 Q. 7b 5 Marks]</b>	<p>An efficient internal control system should provide the followings;</p> <ol style="list-style-type: none"> <li>For proper division of functional responsibilities.</li> <li>For proper authorization and assignment of duties to perform and record the transactions.</li> <li>For adoption of proper practices for adherence with management policies.</li> <li>For proper review and authorization of all transactions before they are recorded in the books of accounts and safeguard all business assets.</li> <li>Proper internal checks</li> <li>Proper internal audit system.</li> </ol>
<b>Objectives of Internal Control</b>  <b>[MTP Dec 17 Q. 7b 7 Marks]</b>	<p>Each organization must have a system of internal control in place for achieving the preset goals. Other than accomplishing the desired goals and objectives of the organization, this system plays a very important role in any organization. The main objectives of internal control are enumerated below:</p> <ol style="list-style-type: none"> <li><b>Compliance:</b> To have compliance with law and the accounting practices generally accepted and followed in the country. The accounting process also needs to be in compliance with these.</li> <li><b>Reliance:</b> To increase the reliance on the internal systems, people and accounting practices followed by the organization, so that the chances of frauds are reduced.</li> <li><b>Safeguarding:</b> To safeguard the organization's accounts, employees and assets by formation of fool-proof policies, rules and regulations.</li> <li><b>Security:</b> To provide security to customers, employees and property of the organization. Physical security systems like security guards, locks and anti-theft devices are used for providing protection.</li> <li><b>Increased efficiency:</b> To assist in human resource and performance management, and to keep proper control over business activities to achieve maximum levels of efficiency.</li> <li><b>Evaluation:</b> To evaluate the accounting system for proper authorization of</li> </ol>

	<p>transactions.</p> <p><b>vii) Review and correction:</b> To review the working of the business, locate weak points in operations and to take corrective measures for proper working.</p> <p><b>viii) Authorization:</b> To provide proper authority for purchase, sale, valuation, verification and possession of assets.</p> <p><b>ix) Delegation:</b> To provide for division of duties among the employees where all staff members work cohesively.</p> <p><b>x) Accurate planning:</b> To ensure that the auditors and the accountants of the organization make all the financial reports correctly and to ensure that financial planning is done accurately.</p> <p><b>xi) Conformity with accounting principles:</b> To conform to the basic accounting concepts, and principles that was governing an organization.</p> <p><b>xii) Resource utilization:</b> To ensure that all the resources: Man, Material, Money and Machines of the organization are optimally used.</p> <p><b>xiii) Safeguarding of resources:</b> To protect the resources of the organization against mismanagement or fraud and to ensure that the company's activities are in accordance with laws and regulations.</p> <p><b>xiv) Setting future Corporate Goals:</b> An efficient system of internal control helps the organization in goal setting. However, the organization should have certain policies, rules and regulations in place to achieve the preset goals.</p>
<b>Advantages of Internal Controls</b>	<p><b>(i) Efficiency, effectiveness and economy:</b> A good internal control system ensures that the resources are utilized only for their intended purposes and helps to overcome the risk associated with the misuse of organization's funds and other resources.</p> <p><b>(ii) Prevention of errors and irregularities:</b> It prevents errors and irregularities by detecting them in a timely manner, thereby promoting reliable and accurate accounting records.</p> <p><b>(iii) Safeguard from irregularities or misappropriations:</b> A good internal control system errors the protection of organisation resources from misappropriation and do safeguard from any irregularities.</p> <p><b>(iv) Employees' satisfaction:</b> It protects the interests of employees by segregation of duties and delegation of responsibilities.</p>
<b>Types of Internal Control Systems</b>  <b>[Q. 7b 6 Marks June 2019]</b>	<p>The type of internal control system to be employed in an organization depends upon the requirements and nature of the business. Generally, there are two types of Internal Control in an Organisation: preventive and detective controls. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role by providing evidence that the preventive controls are functioning as intended.</p> <p><b>i) Preventive Controls</b> are designed to discourage errors or irregularities from</p>

	<p>occurring. They are proactive controls that help to ensure departmental objectives are being met. Examples of preventive controls are:</p> <ul style="list-style-type: none"> <li>• <b>Segregation of Duties:</b> Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.</li> <li>• <b>Approvals, Authorizations, and Verifications:</b> Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.</li> <li>• <b>Security of Assets (Preventive and Detective):</b> Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.</li> </ul> <p>ii) <b>Detective Controls</b> are designed to find errors or irregularities after they have occurred. Examples of detective controls are:</p> <ul style="list-style-type: none"> <li>• <b>Reviews of Performance:</b> Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.</li> <li>• <b>Reconciliations:</b> An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.</li> <li>• <b>Physical Inventories</b></li> <li>• <b>Audits</b></li> </ul> <p>iii) <b>Corrective Controls</b> target at the correction of errors and irregularities as soon as they are detected.</p> <p><b>Steps in Internal Control</b></p> <p>An effective internal control system consists of certain important steps:</p> <ul style="list-style-type: none"> <li>(i) <b>Control Environment:</b> Establish Integrity &amp; ethical value.</li> <li>(ii) <b>Assessment of Risk:</b> Establishment of plan to prevent risks.</li> <li>(iii) <b>Control Activities:</b> Formulating policies &amp; procedures.</li> <li>(iv) <b>Information &amp; communication:</b> Evaluation of employee performance.</li> <li>(v) <b>Monitoring:</b> Assessing overall performance of the Organisation.</li> </ul>
<b>Nature and Scope of Internal Control</b>	<p>(i) <b>Nature:</b> Internal control is an essential prerequisite for efficient and effective management of any organization. It is, thus a primary responsibility of every management to establish and maintain an adequate system of internal control appropriate to the size and nature of the business of the entity.</p> <p>SA 265 on "Communicating deficiencies in internal control to those charged with Governance and Management" defines the system of internal control as "all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the</p>

	<p>orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information”.</p> <p><b>(ii) Scope:</b> SA 265 defines ‘accounting system’ as “series of tasks and records of an entity by which transactions are processed as a means of maintaining financial records”. The system of internal control “extends beyond those matters which relate directly to the functions of the accounting system” and comprises control environment and control procedures.</p> <p>‘Control’ represents the overall attitude, awareness and actions of directors and management regarding the internal control system of the entity. For example, in a strong control environment, there would be tight budgetary controls and an effective internal audit function. The control environment in an enterprise depends largely on the following factors:</p> <ol style="list-style-type: none"> <li>The entity’s organizational structure and methods of assigning authority and responsibility (including segregation of duties and supervisory functions).</li> <li>The function of the board of directors or the corresponding governing body and its committees, e.g. how strong is the audit committee of the board of directors.</li> <li>Management’s philosophy and operating style. Does the management believe in having a strong control environment (which implies that the management itself would also be subjected to the discipline of controls)?</li> <li>Management’s control system including the internal audit function, personnel policies and procedures.</li> </ol> <p>‘Control procedures’ are the policies and procedures that the management has established to achieve the entity’s specific objectives, e.g. physical verification of assets, periodical review and reconciliation of accounts, specific controls on computer generated data.</p> <p>The scope of internal control, as per the above definition, extends beyond mere accounting controls. Thus operational controls such as quality control, work standards, budgetary control, periodic reporting, policy appraisals, quantitative controls, etc. are all parts of the internal control system.</p>
<p><b>Basic Elements of Internal Control</b></p> <p><b>[MTP Dec 19 Q.7b 5 Marks]</b></p>	<p>An effective system of internal control should have the following basic elements:</p> <ol style="list-style-type: none"> <li><b>1. Financial and other Organizational Plans:</b> This may take the form of manual suitably classified by flow charts. It should specify the various duties and responsibilities of both management and staff, stating the powers of authorisation that reside with various members. This is important as in the event of staff absence or otherwise the correct flow of work and the internal control system could be vitiated by any wrong implementation of procedures by staff either unintentionally or willfully.</li> <li><b>2. Competent Personnel:</b> In any internal control system, personnel are the most important element.</li> </ol>

	<p>When the employees are competent and efficient in their assigned work, the internal control system can be worked and operated efficiently and effectively even if some of the other elements of the internal control system are absent.</p> <p><b>3. Division of Work:</b> This refers to the procedure of division of work properly among the employees of the organization. Each and every work of the organization should be divided in different stages and should be allocated to the employees in accordance with quality and skill.</p> <p><b>4. Separation of operational responsibility from record keeping:</b> If each department of an organization is being assigned to prepare its own records and reports, there may be a tendency to manipulate results for showing better performance. So in order to ensure reliable records and information, record-keeping function is separated from the operational responsibility of the concerned department.</p> <p><b>5. Separation of the custody of assets from accounting:</b> To protect against misuse of assets and their misappropriation, it is required that the custody of assets and their accounting should be done by separate persons. When a particular person performs both the functions, there is a chance of utilizing the organisation's assets for his personal interest and adjusting the records to relieve himself from the responsibility of the assets.</p> <p><b>6. Authorization:</b> In a internal control system, all the activities must be authorized by a proper authority. The individual or group which can grant either specific or general authority for transactions should hold a position commensurate with the nature and significance of the transactions and the policy for such authority should be established by the top management.</p> <p><b>7. Managerial supervision and review:</b> The internal control system should be implemented and maintained in conformity with the environmental and elemental changes of the concern. By adapting any specific control system permanently, the extent to which the procedures of flexible controls have been followed in real practice should be observed and re-examined.</p>
<b>Important of Internal Controls:</b>	<p>The various benefits accrue out of the Internal control system are enumerated below;</p> <p>i) <b>Attainment of goal &amp; Objectives:</b> - A sound internal control helps the entity towards the attainment of goal &amp; objective of the business.</p> <p>ii) <b>Reliable financial Information:</b> A sound internal control helps the organization to set reliable financial information for managerial decision making.</p> <p>iii) <b>Compliance with law &amp; Regulations:</b> Sound Internal control system ensures various compliance with laws &amp; regulation prevailing in the country</p> <p>iv) <b>Efficient &amp; Effective operation:</b> - A sound internal control system ensures efficient and effective operations that accomplish the goals of the organizations and protect employees and assets of the business.</p>

	<p>v) <b>Prevention of fraud &amp; errors:</b> - A sound internal control system prevents and detects frauds and errors and ensures timely preparations of financial statements and various reports for decision making.</p>
<b>Limitations of Internal Control</b>	<p>i. <b>Organizational Structure:</b> Deficiencies in organizational structure make internal control ineffective.</p> <p>ii. <b>Size of the Organization:</b> Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.</p> <p>iii. <b>Unusual Transactions:</b> The internal control procedures normally fail to keep a check on unusual transactions.</p> <p>iv. <b>Costly:</b> The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.</p> <p>v. <b>Abuse of Power:</b> Members at the top-level management may override/interfere with control.</p> <p>vi. <b>Collusion of two or more People:</b> It may lead to internal controls being over-ridden.</p> <p>vii. <b>Obsolescence:</b> Control system may become redundant with passage of time if not updated with change in the size and nature of business.</p> <p>viii. <b>Potential for human error:</b> Due to misunderstanding of the concept of internal control human errors may occur while carrying out Internal Control System.</p> <p>ix. <b>Frequent follow-up measures:</b> Follow-up procedures need to be frequent to ensure its effectiveness, which is extremely time-consuming.</p>
<b>Responsibilities of Management Vis-A-Vis Auditors</b>	<p>(a) <b>Primary Responsibility of Management:</b> The prime responsibility for maintaining an adequate accounting system and incorporating various internal controls rests with the management. The responsibility of closely monitoring the system to ensure that it is in place, so as to facilitate the basic objectives of installing it, also rests with the management.</p> <p>(b) <b>Auditor's Responsibility:</b> To safeguard his own interests, the auditor might resort to examination and evaluation of the internal controls that exist in the organization. He formulates an audit programme only after satisfying himself that such internal control systems are adequate and in consonance with the requirements of the business. The auditor should bring the weaknesses of the internal control system, if any, to the management's notice through a "letter of weakness" or "management letter".</p>
<b>Evaluation of Internal Control By The Auditor</b>	<p><b>A. Understanding the System</b></p> <p>This can be done in the following ways:</p> <p>i. Discussions with personnel at various levels of the organization.</p> <p>ii. Reference to organization charts, procedure manuals, information flow channels, etc.</p> <p>iii. Inquiries using a brief, but complete questionnaire</p>

	<p><b>B. Testing of internal control</b></p> <p>This can be done in the following ways:</p> <p><b>i. Procedural tests:</b> These tests deal with checking the compliance of the procedures laid down by the management in respect of transactional flow at each stage. They provide reasonable assurance about the proper implementation and effectiveness of internal controls.</p> <p><b>ii. Examination in depth:</b> This involves examination of a few selected transactions from the beginning till the end. Recording of transactions at various stages, documentation of the same, and authenticity of authorizations is checked in detail. The Auditor forms a conclusion, based on his examination of the internal control system, which incorporates the following points:</p> <ol style="list-style-type: none"> <li>The degree and nature of weaknesses in the system.</li> <li>The extent to which audit reliance may be placed.</li> <li>The nature, timing and extent of substantive procedures that need to be applied.</li> </ol>
<p><b>Techniques for Evaluation of Internal Control System</b></p> <p><b>[Q. 7b 4 Marks December 2017]</b></p> <p><b>[MTP June 2020 Q. 7b 4 Marks]</b></p>	<p><b>i. Narrative Record:</b> It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.</p> <p><b>ii. Check List:</b> It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.</p> <p><b>iii. Flow Chart:</b> It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.</p> <p><b>iv. Internal Control Questionnaire:</b> This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No".</p>



**CONCEPT 37. INTERNAL AUDIT – INDUSTRY SPECIFIC**

<b>INTERNAL AUDIT</b>	<p>Internal audit is an independent appraisal activity within the organization by the staff of the entity or by an independent professional appointed for that purpose, for review of accounting, financial and other operations and controls established within an organization as a service to the organization. The objective of internal audit is to furnish the analysis, appraisals, suggestions and information concerning the activities reviewed to the management for promoting effective control at reasonable cost.</p> <p>According to the Institute of Internal Auditors New York, “Internal audit is an independent appraisal activity within the organization for the review of financial, accounting and other operations done as a basis of service to the management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls”.</p> <p>According to Prof. Walter B. Meigs, “Internal auditing consists of a continuous, critical review of financial and operating activities by a staff of auditors functioning as full time salaried employees.”</p>
<b>Internal Audit under section 138 of Companies Act, 2013</b>	<p>Internal Audit is required by –</p> <p>(1) Such class or classes of companies as may be prescribed shall be required to 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 to conduct internal audit of the functions and activities of the company. It may be noted that under old company law i.e. Companies Act, 1956, there was no provision for compulsory internal audit.</p> <p>(2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.</p>
<p><b>According to the Institute of Internal Auditors, internal audit involves five areas of operations:</b></p> <p><b>[MTP June 19 Q.7a 5 Marks]</b></p>	<p><b>i. Reliability and integrity of financial and operating information:</b> Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify, measures, classify and report such information.</p> <p><b>ii. Compliance with laws, policies, plans, procedures and regulations:</b> Internal auditor should review the systems established to ensure compliance with those policies, plan and procedures, law and regulations which could have a significant impact on operations and reports and should determine whether the organization is in compliance thereof.</p> <p><b>iii. Safeguarding of Assets:</b> Internal auditors should verify the existence of assets and should review the means of safeguarding assets.</p> <p><b>iv. Economic and efficient use of resources:</b> Internal auditor should ensure the economic and efficient use of resources available.</p> <p><b>v. Accomplishing of established objectives and goals for operations:</b> Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or</p>



	programmes are being carried out as planned.
<b>Features of Internal Audit</b>	<ul style="list-style-type: none"> <li>i. It is an independent appraisal activity within the organization.</li> <li>ii. It can be conducted by the staff of the entity or by an independent professional appointed for that purpose.</li> <li>iii. It is conducted for review of accounting, financial and other operations and controls established within an organization.</li> <li>iv. It is conducted as a service to the organization and is not a part of the organization.</li> <li>v. It intends to furnish the analysis, appraisals, suggestions and information concerning the activities reviewed to the management.</li> <li>vi. Internal auditing functions as a continuous effort for promoting effective control at reasonable cost.</li> </ul>
<b>Functions of Internal Audit</b>	<p>Very large organizations and some small and medium size organizations also have found the need for internal audit in addition to the external audit. Internal auditors are employees of the organization and work exclusively for the organization. Their functions partly overlap those of the external auditors and in part are quite different.</p> <p>The functions of internal auditors can be described as follows:</p> <p><b>1. An appraisal function:</b> The internal auditor's job is to appraise the activity of others, not to perform a specific part of data processing. For example, a person who spends his time checking employee expense claims is not performing an internal audit function. But an employee who spends some times reviewing the system of checking employee expense claims may be performing an internal audit function.</p> <p><b>2. As a service to the organization:</b> The management requires that the auditor ensures the following:</p> <ul style="list-style-type: none"> <li>i. That its policies are fulfilled.</li> <li>ii. That the information it requires to manage effectively is reliable and complete; this information is not only that which is provided by the accounting system.</li> <li>iii. That the organisation's assets are safeguarded.</li> <li>iv. That the internal control system is well designed.</li> <li>v. That the internal control system works in practice.</li> </ul> <p>The internal auditor's activities will be directed to ensure that these requirements are met. The internal auditor can be seen as the notice of the board within the enterprise.</p> <p><b>3. Other duties:</b> other duties may include the following events:</p> <ul style="list-style-type: none"> <li>i. Being concerned with the implementation of social responsibility policies adopted by top management.</li> <li>ii. Being concerned with the response of the internal control system to errors and required changes to prevent errors.</li> <li>iii. Being concerned with the response of the internal control system to external stimuli. The internal control system must continually upgrade itself to deal with</li> </ul>

	<p>change.</p> <p>iv. Acting as a training officer in internal control matters.</p> <p>v. Auditing the information given to management particularly interim accounts and management accounting reports.</p> <p>vi. Taking a share of the external auditor's responsibility in relation to the figures in the annual accounts and</p> <p>vii. Being concerned with the compliance with external regulations such as those on the environment, financial services, related parties etc.</p>
<b>Scope</b>	<p>The Institute of Internal Auditors defines scope of internal auditing as 'examination and evaluation of the adequacy and effectiveness of organisation's system of internal control and the quality of actual performance'. Therefore, internal auditing is concerned with an evaluation of both internal control as well as the quality of actual performance. According to the Institute, the scope of internal audit involves the following:</p> <p>i. Review the reliability and integrity of financial and operating information and the means to locate, identify measure, classify and report such information.</p> <p>ii. Appraise the economy and efficiency with which resources are employed.</p> <p>iii. Review the systems established to ensure compliance with those policies, plans, procedures, laws and regulations which could have a significant effect and impact on operations and report, and should determine whether the organization is in compliance.</p> <p>iv. Review the means of safeguarding assets and as appropriate verify the existence of such assets.</p> <p>v. Review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.</p> <p>vi. Internal auditing, therefore, is a function distinct from authorization and recording. It is concerned not only with examination of the transaction as recorded in the books of accounts but also with appraisal or procedure with a view to effecting change for better efficiency, where possible.</p>
<b>Need of Internal Audit</b>	<p>The need for internal audit has becoming in demand due to the enunciated reasons:</p> <p>i. Increased size and complexity of businesses.</p> <p>ii. Enhanced compliance requirements. The penalty for non compliance has increased.</p> <p>iii. Focus on risk management and internal controls to manage them.</p> <p>iv. Unconventional business models.</p> <p>v. Intensive use of information technology.</p> <p>vi. Stringent norms mandated by regulators to protect investors.</p> <p>vii. An increasingly competitive environment.</p>
<b>Internal audit is an important management tool</b>	<p>a. Internal audit ensures compliance of Companies (Auditors Report) Order, 2016.</p> <p>b. It ensures compliance of accounting standards and policies.</p> <p>c. It ensures reliability of MIS through internal audit's independent appraisal and</p>

<p>for the following reasons:</p> <p>[Q.7b 6 Marks June 2018]</p> <p>[MTP June 2020 Q.7b 7 Marks]</p> <p>[MTP Dec 2017 Q.10c 4 Marks]</p> <p>[MTP June 2017 Q.10c 4 Marks]</p>	<p>review.</p> <p>d. It looks into the standard of efficiency of business operation.</p> <p>e. It can evaluate various problems independently and suggest improvement.</p> <p>f. This system makes the internal control system effective.</p> <p>g. It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.</p> <p>h. It performs as an integral part of 'Management by system'.</p> <p>i. It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.</p>
<p><b>Advantages of Internal Audit</b></p>	<p><b>(A) To the management in specific:</b></p> <p>i. It gives a review of overall internal control system established by the management.</p> <p>ii. It furnishes the deviations in following the procedures adopted for safeguarding assets.</p> <p>iii. It appraises the organizational structure and management information system.</p> <p>iv. It establishes that the policies, plans and strategies implemented are well in place and gives suggestions on management information systems reports for promoting effective control at reasonable cost.</p> <p><b>(B) To the statutory auditor in specific</b></p> <p>i. It evaluates the internal control system, so the statutory auditor can reduce the number of tests that he may have had to conduct in case there was no internal audit</p> <p>ii. It carries out physical stock taking procedures, so reliance on stock valuation is increased.</p> <p>iii. It helps in timely completion of accounts and accuracy of records.</p> <p>iv. It evaluates the contingent liability existing at the year end.</p> <p>v. It ensures correctness of financial statements through a system of pre-audit or continuous audit.</p> <p><b>(C) To the organization as a whole and other stakeholders in general</b></p> <p>i. The regular audit and checks result in accurate and efficient accounting system.</p> <p>ii. It is a critical review of the business' performance and management.</p> <p>iii. It provides strict supervision and direction to have effective controls.</p> <p>iv. It provides safeguard to the business assets and prevents misuse and misappropriation of all business assets.</p> <p>v. The auditor can suggest ways and means to improve performance of the business.</p> <p>vi. It prevents occurrence of errors and frauds.</p> <p>vii. It enhances the performance of the business by division of duties and responsibilities as per the capability of the employees.</p> <p>viii. It keeps a check on proper utilization of resources, which leads to reduction in costs.</p>

<b>Difference between Internal Audit and Operational Audit:</b>	<b>SL. NO</b>	<b>INTERNAL AUDIT</b>	<b>OPERATIONAL AUDIT</b>
	i.	Compliance objective	Risk identification, process improvement objective
	ii.	Financial accounts focus	Business focus
	iii.	Audit focus	Efficiency & improvement focus
	iv.	Transaction-based	Process-based
	v.	Policies and procedures focus	Risk management focus
	vi.	Cost Centre wise budget monitoring	Accountability for performance improvement Results
	vii.	Focus on policies, transactions and compliance	Focus on goals, strategies and risk management Processes

**CONCEPT 38. VOUCHING**

<b>Voucher-meaning</b>	A voucher is a piece of substantiating evidence, in the form of a written record of expenditure, disbursement, or completed transaction.
<b>Examples of types of vouchers:</b>	Cash Memo, Sale Invoice, Purchase Requisition Slip, Purchase Invoice, Gate Keeper's Note, Bank Paying Slip, Bank Statements, Minutes Book, etc.
<b>Types of Vouchers</b>	<p><b>i. Original and Collateral Vouchers:</b> Original vouchers are called primary vouchers, and their copies or supporting documents are called collateral vouchers.</p> <p><b>ii. Internal and External Vouchers:</b> Vouchers may generate inside the company (internal vouchers) or outside the company (external vouchers).</p> <p><b>iii. Missing Vouchers:</b></p> <p>(a) A missing voucher can be any of the following: missing Cash Memo, missing page in a Cash Collection Statement, missing inward challan for goods received, missing Inspection Report for material, missing TDS Certificate for tax deductions at source, missing Resolution to authorize increase in borrowing power by the company, missing Bank Statement for a day or a month, etc.</p> <p>(b) A voucher could become missing due to:</p> <ol style="list-style-type: none"> <li>Wrong or careless filing of document. E.g., missing Bank Statement for a day or a month, missing TDS Certificate.</li> <li>Unintentional non-awareness of statutory requirements. E.g., missing Resolution to authorize increase in borrowing power by the company, or accidental fire, or lost otherwise.</li> <li>Intention to hide the misappropriation by a person. E.g., non-recording of Purchas Invoices received later for goods received and taken in stocks, missing Cash Memo, etc.</li> </ol>

	<p>(c) The auditor should be careful and should carry out cross verification processes from other sources and documents to be able to form a firm opinion in the case of missing vouchers.</p> <p>(d) The auditor should qualify his report or give a Disclaimer of Opinion in this case, or may give an adverse report with reasoning on a particular issue depending upon the materiality of the missing voucher as necessary evidence on the issue.</p>
<b>VOUCHING</b>	<p>“Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client’s record.” - Spicer and Pegler.</p> <p>The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account.</p> <p>Vouching is said to be “the essence of auditing” or may be termed as the “backbone of auditing”</p>
<b>TEEMING &amp; LADING/ LAPPING</b>	<p>Teeming &amp; Lading is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customer. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper.</p> <p>E.g., a salesman recovers `10,000 from customer C and misappropriates the same, but to conceal the misappropriation, he declares `10,000 received later from another customer D as received from C so that the balance of C confirms to the client’s debtor list, and so on for recovery from E of same amount declared as from D.</p> <p>Teeming and lading may not amount to fraud, but negligence on the part of the management and weaknesses in internal checks or controls may lead to substantial amounts being misappropriated by the cashier. This may result in a huge loss if he is not in a position to clear the debts when caught.</p> <p>The auditor has to follow the following procedure for timely detection of teeming and lading:</p> <ol style="list-style-type: none"> <li>Ascertain if the Cash Memos are consecutively numbered, and the dates, name and amount as per the Daily Summary reconcile with relevant cash receipt records.</li> <li>Reconcile individual cash amounts as per receipts with records in the Rough Cash Book.</li> <li>Reconcile the receipts as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos, with counterfoils of the pay-in-slips.</li> <li>Ensure whether cash receipts are deposited in the bank on a timely basis.</li> </ol>

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|  | <p>v. Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments.</p> <p>vi. Confirmations may be obtained from the debtors from time to time.</p> |
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**CONCEPT 39. AUDIT OF RECEIPTS**

<b>(1) Cash sales</b>	<p>i. Ensure that the entity internal control is in place over receipt from sales. Examine authorisation level for making cash sales and receiving the amount.</p> <p>ii. Examine few bills in order to check the accuracy of rate, amount, discount and tax computations.</p> <p>iii. Examine the cash sales summary book if the volume of cash sales is voluminous .</p> <p>iv. Cash sales need to be verified with carbon copy of cash memos.</p> <p>v. Examine with the entry made in cash book with reference to date on memos.</p> <p>vi. Examine the system followed by the entity to deposit the cash sales in bank account. It needs to be verified with the bank statement.</p> <p>vii. Examine the cancelled cash memos with its original copy to prevent misappropriation.</p>
<b>(2) Sale of Assets</b>	<p>i. Ensure that the entity internal control is in place in respect of authorisation for making the sale.</p> <p>ii. Ensure the means to sale the assets, is it is a direct sale or by means of agent. If it is a direct sale then check the amount collected with reference of copy of receipt issued and if it is by agent then examines terms with them.</p> <p>iii. Ensure the sale value of assets is reasonable.</p> <p>iv. Check that the amount of sale proceeds is duly accounted for.</p> <p>v. The profit or loss arising from the sale of assets is duly reflected in the financial statement.</p>

**CONCEPT 40. AUDIT OF EXPENDITURE**

<b>(1) Transactions with Directors</b>	<p><b>i. Compliance with Sec 188 of Co. Act, 2013:</b> Check that any contract entered into by the director or his relatives etc. with the company is in accordance with the provisions of section 188 of the Companies Act, 2013.</p> <p><b>ii. Disclosure of interest by Director:</b> Every director of a company who is directly or indirectly, concerned or interested in a contract or agreement entered or proposed to be entered into with the company, must disclose his interest to the company at the Board meeting (Section 184).</p> <p><b>iii. Compliance with Sec 197 of Co. Act, 2013:</b> The remuneration paid to the directors of public companies or the private companies which are the subsidiaries of public companies should be in accordance with the provisions of section 197 of the Companies Act, 2013.</p>
<b>(2) Payment for Acquisition of</b>	<p><b>i. Authorization:</b> The payment for acquisition of assets should be made under proper authorization and be duly supported by receipt for amount paid.</p>

<b>Assets</b>	<p><b>ii. Ownership:</b> Check the title deeds in case of purchase of immovable properties. Also ensure that the ownership in case of the moveable asset has been registered in the name the purchaser.</p> <p><b>iii. Existence:</b> The auditor should also verify the existence, value and the title of the assets acquired.</p> <p><b>iv. Compliance with Sec 179 of Co. Act, 2013:</b> In case of a company, ensure that the provisions of section 179 of the Companies Act, 2013 have been complied with.</p> <p><b>v. Capitalization of Assets:</b> Check that the cost of the asset purchased has been properly capitalized in the books of account. Thus, the amounts paid to bring the asset to their present condition or location and incurred upto the asset being put into use should be capitalized. Further such taxes (e.g. CENVAT) which are recoverable from the authorities shall not form the part of cost of the asset.</p>
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**CONCEPT 41. VERIFICATION OF ASSETS AND LIABILITIES**

<b>VERIFICATION</b>	<p>Only the vouching to ascertain the arithmetical accuracy is not enough, the auditor is supposed to go beyond that while doing audit. In all types of transactions vouching is must, but in case of capital items the auditor is required to go beyond that and verify the physical existence and evaluate the assets and liabilities to arrive at true and fair view of the state of affairs of business. Now a day it is statutory liability of the auditor to verify assets &amp; liabilities and if he fails he is held liable for negligence.</p> <p>E.g. in London Oil Storage Co. Ltd., Vs. Seear Husluck and Co., (1904), Acct. L.R. 30-93, it was held that an auditor, who fails to verify the existence of assets as shown in the balance sheet of the company, is liable. In another case, Arthur E. Green &amp; Company Vs. The Controller, Advances &amp; Discount Corporation (1920) Act, LR xiii, it was held that an auditor is guilty of negligence, if he fails to detect time barred debts within the schedule of debts.</p> <p>Verification, as defined by Spicer and Pegler, is “An enquiry into the Value, Ownership, Title, Existence, possession and presence of any charge on the assets”, while according to Lan Caster, “The verification of assets is a process by which the auditor substantiates the accuracy of the right hand side of the balance sheet, and must be considered as having three distinct objects –</p> <ul style="list-style-type: none"> <li>(a) the verification of the existence of assets</li> <li>(b) the valuation of assets and</li> <li>(c) the authority of their acquisition.</li> </ul>
<b>Meaning</b>	<p>Verification means “Proving the truth”. An auditor has not only to see the arithmetical accuracy and bonafides of the transactions in the books of accounts by vouching only, but has also to see that the assets as recorded in the balance sheet actually exist. The fact that there is an entry regarding purchases of an asset and has been found to be currently recorded, is not a proof that the asset is in the possession of the concern at the date of balance sheet. It is possible that after the</p>

	<p>asset had been acquired and the necessary entries made in the books of accounts, the asset might have been disposed of or pledged or mortgaged and no entry had been made regarding these facts in the books of accounts before the closing of the financial year. He has also to see whether a particular asset as appearing in the balance sheet exists or not. Verification of liabilities is also as important as the verification and assets. If the liabilities are overstated or understated, the balance sheet will not represent a true and fair view of the state of affairs of the Company.</p> <p>In short, verification is a function of examining assets &amp; liabilities to check (i) Value (ii) Ownership (iii) Title (iv) Existence (v) Possession and (vi) to see whether the assets are free from any charge or encumbrance etc.</p>
<b>Importance of Verification</b>	<p>Verification is very important function from view point of both, the auditor and the client as it gives clear idea as to true and fair view of balance sheet. The importance of verification may be described as under –</p> <p><b>(a) True and fair view of Balance Sheet</b> – verification of assets and liabilities enables the auditor to comment on true and fair state of affairs of the business.</p> <p><b>(b) Valuation</b> – verification enables the auditor to determine whether the assets or liabilities are overstated or understated.</p> <p><b>(c) Omissions</b> – verification facilitates the act of confirming the omission of any asset or liability in the balance sheet.</p>
<b>Scope of Verification</b>	<p>Verification includes confirming of whether the assets were in existence on the date of balance sheet, whether assets had been acquired for the purpose of business only, whether the assets had been acquired under a proper authority, whether the right of ownership of the assets vested in the enterprise, whether the assets were free from any charge and whether, the assets were properly valued and disclosed in the balance sheet.</p>
<b>Objects of Verification</b>  <b>[MTP Dec 19 Q7b 6 Marks]</b>	<p>Verification of assets and liabilities is done with the following objects:</p> <ol style="list-style-type: none"> <li>To know whether the Balance-Sheet exhibits a true and fair view of the State of affairs of the business.</li> <li>To find out whether the assets were in existence</li> <li>To find out the ownership and title of the assets</li> <li>To show correct valuation of assets and liabilities</li> <li>To verify the arithmetical accuracy of the books of accounts</li> <li>To ensure that the assets have been recorded properly</li> <li>To detect frauds &amp; errors, if any</li> <li>To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.</li> </ol>
<b>Advantages of Verification</b>	<p>Careful verification of assets fetches the following advantages to the client –</p> <ol style="list-style-type: none"> <li>It avoids manipulation of accounts</li> <li>It guards against improper use of assets</li> <li>It ensures Proper recording and valuation of assets.</li> <li>It exhibits true and fair view of the state of affairs of the Company.</li> </ol>



<b>Technique of Verification</b>	<p>Auditor may adopt the following techniques for verification of assets &amp; liabilities.</p> <p><b>(i) Inspection</b> – This means physical inspection of the assets like counting cash in hand, measuring inventory, inspection of securities, share certificate etc.,</p> <p><b>(ii) Observation</b> – The auditor may observe or witness the inspection of assets done by others.</p> <p><b>(iii) Confirmation</b> – This means obtaining written evidence from outside parties regarding existence of assets like, confirmation from Debtors and Creditors about the balance outstanding etc.</p>
<b>How to conduct the verification work</b>	<ul style="list-style-type: none"> <li>i) Examine the documentary evidence and see that the assets are properly recorded in the books of accounts.</li> <li>ii) Verify the opening balance from the schedule of fixed assets, ledger or register.</li> <li>iii) Verify acquisition on the basis of orders, invoices, title deeds etc.,</li> <li>iv) Verify the self constructed assets on the basis of contractors bill, work order etc.,</li> <li>v) Ensure that the fully written off fixed assets are properly recorded.</li> <li>vi) See the authority of disposal of fixed assets.</li> <li>vii) Follow a proper procedure to ascertain the omissions, if any.</li> <li>viii) Verify ownership of the fixed assets on the basis of title deeds.</li> <li>ix) Verify existence of assets by physical verification. He should ensure that the physical verification of assets is carried out by the management.</li> <li>x) Test check the records of fixed assets with physical verification reports and see that discrepancies, if any, are properly dealt with.</li> <li>xi) See whether the assets are charged. He should verify the Loan Agreements, Register of charge, Board Resolution, Share Holders Resolution etc.,</li> <li>xii) He should keep in mind the following points while verifying the assets &amp; liabilities – <ul style="list-style-type: none"> <li>a. Whether the assets and liabilities are properly traced from ledger to Balance Sheet</li> <li>b. Whether the assets are acquired for the business and liabilities got created for the purpose of business and are clearly stated in the Balance Sheet.</li> <li>c. Whether the assets and liabilities are properly grouped under specified heads in the balance Sheet.</li> <li>d. Whether the assets &amp; liabilities are in actual existence on Balance Sheet date.</li> <li>e. Whether along with ownership the possession of assets lies with the client.</li> <li>f. Whether the assets are properly valued in the Balance Sheet</li> <li>g. Whether the liabilities stated in the Balance Sheet tallies with the confirmation certificate.</li> </ul> </li> </ul>

**LIST OF SELF EXAMINATION QUESTIONS AS GIVEN IN CMA STUDY MATERIAL**

1. Define the term Auditing? State the benefits that accrue out of Auditing? **CONCEPT 14**
2. Briefly state the scope of Auditing and various aspects covered in Audit. **CONCEPT 6 and 10**
3. Distinguish between the following:

- A. Audit and Investigation **CONCEPT 9**
- B. Accounting and Auditing **CONCEPT 7**
- 4. What are the various principles governing an Audit? **CONCEPT 12**
- 5. Write short note on the concept of Materiality in Audit. **CONCEPT 20**
- 6. "Accounting is a necessity but Auditing is a Luxury-Comment.
- 7. Critically comment on "True and Fair Report of the Auditor on the Financial Statements, ensures the future viability of the enterprise". **CONCEPT 19**
- 8. Differentiate between External and Internal Audit. **CONCEPT 17**
- 9. What are the qualities of Auditors? **CONCEPT 8**
- 10. What are the advantages accrue out of audit in a Sole proprietorship and partnership firm? **CONCEPT 23**
- 11. Differentiate between Private and statutory audit. **CONCEPT 23**
- 12. Distinguish between the following;
  - a. Statutory Audit and Government audit **CONCEPT 23**
  - b. Company and firm **CONCEPT 23**
  - c. Statutory audit and Internal audit **CONCEPT 23**
  - d. Statutory audit and forensic audit **CONCEPT 23**
- 13. Write a short note on the followings;
  - a. Social audit **CONCEPT 23**
  - b. Environmental audit **CONCEPT 23**
  - c. Continuous audit **CONCEPT 23**
  - d. Proprietary audit **CONCEPT 23**
  - e. Interim audit **CONCEPT 23**
  - f. Balance sheet audit **CONCEPT 23**
  - g. Statutory Report **CONCEPT 23**
- 14. Pankaj & Associates a Chartered Accountant firm in Kolkata has been appointed by XYZ Company limited for conducting an audit. Draw an audit engagement letter that needs to be furnished by XYZ Company limited for effecting this engagement. **CONCEPT 24**
- 15. What do you mean by audit programme? Discuss the advantages accrue to the auditor by preparing the audit programme. **CONCEPT 25**
- 16. Discuss the disadvantages of Audit programme and means to overcome such disadvantages. **CONCEPT 25**
- 17. Critically examine that "Audit working papers are the property of the Auditor". **CONCEPT 26**
- 18. Distinguish between Permanent & Current Audit file. **CONCEPT 26**
- 19. Discuss the contents of Audit note book. **CONCEPT 27**
- 20. What do you mean by Audit Evidence? List down the need for Audit Evidence. **CONCEPT 30**
- 21. Discuss the basic elements of the Auditor's Report. **CONCEPT 31**
- 22. What do you mean by Internal check and do discuss the auditor duty in regard to Internal Check System? **CONCEPT 32**
- 23. Distinguish between the followings;
  - A. Checklist and Internal Control Questionnaire **CONCEPT 32**
  - B. Internal Audit, Internal Control and Internal Check **CONCEPT 33**
  - C. Internal Audit and External Audit **CONCEPT 17**
  - D. Internal Audit and Operational Audit **CONCEPT 38**
  - E. Test checking and Statistical Sampling **CONCEPT 23**
- 24. Write a short notes on the followings;
  - A. Walk through test **CONCEPT 35**
  - B. Teaming & Lading **CONCEPT 39**

- C. Internal Control and its objective **CONCEPT 37**
  - D. Cut off Procedures **CONCEPT 34**
  - E. Missing Voucher **CONCEPT 39**
- 25. Critically comment on “Proving the Truth”. **CONCEPT 42****

# Study Note 7

## PROVISION RELATING TO AUDIT UNDER COMPANIES ACT

### CONCEPT 42. INTRODUCTION TO COMPANY AUDIT

<b>Provisions of Companies Act, 2013</b>	<p>The Companies Act 2013 has made the audit of accounts of companies in India compulsory.</p> <p>Section 139 to 148 provide for the qualifications, disqualifications, appointment, removal, rights, duties &amp; liabilities of company auditors to be read with Companies (Audit and Auditors) Rules, 2014.</p>
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### CONCEPT 43. APPOINTMENT OF AUDITORS [SECTION 139]

<b>Appointment at AGM</b>	<ul style="list-style-type: none"> <li>✓ Every company shall,</li> <li>✓ at the first annual general meeting,</li> <li>✓ appoint an individual or a firm as an auditor</li> <li>✓ who shall hold office from the conclusion of that meeting</li> <li>✓ till the conclusion of its sixth annual general meeting and</li> <li>✓ thereafter till the conclusion of every sixth meeting</li> <li>✓ and the manner and procedure of selection of auditors by the members of the company at such meeting shall be as prescribed in rule 3.</li> </ul>
<b>Rule 3 : Manner and Procedure of Selection and Appointment of Auditors</b>	<p>(1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company;</p> <p>Provided that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court. (2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.</p> <p>(3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases,</p>

	<p>the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.</p> <p>(4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.</p> <p>(5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.</p> <p>(6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.</p> <p>(7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.</p>
<b>Consent of Auditor</b>	<p>Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions <b>as prescribed in rule 4</b> of chapter X under the Act, shall be obtained from the auditor.</p>
<b>Rule 4 : Conditions for Appointment and Notice to Registrar</b>	<p>(1) The auditor appointed under rule 3 shall submit a certificate that -</p> <p>(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;</p> <p>(b) the proposed appointment is as per the term provided under the Act;</p> <p>(c) the proposed appointment is within the limits laid down by or under the authority of the Act;</p> <p>(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.</p> <p>(2) The notice to Registrar about appointment of auditor under fourth proviso to sub-section (1) of section 139 shall be in Form ADT-1</p> <p>Provided also that the certificate shall also indicate whether the auditor satisfies</p>

	the criteria provided in section 141.
<b>Company to inform Auditor</b>	The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within thirty days of the meeting in which the auditor is appointed.
<b>Appointment includes Reappointment</b>	For the purposes of this Chapter, "appointment" includes re-appointment.
<b>Maximum Number of Consecutive Reappointment</b>	No listed company or a company belonging to such class or classes of companies as prescribed in <a href="#">rule 5</a> under the act, shall appoint or re-appoint— (a) an individual as auditor for more than one term of five consecutive years; and (b) an audit firm as auditor for more than two terms of five consecutive years.
<b>Rule 5 : Class of Companies</b>	The class of companies shall mean the following classes of companies excluding one person companies and small companies:- (a) all unlisted public companies having paid up share capital of rupees ten crore or more;  (b) all private limited companies having paid up share capital of rupees 1[fifty] crore or more;  (c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.
<b>Cooling Off Period</b>	<b>Provided that—</b> (i) an individual auditor who has completed his term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;  (ii) an audit firm which has completed its term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.  Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.  Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act.

	<p>Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.</p> <p>(3) Subject to the provisions of this Act, members of a company may resolve to provide that—</p> <p>(a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or</p> <p>(b) the audit shall be conducted by more than one auditor.</p> <p>(4) The Central Government may, by <u>rules 6</u>, prescribe the manner in which the companies shall rotate their auditors.</p>
<p><b>Rule 6 : Manner of Rotation of Auditors by the Companies on Expiry of Their Term</b></p> <p>[June 18 Q.8b 6 Marks]</p> <p>[MTP June 19 Q.8a 7 Marks]</p> <p>[MTP June 18 Q.8b 6 Marks]</p> <p>[MTP June 17 Q.8b 6 Marks]</p>	<p>(1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.</p> <p>(2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.</p> <p>(3) For the purpose of the rotation of auditors-</p> <p>(i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;</p> <p>(ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.</p>
<p><b>Appointment in Government Company</b></p>	<p>In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year,</p> <p>Appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, <u>within a period of one hundred eighty days from the commencement of the financial year</u>, who shall hold office till the conclusion of the annual general meeting.</p>

<p><b>First Auditor of Non Government Company</b></p> <p>[Dec 18 Q. 8b 6 Marks]</p> <p>[MTP Dec 20 Q.8a 4 Marks]</p> <p>[MTP Dec 18 Q.8b 4 Marks]</p> <p>[MTP June 18 Q.10d 4 Marks]</p> <p>[MTP Dec 17 Q.10d 4 Marks]</p> <p>[MTP June 17 Q.10d 4 Marks]</p>	<p>The first auditor of a company, other than a Government company, shall be appointed <u>by the Board of Directors within thirty days</u> from the date of registration of the company and <u>in the case of failure</u> of the Board to appoint such auditor, it shall inform the <u>members of the company, who shall within ninety days</u> at an extraordinary general meeting appoint such auditor and such auditor shall hold office <u>till the conclusion of the first annual general meeting</u>.</p>
<p><b>First Auditor of Government Company</b></p> <p>[Dec 18 Q. 8b 6 Marks]</p> <p>[Dec 17 Q. 8a 4 Marks]</p> <p>[MTP Dec 20 Q.8a 4 Marks]</p> <p>[MTP Dec 18 Q.8b 4 Marks]</p> <p>[MTP June 18 Q.10d 4 Marks]</p> <p>[MTP Dec 17 Q.10d 4 Marks]</p> <p>[MTP June 17 Q.10d 4 Marks]</p>	<p>In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments,</p> <p>The first auditor shall be appointed <u>by the Comptroller and Auditor-General of India within sixty days</u> from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, <u>the Board of Directors of the company shall appoint such auditor within the next thirty days</u>; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the <u>members of the company who shall appoint such auditor within the sixty days</u> at an extraordinary general meeting, who shall <u>hold office till the conclusion of the first annual general meeting</u>.</p>



<b>Casual Vacancy</b>	<p>Any casual vacancy in the office of an auditor shall—</p> <p>(i) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;</p> <p>(ii) in the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days.</p> <p>Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.</p>
<b>Reappointment</b> [MTP Dec 20 Q.8b 3 Marks]	<p>A retiring auditor may be re-appointed at an annual general meeting, if—</p> <p>(a) he is not disqualified for re-appointment;</p> <p>(b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and</p> <p>(c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.</p>
<b>What if AGM does not make any appointment or reappointment?</b>	Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
<b>Audit Committee Recommendations</b>	Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

**CONCEPT 44. REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE [SECTION 140]**

<b>Removal by SR and CG Approval</b>	The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government.
<b>Removal Process</b>	(1) The application to the Central Government for removal of auditor shall be made in eForm ADT-2 and shall be accompanied with fees as provided for this purpose

<p><b>[June 19 Q.8b 4 Marks]</b></p> <p><b>[Dec 17 Q.8a 3 Marks]</b></p>	<p>under the Companies (Registration Offices and Fees) Rules, 2014.</p> <p>(2) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.</p> <p>(3) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.</p>
<p><b>Opportunity of being heard</b></p>	<p>Before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.</p>
<p><b>Resignation</b></p>	<p>The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form (ADT - 3) with the company and the Registrar, and in case of companies referred to in sub-section (5) of section 139, Govt. companies and companies where CAG, appoints auditor, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation.</p> <p>If the auditor does not comply with the provision of sub-section (2), he or it shall be liable to a penalty of fifty thousand rupees or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.</p>
<p><b>Requirement of Special Notice</b></p>	<p>Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years.</p> <p>On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor</p>
<p><b>Representation by Auditor</b></p>	<p>Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so, —</p> <p>(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and</p> <p>(b) send a copy of the representation to every member of the company to whom</p>

	<p>notice of the meeting is sent, whether before or after the receipt of the representation by the company, and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.</p> <p>Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.</p> <p>Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.</p>
<b>Order by Tribunal to Change Auditors</b>	<p>Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.</p> <p>Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.</p> <p>Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.</p>

**CONCEPT 45. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS [SECTION 141]**

<b>Basic Eligibility</b>	<p>A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.</p> <p>Provided that 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.</p> <p>Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.</p>

<b>Disqualifications</b>	The following persons shall not be eligible for appointment as an auditor of a company, namely:—
<b>[June 2017 Q. 8a 7 Marks]</b>	(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
<b>[MTP Dec 19 Q.8a 10 Marks]</b>	(b) an officer or employee of the company;
<b>[MTP June 19 Q.8a 10 Marks]</b>	(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
<b>[MTP Dec 18 Q.8a 8 Marks]</b>	(d) a person who, or his relative or partner—
<b>[MTP June 18 Q.8a 7 Marks]</b>	(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.
<b>[MTP Dec 17 Q.8a 8 Marks]</b>	Provided that the relative may hold security or interest in the company of face value <b>not exceeding not exceeding rupees one lakh</b> .
<b>[MTP June 17 Q.8a 9 Marks]</b>	Provided further that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor <b>within sixty days of such acquisition or interest</b> .
	(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, <b>in excess of rupees five lakh</b> ; or
	(iii) 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, <b>in excess of one lakh rupees</b> ;
	(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as prescribed in rule 10 of chapter X under the act;
	<i>The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except -</i>
	<i>(i) 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 and the rules or the regulations made under those Acts;</i>
	<i>(ii) 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, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.</i>

	<p>(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;</p> <p>(g) 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 twenty companies;</p> <p>(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;</p> <p>(i) 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.</p> <p>Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.</p>
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**CONCEPT 46. REMUNERATION OF AUDITORS [SECTION 142]**

<b>Who decides it?</b>  <b>[MTP Dec 19 Q.8b 2 Marks]</b>	<p>The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.</p> <p>Provided that the Board may fix remuneration of the first auditor appointed by it.</p>
<b>Components of Remuneration</b>	<p>The remuneration 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 does not include any remuneration paid to him for "any other service" rendered by him at the request of the company.</p>

**CONCEPT 47. POWERS AND DUTIES OF AUDITORS [SECTION 143]**

<b>Powers and Duties</b>  <b>[June 19 Q. 8a 8 Marks]</b>  <b>[Dec 17 Q. 8b 5]</b>	<p>(1) Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:—</p>
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<p><b>Marks]</b></p> <p><b>[MTP Dec 20 Q.8b 8 Marks]</b></p>	<p>(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;</p> <p>(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;</p> <p>(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;</p> <p>(d) whether loans and advances made by the company have been shown as deposits;</p> <p>(e) whether personal expenses have been charged to revenue account;</p> <p>(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.</p> <p>Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries and associates companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries and associates companies.</p> <p>(2) The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as prescribed in <u>rule 11.</u></p> <p>(3) The auditor's report shall also state—</p> <p>(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;</p> <p>(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and</p>
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proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

(j) such other matters as may be prescribed.

(4) Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

(5) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Government, or partly by the Central Government and partly by one or more State Government, the Comptroller and Auditor- General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

(6) The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report under sub-section (5) have a right to,—

(a) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of

such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor- General of India may direct; and

(b) comment upon or supplement such audit report.

Provided that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(7) Without prejudice to the provisions of this Chapter, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of Companies Act, 2013, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

(8) Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as prescribed in rule 12.

(9) Every auditor shall comply with the auditing standards.

(10) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

(11) The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.



	<p>Provided that until the National Financial Reporting Authority is constituted under section 132, the Central Government may hold consultation required under this sub-section with the Committee chaired by an officer of the rank of Joint Secretary or equivalent in the Ministry of corporate Affairs and the committee shall have the representatives from the Institute of Chartered Accountants of India and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards and the office of the Comptroller and Auditor-General.</p> <p>(12) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as prescribed in rule 13 of chapter X under the act, is being or has been committed in the company by its officers or employees the auditor shall report the matter to the Central Government within such time and in such manner as prescribed in rule 13 of chapter X under the Act:</p> <p>Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed in rule 13 of chapter X under the Act:</p> <p>Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as prescribed in rule 13 of chapter X under the Act.</p> <p>(13) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.</p> <p>(14) The provisions of this section shall mutatis mutandis apply to—  (a) the cost accountant in practice conducting cost audit under section 148; or  (b) the company secretary in practice conducting secretarial audit under section 204.</p> <p>(15) If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall be one lakh rupees for unlisted company and rupees five lakhs for listed company.</p>
<b>Rule 11 : Other Matters to be Included in Auditors Report</b>	<p>The auditor's report shall also include their views and comments on the following matters, namely:-</p> <p>(a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;</p> <p>(b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;</p>

	<p>(c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.</p> <p>d) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30<sup>th</sup> December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.</p>
<b>Rule 12 : Duties and Powers of the Company's Auditor with Reference to the Audit of the Branch and the Branch Auditor</b>	<p>(1) For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.</p> <p>(2) The branch auditor shall submit his report to the company's auditor.</p> <p>(3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.</p> <p>Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.</p>
<b>Rule 13 Reporting of Frauds by Auditor and Other Matters</b>  <b>[June 18 Q. 8a 6 Marks]</b>  <b>[MTP Dec 20 Q.8a 9 Marks]</b>	<p>(1) If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.</p> <p>(2) The auditor shall report the matter to the Central Government as under:-</p> <p>(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;</p> <p>(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;</p> <p>(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;</p> <p>(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post</p>

	<p>followed by an e-mail in confirmation of the same;</p> <p>(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and</p> <p>(f) The report shall be in the form of a statement as specified in Form ADT-4.</p> <p>(3) In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-</p> <p>(a) Nature of Fraud with description;</p> <p>(b) Approximate amount involved; and</p> <p>(c) Parties involved.</p> <p>(4) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:-</p> <p>(a) Nature of Fraud with description;</p> <p>(b) Approximate Amount involved;</p> <p>(c) Parties involved, if remedial action not taken; and</p> <p>(d) Remedial actions taken.</p> <p>(5) The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively."</p>
<b>DUTIES AND POWERS OF THE COMPANY'S AUDITOR WITH REFERENCE TO THE AUDIT OF THE BRANCH AND THE BRANCH AUDITOR</b>	<p>For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in subsections (1) to (4) of section 143.</p> <p>The branch auditor shall submit his report to the company's auditor.</p> <p>The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.</p>

**CONCEPT 48. AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]**

<b>List of prohibited Services</b>  <b>[Dec 2019 Q.8b 6 Marks]</b>	<p>An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case maybe, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:—</p>
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[June 2017 Q. 8b 5 Marks]	(a) accounting and book keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services;
[MTP Dec 19 Q.8a 8 Marks]	(e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services;
[MTP June 19 Q.8b 5 Marks]	(h) management services; and (i) any other kind of services as may be prescribed.
[MTP June 18 Q.8b 5 Marks]	<b>Explanation.</b> —For the purposes of this sub-section, the term “directly or indirectly” shall include rendering of services by the auditor, —
[MTP June 17 Q.8a 6 Marks]	(i) In case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;  (ii) In case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

**CONCEPT 49. AUDITOR TO SIGN AUDIT REPORTS ETC. [SECTION 145]**

<b>Who will sign Audit Report?</b>	The person appointed as an auditor of the company shall sign the auditor’s report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141, and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor’s report shall be read before the company in general meeting and shall be open to inspection by any member of the company.
[MTP June 17 Q.8b 3 Marks]	

**CONCEPT 50. AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]**

<b>Auditors to attend General Meeting</b>	All notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.
[MTP Dec 17 Q.8b 3 Marks]	

**CONCEPT 51. PUNISHMENT FOR CONTRAVENTION [SECTION 147]**

<p><b>Punishment Provisions</b></p> <p><b>[Dec 2019 Q. 8a 6 Marks]</b></p> <p><b>[MTP Dec 18 Q.8a 8 Marks]</b></p>	<p>(1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.</p> <p>(2) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less. Provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.</p> <p>(3) Where an auditor has been convicted under sub-section (2), he shall be liable to—</p> <p>(i) refund the remuneration received by him to the company; and</p> <p>(ii) pay for damages to the company, statutory bodies or authorities or to members and creditors of the company for loss arising out of incorrect or misleading statements of particulars made in his audit report.</p> <p>(4) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.</p> <p>(5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.</p> <p>Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.</p>
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**CONCEPT 52. AUDIT COMMITTEE [SECTION 177] [Dec 18 Q. 8a 6 Marks]**

<b>Mandatory Requirement of Audit Committee</b>	<p>Constitution of an Audit committee is mandatory for the;</p> <ul style="list-style-type: none"> <li>• Every listed Company; and</li> <li>• Such directors or classes of the companies, as may be prescribed.</li> </ul> <p>As per the Rule 6 of the Companies (Meetings of the Board and its Power) Rules, 2014 following class of the companies have been prescribed for this purpose;</p> <ul style="list-style-type: none"> <li>• All public companies with a paid up share capital ` 10 Crore or more;</li> <li>• All Public Companies having turnover of ` 100 Crore or more;</li> <li>• All Public Companies having in aggregate, outstanding Loans, or borrowings and debentures or deposits exceeding ` 50 Crore or more.</li> </ul> <p>An Audit committee shall have minimum 3 Directors majority of them should be Independent Directors. Majority of the member of the Audit Committee should be able to read &amp; understand the financial statement.</p>
<b>Function of Audit Committee</b>  <b>[MTP Dec 17 Q.8b 4 Marks]</b>	<p>The various Functions of the Audit Committee is enumerated below;</p> <ul style="list-style-type: none"> <li>• Recommend the appointment and fixation of the remuneration of Auditor.</li> <li>• Review and monitor the Auditors independence and performance and effectiveness of audit process.</li> <li>• Examination of the Financial Statement and Auditor's report thereon.</li> <li>• Scrutiny of Inter Corporate Loans and Investment,</li> <li>• Valuation of the Assets of the Company,</li> <li>• Evaluation of the internal financial control and risk management system of the entity.</li> <li>• Evaluation of the use of the funds rose through public offers.</li> <li>• Evaluation of any related party transaction.</li> </ul>
<b>Powers of the Audit Committee</b>  <b>[MTP Dec 19 Q.8b 3 Marks]</b>  <b>[MTP Dec 18 Q.8b 4 Marks]</b>  <b>[MTP June 18 Q.8a 6 Marks]</b>	<p>The powers of the Audit Committee are enumerated below:</p> <ul style="list-style-type: none"> <li>• Audit Committee has the power to call for comments of the Auditor about Internal Control Systems and the scope of the Audit including its observation.</li> <li>• Before submission of the report to the Board the Audit Committee have the power to review the Financial Statement.</li> <li>• Power to discuss any issues including issue of independence of audit work with the Statutory &amp; Internal Auditor and the Management of the Company in relation to matter contained in the Financial Statement.</li> <li>• Power to investigate into any matter under the perview of Audit Committee.</li> <li>• Auditors of the company and key managerial personnel shall have a right to be heard into the meeting.</li> <li>• Composition of Audit Committee is to be disclosed in Board's Report.</li> </ul>

- In case recommendation of the Audit Committee is not accepted by the Board, the Board shall disclose in Board's report along with reasons

**CONCEPT 53. COST AUDIT [SECTION 148]**

<b>Rules regarding Cost Audit</b>	(1) Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:
<b>[Dec 2019 Q.9a 6 Marks]</b>	
<b>[June 2019 Q.9a 7 Marks]</b>	Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.
<b>[Dec 2018 Q.9a 6 Marks]</b>	
<b>[Dec 2017 Q.9a 4 Marks]</b>	(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under subsection (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.
<b>[June 2017 Q. 9b 8 Marks]</b>	(3) The audit under sub-section (2) shall be conducted by a Cost Accountant who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed:
<b>[MTP Dec 19 Q.9a 10 Marks]</b>	Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:
<b>[MTP Dec 19 Q.9a 4 Marks]</b>	Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.
<b>[MTP Dec 18 Q.9a 4 Marks]</b>	<b>Explanation.</b> —For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost Accountants of India, with the approval of the Central Government.
	(4) An audit conducted under this section shall be in addition to the audit conducted under section 143.
	(5) The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section 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:
	Provided that the report on the audit of cost records shall be submitted by the cost accountant to the Board of Directors of the company.



	<p>(6) A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.</p> <p>(7) If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.</p> <p>8) If any default is made in complying with the provisions of this section,—  (a) The company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;  (b) The cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.</p>
<b>PROCEDURE FOR COST AUDIT AND APPOINTMENT OF COST AUDITOR (FOR FINANCIAL YEAR COMMENCING ON OR AFTER 1st APRIL, 2014 ONWARDS)</b>	<p>Pursuant to Companies Act 2013 and in supersession of Cost Accounting Records Rules 2011 and Companies (Cost Audit Report) Rules 2011, the Ministry of Corporate Affairs notified Companies (Cost Records and Audit) Rules 2014 on 30th June 2014 which were amended vide Companies (Cost Records and Audit) Amendment Rules 2014 on 31st December 2014. The mechanism with respect to maintenance of cost records, cost audit and appointment of cost auditors has been changed and shall be in accordance with Companies (Cost Records and Audit) Rules 2014 as amended. Rules referred under this chapter of the study material denotes Companies (Cost Records and Audit) Rules, 2014, unless specified otherwise.</p>
<b>Maintenance of Cost Accounting Records and Cost Audit</b>	<p>The Rules state that cost records are to be maintained in Form CRA-1, which provides principles to be followed for different cost elements. The principles are in sync with the cost accounting standards issued by the Institute of Cost Accountants of India. Since the Rules are principle based, no format has been prescribed for maintenance of cost accounting records like pre-2011 industry specific rules. It is opened for industry to maintain cost accounting records according to its size and nature of business so long as it determines a true and fair view of the cost of production, cost of sales and margin of the products/services.</p> <p>The cost audit report is required to be in conformity with the “cost auditing standards” as referred to in Section 148 of the Companies Act, 2013.</p> <p>It may be noted that the Council of the Institute of Cost Accountants of India has made it mandatory for cost accountants in practice to follow and conform to the Cost Accounting Standards issued by it and it is incumbent on the cost auditors to report any deviations from cost accounting standards.</p>



<b>Applicability of Cost Audit</b>	<p>Applicability of cost audit is guided by notification dated 14th July, 2016 which merged erstwhile table 'A' &amp; table 'B' into a single table.</p> <p>Every company, under regulated category (table A) shall get cost records audited if the turnover from all its products or services is ` 50 crores or more and the aggregate turnover from individual product or services is ` 25 cores or more.</p> <p>In case of non regulated category (table B) the threshold is 150 crores or more and 35 crores or more.</p> <p>The rule shall not apply if revenue from exports exceeds 75% of total revenue or which is operating from SEZ.</p> <p>However, foreign companies having only liaison office in India and engaged in production, import and supply or trading of medical devices listed in Sl. 33 of Table B are exempted. Further, companies which are classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) are also excluded from the purview of the Rules.</p> <p>Rule shall also not apply to generation of electricity for captive consumption.</p>
<b>APPOINTMENT OF COST AUDITOR</b>	<p>The cost auditor is to be appointed by the Board of Directors (BOD) on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors. The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2 along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014</p> <p>Subrule 1A of Rule 6 provides that the cost auditor appointed shall submit a report, that -</p> <ul style="list-style-type: none"> <li>(a) he / it is eligible for appointment and is not disqualified;</li> <li>(b) Satisfied the Criteria of section 141 of the Companies Act</li> <li>(c) Proposed appointment is within limits</li> <li>(d) Affirmation of list of proceeding, is any. Every cost auditor shall continue upto 180 days or till he submits the audit report.</li> </ul> <p>Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors (BOD) within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.</p>
<b>Who can be appointed cost</b>	<p>Only a Cost Accountant, as defined under section 2(28) of the Companies Act, 2013, can be appointed as a cost auditor.</p>

auditor?	<p>Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.</p>
<b>Eligibility criteria for appointment as a cost auditor</b>	<p>Eligibility Criteria under Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 and Section 148 of the Companies Act, 2013. The following persons are not eligible for appointment as a cost auditor:</p> <p>A body corporate. However, a Limited Liability partnership registered under the Limited Liability Partnership Act, 2008 can be appointed. [Section 141(3)(a)]. An officer or employee of the company. [Section 141(3)(b)].</p> <p>A person who is a partner, or who is in the employment, of an officer or employee of the company. [Section 141(3)(c)].</p> <p>A person who, or his relative or partner is holding any security of or interest in the company or any of its subsidiary or of its holding or associate company or a subsidiary of such holding company. [Section 141(3) (d)(i)].</p> <p>Relatives of any partner of the firm holding any security of or interest in the company of face value exceeding ` 1 lakh. [Section 141(3)(d)(i) and Rule 10(1) of Companies (Audit and Auditors) Rules, 2014].</p> <p>A person who is indebted to the company or its subsidiary, or its holding or associate company or a subsidiary or such holding company, for an amount exceeding ` 5 lakhs. [Section 141(3)(d)(ii) and Rule 10(2) of Companies (Audit and Auditors) Rules, 2014].</p> <p>A person who has given any 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, for an amount exceeding ` 1 lakh. [Section 141(3)(d)(iii) and Rule 10(3) of Companies (Audit and Auditors) Rules, 2014].</p> <p>A person or a firm who, whether directly or indirectly, has business relationship with the company or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. [Section 141(3)(e) and Rule 10(4) of Companies (Audit and Auditors) Rules, 2014].</p> <p>"Business Relationship" is defined in Rule 10(4) of Companies (Audit and Auditors) Rules, 2014 and the same shall be construed as any transaction entered into for a commercial purpose, except commercial transactions which are in the nature of professional services permitted to be rendered by a cost auditor or a cost audit</p>

	<p>firm under the Act and 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 cost auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.</p> <p>A person whose relative is a director or is in the employment of the company as a director or key managerial personnel of the company. [Section 141(3)(f)].</p> <p>A person who is in the full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor if such person or persons is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies. [Section 141(3)(g)].</p> <p>A person who has been convicted by a court for an offence involving fraud and a period of ten years has not elapsed from the date of such conviction. [Section 141(3)(h)].</p> <p>Any person whose subsidiary or associate company or any other form of entity, is engaged as on date of appointment in consulting and providing specialised services to the company and its subsidiary companies: [Section 141(3)(i) and Section 144].</p> <ul style="list-style-type: none"> <li>● accounting and book keeping services</li> <li>● internal audit</li> <li>● design and implementation of any financial information system</li> <li>● actuarial services</li> <li>● investment advisory services</li> <li>● investment banking services</li> <li>● rendering of outsourced financial services</li> <li>● management services</li> </ul>
<p><b>Is Rotation applicable to cost auditor?</b></p> <p><b>[MTP Dec 20 Q.9a 6 Marks]</b></p> <p><b>[MTP June 18 Q.9a 5 Marks]</b></p> <p><b>[MTP Dec 17 Q.9a 5 Marks]</b></p> <p><b>[MTP June 17 Q.9a 5 Marks]</b></p>	<p>The provisions for maintenance of cost accounting records and cost audit are governed by Section 148 of the Companies Act, 2013. The provisions of Section 148 clearly states that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting audit of cost records of the company. Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143. Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.</p> <p>Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial). The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be</p>

	noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.
<b>Remuneration of the Cost Auditor</b>  <b>[June 18 Q. 9a 5 Marks]</b>  <b>[MTP Dec 20 Q.9a 4 Marks]</b>  <b>[MTP June 19 Q.9b 5 Marks]</b>  <b>[MTP Dec 18 Q.9a 5 Marks]</b>  <b>[MTP Dec 17 Q.9a 4 Marks]</b>	<p>Rule 14 of the Companies (Audit and Auditors) Rules, 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:</p> <p>For the purpose of sub-section (3) of section 148-</p> <p>in the case of companies which are required to constitute an audit committee-</p> <p>the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor; the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;</p> <p>in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.</p>
<b>Removal of Cost Auditor</b>	The cost auditor may be removed before the term by Board resolution after giving reasonable opportunity of hearing and recording the reasons for removal.
<b>Obligation to report offence of fraud</b>	<p>Sub-rule (7) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 states that "the provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules".</p> <p>As per sub-section (12) of section 143 of the Companies Act 2013, extract of which is given above, it is obligatory on the part of cost auditor to report offence of fraud which is being or has been committed in the company by its officers or employees, to the Central Government as per the prescribed procedure under the Rules.</p> <p>As per the proviso to above sub-section, it has been stated that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.</p>
<b>Cost Audit Report</b>	"Cost audit report" is defined under Rule 2(d) of the Rules. It denotes the duly

<b>[MTP June 19 Q.9a 5 Marks]</b>	<p>signed cost auditor's report on the cost records examined and cost statements which are prepared as per these Rules. Cost records means books of account relating to utilisation of material, labour and other items of cost for production or provision of services.</p> <p>As per sub-rule (4) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 as amended, a Cost Auditor is required to submit the Cost Audit Report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3 to Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly on any reservation or qualification contained therein.</p>
<b>Form for filing Cost Audit Report with the Central Government</b>	<p>As per sub-rule (6) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 as amended, every company to whom cost auditor submits his or its report shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. The report shall be filed using XBRL taxonomy.</p> <p>It is to be noted that the cost audit report is required to be filed in XBRL format.</p>

**CONCEPT 54. SECRETARIAL AUDIT**

<b>Extract of Provision of Section 204 of the Companies Act 2013 Section 204</b>	<p>Every listed company and a company belonging to other class of companies as may be prescribed in rule 9 of chapter XIII under the Act, shall annex with its Board's report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed in rule 9 of chapter XIII under the Act.</p>
<b>Rule 9 Secretarial Audit Report.</b>	<p>(1) For the purposes of sub-section (1) of section 204, the other class of companies shall be as under-</p> <p>(a) Every public company having a paid-up share capital of fifty crore rupees or more; or</p> <p>(b) Every public company having a turnover of two hundred fifty crore rupees or more.</p> <p>(2) The format of the Secretarial Audit Report shall be in Form No. MR.3.</p> <p>(2) It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of</p>

	<p>the company.</p> <p>(3) The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).</p> <p>(3) If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of ` 2 lakhs.</p>
<b>Procedures of appointment of Secretarial Auditor</b>	<p>As per Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, Secretarial Auditor is required to be appointed by means of resolution passed at a duly convened Board meeting. It is advisable for the Secretarial Auditor to get a letter of engagement from the company. Secretarial Auditor should accept the letter of engagement. However, it is advisable that any changes in the Secretarial Auditor during the financial year are to be reported to the members in the Board's Report. The qualifications, observations or comments / remarks of the secretarial Audit Report shall be read at the annual general meeting of the company along with the explanation and comments of the Board of Directors (Clause 13 of Secretarial Standard - 2).</p>
<b>Purpose of Secretarial Audit</b>	<p>With introduction of various regulations and the kind of importance Govt. is giving to corporate governance, it has become necessary to check the compliances of the laws, regulations and procedure by the companies of particular side. The audit also satisfies the stakeholders like Govt., shareholders, customers, the Board of Directors and Senior management. Management can take corrective action of any deficiency or non compliance.</p>

**CONCEPT 55. SCOPE, BASIC ELEMENTS AND SIGNIFICANCE OF AUDIT REPORT**

<b>Concept &amp; Definitions</b>	<p>While conducting every audit auditor has to go through three phases</p> <ul style="list-style-type: none"> <li>● Preliminary work for audit.</li> <li>● Conduct of actual audit, and</li> <li>● Conclusion of audit, which means submission of Audit Report.</li> </ul> <p>Therefore, Audit Report is called as the ultimate and final product of every audit. The meaning of Audit Report can be well understood from the following selected definitions.</p> <p>Lancaster – "A Report is a statement of collected &amp; considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report."</p>
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	<p>J. B. Ray – “The Report shall either contain as expression of opinion regarding the financial statements, taken as a whole or an assertion to the effect that an opinion cannot be expressed when an overall opinion cannot be expressed, the reason therefore should be stated. In all cases, where auditor’s name is associated with financial statements the report should contain a clear cut indication of the character of the auditor’s examination, if any, and the degree of responsibility he is taking.”</p> <p>In short, the Audit Report is nothing but a statement of observation gathered &amp; considered while proving conclusive evidence of company’s financial position. It is a medium through which an auditors expresses his opinion on the financial statement under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.</p>
<b>Importance of Audit Report</b>	<p>An Audit report is the end product of the auditing &amp; concluding part of the audit process.</p> <p>Audit report gives the auditor’s opinion on the accounts &amp; record of the company, as examined by him.</p> <p>Audit Report reflects the work done by the auditor.</p> <p>Audit report is the instrument which, measures the auditors responsibility in regard to the true &amp; fairness of the financial statement of the company.</p> <p>Audit Report indicates the real position of the financial status of the company &amp; which is used by different stakeholders as a reliable document to assess the financial condition of the company.</p>
<b>The Basic Elements of the Auditors’ Report are –</b>  <b>[Dec 2017 Q.9b 8 Marks]</b>	<p><b>Title:</b> The Auditor’s Report should have an appropriate title i.e. “Auditor’s Report”. It should be distinguished from other Reports, e.g. reports of officers of the entity, Board of Directors.</p> <p><b>Addressee:</b> The Auditor’s Report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the Auditor’s Report is addressed to the authority appointing the Auditor. In case of statutory auditor, it is addressed to shareholders and in case of internal Audit to the Board.</p> <p><b>Opening or Introductory Paragraph:</b> The Auditor’s Report should identify the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.</p> <p>The Report should include a Statement that the Financial Statements are the responsibility of the entity’s management and a Statement that the responsibility of the Auditor is to express an opinion on the Financial Statements based on the audit.</p> <p><b>Scope Paragraph:</b> The Auditor’s Report should describe the scope of the audit by stating that the audit was conducted in accordance with standards on auditing generally accepted in India.</p>



	<p>The Report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the Financial Statements are free of material misstatement.</p> <p>The Auditor's Report should describe the Audit as including examining, on a test basis, evidence to support the amounts and disclosures in Financial Statements, assessing the accounting principles used in the preparation of the Financial Statements, assessing significant estimates made by management, in the preparation of Financial Statements, &amp; evaluating the overall position of Financial Statements.</p> <p>The Report should include a statement by the Auditor that the audit provides a reasonable basis for his opinion.</p> <p><b>Opinion Paragraph:</b> The Opinion paragraph of the Report should indicate the Financial Reporting framework used to prepare the Financial Statements. It should state the Auditor's opinion as to whether the Financial Statements give a true and fair view in accordance with the financial reporting framework and, where appropriate, whether the Financial Statements comply with the statutory requirements.</p> <p><b>Date of the Report:</b> The date of an Auditor's Report is the date on which the Auditor signs the Report expressing an opinion on the Financial Statements. The Auditor should not date the Report earlier than the date on which the Financial Statements are signed or approved by Management. However, they can commence audit earlier.</p> <p><b>Place of Signature:</b> The Report should name the specific location, which is ordinarily the city where the Audit Report is signed.</p> <p><b>Auditor's Signature:</b> The Report should be signed by the Auditor in his personal name. Where a Firm is appointed as the Auditor, the Report should be signed in the personal name of the Auditor and in the name of the Audit Firm. The Partner / Proprietor signing the Report should mention his ICAI Membership Number, preferably with seal/rubber stamp.</p> <p><b>Note:</b> Where the governing statute requires the Auditor to include certain matters in his Report or prescribe the form in which the Auditor should issue his Report, such additional matters should be included in addition to the requirements of SA 700 on "Forming an opinion and reporting on financial statements."</p>
<b>Significance of Opening Paragraph</b>	<p>The Opening or Introductory Paragraph identifies the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.</p> <p>The 'Opening Paragraph' seeks to bring to the notice of the Users of Financial Statements, that preparation of the accounts is the responsibility of the</p>



	<p>Management of the enterprise, whereas the responsibility of the Auditor is to express an opinion on the said accounts based on the audit carried out by him.</p> <p>Through the Opening Paragraph, the Auditor communicates the basic message that the preparation of Financial Statements requires Management to make significant accounting estimates and judgements, as well as to determine the appropriate accounting principles and methods used in preparation of the said Financial Statements.</p>
<b>Significance of Scope Paragraph</b>	<p>The 'Scope Paragraph' seeks to inform the Users about the practices and procedures followed in the conduct of audit by the Auditor.</p> <p>In the Scope Paragraph, the Auditor states that the audit was planned and performed in accordance with Standards on Auditing generally accepted in India, and also that the audit provides a reasonable basis for his opinion.</p> <p>The significance of the Scope Paragraph lies in the fact that the Auditor intends to convey to the readers of his report, about the scope of audit by highlighting the nature and progress of audit. The test check approach of audit adopted by the Auditor in performing his audit work as also the significant aspect of evaluation of accounting principles and accounting estimates is also clarified.</p> <p>The basic objective of auditing that the Auditor provides only "reasonable assurance" is emphasized in the Scope Paragraph. Thus, this paragraph signifies the inherent limitations of audit.</p>
<b>UNQUALIFIED OPINION</b>  <b>[MTP June 19 Q.8b 2 Marks]</b>	<p>An opinion is said to be unqualified, when the Auditor concludes that the Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements.</p> <p>Or,</p> <p>The Auditor gives a Clean or Unqualified Report, when he does not have any significant negative reservation in respect of matters contained in the Financial Statements. Unqualified opinion is the best audit report which company can expect.</p> <p>An Unqualified Opinion indicates the following –</p> <p>The Financial Statements have been prepared using the Generally Accepted Accounting Principles, which have been consistently applied,</p> <p>The Financial Statements comply with relevant statutory requirements and regulations, and</p> <p>There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.</p>

	<p>Any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the Financial Statements. For issuing an Unqualified Audit Report, the Auditor has to satisfy himself that –</p> <p><b>Evidence:</b> Reasonable evidence is obtained in support of transactions recorded in the books of account.</p> <p><b>Standards:</b> Accounting entries passed in the books of account are in conformity with the generally applicable accounting principles and Indian Accounting Standards followed consistently.</p> <p><b>True and Fair:</b> The Financial Statements prepared represent a true and fair summary of the transactions that took place during the year.</p> <p><b>Classification:</b> The process of classification and aggregation followed in the preparation of the Financial Statements is fair and it does not hide a material fact nor does it highlight something, which may distort the real state of affairs.</p> <p><b>Format:</b> The form of Financial Statements is in accordance with the form prescribed by law, if any.</p> <p><b>Free of Misstatements:</b> There are no material misstatements in the Financial Statements. No material transaction recorded in the books of account is illegal or beyond the legal competence of the Company.</p> <p><b>Disclosure:</b> All the disclosures statutorily required or otherwise relevant have been made appropriately.</p>
<b>Modified Audit Report</b>	<p>When the Auditor issues any Report other than unqualified, his Report is said to be modified. As per SA 750, an Auditor's Report is considered to be modified when it includes –</p> <ul style="list-style-type: none"> <li>• Matters That Do Not Affect the Auditor's Opinion - with Emphasis of Matter Paragraph.</li> <li>• Matters That Do Affect the Auditor's Opinion viz: Qualified Opinion, Disclaimer of Opinion, and, Adverse Opinion.</li> </ul>
<b>Emphasises Matters that do not affect the Auditor's Unqualified Opinion.</b>	<p><b>Going Concern Not Resolved:</b> The Auditor should modify the Auditor's Report by adding a paragraph to highlight a material matter regarding a going concern problem where the going concern question is not resolved and adequate disclosures have been made in the Financial Statements.</p> <p><b>Significant Uncertainty:</b> The Auditor should consider modifying his Report by</p>

	<p>adding a paragraph if there is a significant uncertainty (other than going concern problem), the resolution of which is dependent upon future events and which may affect the Financial Statements.</p> <p><b>Multiple Uncertainties:</b> In extreme cases, e.g. multiple uncertainties that are significant to the Financial Statements, the Auditor may consider it appropriate to express a Disclaimer of Opinion instead of adding an emphasis of matter paragraph.</p> <p><b>Impact of Paragraph:</b> The addition of an emphasis of matter paragraph does not affect the Auditor's opinion. The paragraph would preferably be included preceding the Opinion Paragraph and would ordinarily refer to the fact that the Auditor's opinion is not qualified in this respect.</p> <p><b>Example:</b>          "Without qualifying our opinion, we draw attention to Note X of Schedule to the Financial Statements. The entity is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The entity has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the Financial Statements.</p> <p>In our opinion and to the best of our information and according to the explanations given to us, the Financial State-ments give a true and fair view in conformity with the accounting principles generally accepted in India - in the case of the Balance Sheet, of the state of affairs of as at 31st March 2XXX, and in the case of the Profit and Loss Account, of the Profit / Loss for the year ended on that date."</p>
<p><b>Circumstances that may Result in other than an Unqualified Opinion?</b></p> <p><b>[Dec 18 Q.9b 6 Marks]</b></p> <p><b>[MTP Dec 20 Q.9b 6 Marks]</b></p>	<p>An Auditor may not be able to express an Unqualified Opinion when any of the following circumstances exist and in the Auditor's judgement, the effect of the matter is or may be material to the Financial Statements. [SA 700]</p> <p><b>Limitation on Scope:</b> Limitation on scope of Auditor's work may be imposed by the clients or imposed by circumstances. It may lead to situations where the Auditor may have to issue a Qualified Opinion or a Disclaimer of Opinion.</p> <p><b>Disagreement with management:</b> The Auditor may disagree with the Management as to - (a) the acceptability of the accounting policies selected, or the method of their application, (b) the adequacy of disclosure in the Financial Statements, or (c) the compliance of the Financial Statements with relevant regulations and statutory requirements. In such cases, he may have to give an Adverse Opinion or a Qualified Opinion.</p> <p><b>Significant Uncertainty:</b> If there is a significant uncertainty affecting the Financial Statements (other than Going Concern problem), for example, litigation involving</p>

	<p>legal claims, etc. the result of which is dependent upon the resolution of the future events, the Auditor may have to qualify his opinion or disclaim an opinion. However, where such significant uncertainty is not material, the Auditor may issue an Unqualified Opinion, by adding an “Emphasis of Matter” paragraph, without qualifying his opinion.</p>
<b>Manner of Qualification / Disclaimer:</b>	<p>Whenever the Auditor expresses an opinion other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the Financial Statements should be mentioned in the Auditor’s Report.</p> <p>Where it is not practicable to quantify the effect of modifications made in the Audit Report accurately, the Auditor may do so on the basis of estimates made by the Management, after carrying out possible audit tests. He should clearly indicate the fact that the figures are based on Management estimates.</p> <p>This information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the Financial Statements.</p>
<b>QUALIFIED OPINION/ REPORT</b>	<p>A Qualified Audit Report is one where an Auditor gives an opinion on the truth and fairness of Financial Statements, subject to certain reservations.</p> <p>The Auditor’s Reservation is generally stated as: “Subject to the above, we report that the Balance Sheet shows a true and fair view.”</p> <p>The overall impact of all reservations or qualification taken together is not material enough to vitiate the overall true and fair view of Financial Statements, but it is important that such a matter(s) should be brought to the attention of the shareholders.</p> <p>The Report should also give detailed reasons along with quantitative impact on the qualifications on Financial Statements.</p> <p>A Qualified Opinion should be expressed when the Auditor concludes that –</p> <p>An Unqualified Opinion cannot be expressed, or</p> <p>The effect of any disagreement with Management is not so material and pervasive as to require an Adverse Opinion, or</p> <p>The Limitation on scope is not so material and pervasive as to require a Disclaimer of Opinion.</p> <p>Rule 4 of CARO mentions that where the answers by the company to the Auditor on matters to be looked into under CARO, is unfavourable or qualified, the Auditors, report shall also state the basis of such answer.</p>

<p><b>Features of a Qualified Report</b></p> <p>[MTP Dec 20 Q.8b 8 Marks]</p> <p>[MTP Dec 18 Q.9b 8 Marks]</p> <p>[MTP June 18 Q.9b 7 Marks]</p> <p>[MTP Dec 17 Q.9b 8 Marks]</p>	<p>The features of a Qualified Report are –</p> <p><b>Clarity:</b> The Auditor must express the nature of qualification, in a clear and unambiguous manner.</p> <p><b>Explanation:</b> Where the Auditor answers any of the statutory affirmations in the negative or with a qualification, his Report shall state the reasons for such answer.</p> <p><b>Placement:</b> All qualifications should be contained in the Auditor's Report. When there are Notes, which are subject matter of a qualification, the same should preferably be annexed to the Auditors' Report.</p> <p>However a reference to the Notes to Accounts in the Auditors' Report does not automatically become a qualification.</p> <p><b>Subject to:</b> The words "subject to" are essential to state any qualification. The qualification should be preceded by words such as "Subject to" or "Except that" to make it clear that he is making an exception.</p> <p><b>Nature of Qualification:</b> Vague statements, the effect of which on accounts cannot be ascertained, like, 'The debtors balances are subject to confirmation', 'No provision for taxation has been made in view of the loss during the year', etc. should be avoided.</p> <p><b>Violation of Law:</b> Where the Company has committed an irregularity resulting in a breach of law, the Auditor should bring the same to the notice of the shareholders by properly qualifying his report.</p> <p><b>Quantification:</b> The Auditors should quantify, wherever possible, the effect of these qualifications on the Financial Statements if the same is material. Where the effect of qualification cannot be accurately quantified, the Auditor may reflect the effect on the basis of Management estimates, after carrying out necessary audit tests on such estimates.</p> <p><b>Notes -</b></p> <p><b>Report Relationship:</b> Where notes of a qualificatory nature appear in the accounts, the Auditors should state all qualifications independently in their report so that the user can assess the significance of these qualifications.</p> <p><b>Draft Report:</b> The Auditor may discuss matters of qualification with the Management of the Company to acquire their views. It is not necessary that the Auditor should accept the Management's view and modify his opinion. But it would enable the Auditor to accurately draft the qualifications in his Final Report.</p>
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## CONCEPT 56.

## CARO 2020

<b>CARO 2020</b>	<p>MCA has notified new Companies (Auditor's Report) Order, 2020 on 25th February, 2020 which replaced CARO, 2016. It is a new format of reporting of statutory audit having additional reporting requirements decided in consultation with National Financial Reporting Authority (NFRA). CARO, 2020 is applicable for all statutory audits commencing on or after 1.4.2020 corresponding to Financial Year 2019-20.</p> <p>However, by notification, applicability of CARO has been deferred by one year. Now, CARO will be applicable for the accounts of financial year 2020-21.</p> <p>CARO 2016 is applicable to every company including a foreign company as defined in clause (42) of Section 2 of the Companies Act 2013.</p>
<b>The following classes of companies are outside the purview of the CARO 2020.</b>	<p>(a) Banking company as defined under Section 5 (c) of the Banking Regulation Act, 1949.</p> <p>(b) Insurance company as defined under the Insurance Act 1938.</p> <p>(c) Company licensed to operate under Section 8 of the Companies Act 2013 (companies registered with charitable object).</p> <p>(d) A one person company (OPC) as defined under clause (62) of Section 2 of Companies Act 2013 (OPC means a company which has only one person as a member).</p> <p>(e) A small company under Section 2 (85) of the Companies Act, 2013.</p> <p><b>Interpretation:</b></p> <p>(1) As per sec 2(85) of Companies Act 2013 small company means a company, other than a public company: Paid up share capital of which does not exceed ` 50 lacs or such higher amount as may be prescribed which shall not be more than ` 10 crore, and Turnover of which as per its last profit and loss account does not exceed ` 2 crore or such higher amount as may be prescribed which shall not be more than ` 100 crore.</p> <p>(2) The following company shall not qualify as a small company:</p> <ul style="list-style-type: none"> <li>➤ A holding company or a subsidiary company.</li> <li>➤ A company registered under Section 8 of the Act.</li> <li>➤ A company or body corporate governed by any special act.</li> </ul> <p>(f) The auditor of following type of Private Companies are not required to comment on the matter prescribed under CARO 2020: (1) A private company which is not holding or subsidiary company of a public company, and</p> <p>(2) A private company having a paid up capital and reserve and surplus not more than ` 1 crore as on the balance sheet date, and</p>

	<p>(3) A private company which does not have total borrowing exceeding ` 1 crore from any bank and financial institution at any point of time during the financial year, and</p> <p>(4) A private company which does not have total revenue exceeding ` 10 crore during the financial year.</p> <p><b>Note:</b> Such revenue means revenue as disclosed in scheduled III to the Companies Act, 2013 and includes revenue from discontinuing operation.</p>												
<b>Matters included in CARO 2020 are discussed below:</b>	<p>The auditor’s report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-</p> <p>(i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;</p> <p>(B) whether the company is maintaining proper records showing full particulars of intangible assets;</p> <p>(b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;</p> <p>(c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-</p> <table><tr><th>Description of properly</th><th>Gross carrying value</th><th>Held in name of</th><th>Whether promoter, director or their relative or employee</th><th>Period held - indicate range, where appropriate</th><th>Reason for not being held in name of company*</th></tr><tr><td>---</td><td>---</td><td>---</td><td>---</td><td>---</td><td>*also indicate if in dispute</td></tr></table> <p>(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;</p> <p>(e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made there under, if so, whether the company has appropriately disclosed the details in its financial statements;</p> <p>(ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of</p>	Description of properly	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held - indicate range, where appropriate	Reason for not being held in name of company*	---	---	---	---	---	*also indicate if in dispute
Description of properly	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held - indicate range, where appropriate	Reason for not being held in name of company*								
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	<p>inventory were noticed and if so, whether they have been properly dealt with in the books of account;</p> <p>(b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;</p> <p>(iii) whether during the year the company has made investments in, provided my guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-</p> <p>(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-</p> <p>(A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;</p> <p>(B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;</p> <p>(b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;</p> <p>(c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;</p> <p>(d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;</p> <p>(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];</p> <p>(f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;</p> <p>(iv) in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof;</p>
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(v) in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made there under, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;

(vi) whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act and whether such accounts and records have been so made and maintained;

(vii) (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

(viii) whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

(ix) (a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below. -

Nature of borrowing, including debt securities	Name of lender*	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	*lender wise details to be provided in case of defaults to banks, financial institutions and Government				

(b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;

(c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;

(d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;

	<p>(e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the- amount in each case;</p> <p>(f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;</p> <p>(x) (a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;</p> <p>(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance,'</p> <p>(xi) (a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;</p> <p>(b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014_ with the Central Government;</p> <p>(c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;</p> <p>(xii) (a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability;</p> <p>(b) whether the Nidhi Company is maintaining ten per cent, unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability,</p> <p>(c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;</p> <p>(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards;</p> <p>(xiv) (a) whether the company has an internal audit system commensurate with the size and nature of its business;</p> <p>(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;</p> <p>(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with;</p>
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	<p>(xvi) (a) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained;</p> <p>(b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934;</p> <p>(c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;</p> <p>(d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group;</p> <p>(xvii) whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;</p> <p>(xviii) whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;</p> <p>(xix) on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date;</p> <p>(xx) (a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;</p> <p>(b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of subsection (6) of section 135 of the said Act;</p> <p>(xxi) whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.</p>
<b>Reasons to be stated for unfavorable or qualified</b>	<p>(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.</p>

answers,-	(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.
<b>ICAI's Guidance Note on CARO 2020</b>	<p>The ICAI, with a view to provide appropriate guidance to its members, has brought out Guidance Note on the Companies (Auditor's Report) Order, 2020 on 13th June 2020. It is divided into:</p> <p>(a) Relevant provision which contains Requirement of all clauses. (b) Audit procedures and Reporting which covers Procedure to be adopted by auditor.</p> <p>This Guidance Note has been written in an easy to understand language and contains detailed guidance on various Clauses of CARO 2020 and the various issues and intricacies involved therein, so that the requirements and expectations of the Order can be fulfilled in letter and spirit by the auditors. It's a comprehensive and self contained reference document for the members. It would supersede the guidance on CARO 2016.</p>

**CONCEPT 57. ASPECTS TO BE CONSIDERED IN QUALIFYING A REPORT**

<b>Aspects to be considered in qualifying a report</b>  <b>[Dec 2019 Q. 9b 6 Marks]</b>	<p>Examine whether the Auditors are in active disagreement with something which has been done by the Company, or they are merely unable to form an opinion, say, for lack of adequate information about an item.</p> <p>Establish whether the matters in question are so material as to affect the presentation of a true and fair view of the whole of the affairs of the Company, or they are of such a nature as to affect on particular item disclosed in the accounts.</p> <p>See whether the matters constituting the qualification involve a material contravention of any requirements of the Companies Act, which have a bearing on the accounts.</p>
<b>Illustrations:</b>	<p><b>Some situations calling for qualifications in Audit Reports are</b></p> <ol style="list-style-type: none"> <li>Where the Auditors are unable to obtain all the information and explanations which they consider necessary for the purposes of their audit, e.g. - <ul style="list-style-type: none"> <li>➤ Absence of satisfactory documentary evidence of the existence of ownership of the material assets, such as, title deeds in respect of land,</li> <li>➤ Absence of vouchers in respect of material payments made by the Company,</li> <li>➤ Destruction of books and records by fire or accident,</li> <li>➤ Non-availability of books and records owing to unavoidable circumstances, such as books and records of a foreign branch with</li> </ul> </li> </ol>

	<p>which no communication is possible.</p> <ol style="list-style-type: none"> <li>2. Where proper books of accounts have not been kept in accordance with the law.</li> <li>3. Where the Balance Sheet and P&amp;L Account are not in agreement with the books of account and returns.</li> <li>4. When the information required by law is not furnished.</li> <li>5. Board of Directors are required to reply to the qualifications which forms part of the Board's report which is circulated to shareholders.</li> <li>6. When the accounts do not disclose a true and fair view like -</li> <li>7. Where the accounting practices followed by the Company are not considered appropriate to the circumstances and nature of the business e.g. treatment of HP Sales as outright sales,</li> <li>8. Where there has been a change in accounting principles or procedures in relation to material items, such, valuation of stock, depreciation, treatment of by-product cost, etc. without adequate explanation and disclosure of effect of the change,</li> <li>9. Where difference of opinion with management has arisen regarding valuation or realisability of assets, such as Stock-in-Trade, Debtors, Loans &amp; Advances or the extent of liabilities, contingent or otherwise,</li> <li>10. Where income or expenditure is not properly reflected so as to show a fair figure of profit for the year,</li> <li>11. Where information is not required by law to be disclosed but the disclosure of which is considered essential by the Auditors in order to show a true and fair view,</li> <li>12. Where there is a contravention of the provisions of the Companies Act having a bearing upon the accounts and transactions of the Company e.g. donations to political parties or for political purposes in contravention of Section 182, or contributions to charitable or other funds in excess of the limitation specified in Section 181;</li> <li>13. Where the Company has contravened the provisions of its Memorandum and Articles of Association.</li> </ol>
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**CONCEPT 58. DISCLAIMER OF OPINION**

<b>Disclaimer of Opinion</b>  <b>[June 19 Q.9b 5 Marks]</b>	<p>A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about the matters contained in the Financial Statements.</p> <p>A Disclaimer of Opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the Auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the Financial Statements.</p> <p>It may happen in situations such as –</p> <ol style="list-style-type: none"> <li>(a) when books of account of the Company seized by Income- Tax Authorities,</li> <li>(b) when it is not possible for the Auditor to obtain certain information or</li> <li>(c) when scope of audit work is restricted.</li> </ol>
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	The Auditor will state in his Report that he is unable to term an opinion on the Financial Statements. Such Report is called as “Disclaimer of Opinion Report”.
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**CONCEPT 59. PIECEMEAL OPINION**

<b>Piecemeal Opinion</b>	<p>The Auditor, may in some cases, find that the Financial Statements he has examined present only a partial true and fair view. In such cases, he may report that he is unable to express an opinion, limited to certain items in the statement, with which he is satisfied. Such a situation would warrant a Piecemeal Opinion.</p> <p>As the name suggests, the Auditor gives a divided opinion on matters with which he is satisfied and with which he is not. The Auditor should state the reasons for having given a Piecemeal Opinion.</p>
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**CONCEPT 60. ADVERSE OR NEGATIVE REPORT**

<b>ADVERSE OR NEGATIVE REPORT</b>	An Adverse or Negative Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements / Financial Report.
<b>[June 19 Q.9b 5 Marks]</b>	The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and the working results of the organisation.
<b>[MTP June 17 Q.9b 4 Marks]</b>	<p>The Auditor should state the reasons for issuing such a report.</p> <p>An Adverse Opinion should be expressed when the effect of a disagreement is so material and pervasive to the Financial Statements, that the Auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the Financial Statements.</p>
<b>Some Remarks which are not Qualifications.</b>	<p><b>Meaning:</b> Statements or Observations which are not qualificatory in nature may exist in the Auditor’s Report. Some requirements under CARO or inquiry U/S 143 are of this non-qualificatory character.</p> <p><b>Conditions under which “Remarks’ can be inserted are –</b></p> <p>The matter is of such importance in relation to the Balance Sheet as a whole that it should be brought to the notice of the members, and</p> <p>The point is not clearly brought out on the face of the accounts, as they stand by the note or otherwise, and</p> <p>The point does not affect the true and fair character of the accounts.</p> <p><b>Manner of Reporting:</b> Where it is necessary, either statutorily or otherwise, to include a “remark” in an Audit Report which is not a qualification, the remark should be inserted as a single sentence prior to the Auditor’s Opinion which should not include any reference to the remark. This remark can be put in the body of the</p>

Auditor's Report only when the Notes on Accounts do not include this information.

**Example:**

"The properties abroad shown in the Balance Sheet at are in the course of being but have not yet been, registered in the Company's name." (The Opinion Paragraph should not have any reference to the above remark).

**CONCEPT 61. DISTINGUISH BETWEEN EXPLANATORY NOTES AND QUALIFICATORY NOTES**

Difference	Explanatory Notes	Qualificatory Notes
	An Explanatory Note is meant to explain or supplement a matter contained in or related to Financial Statements.	A Qualificatory Note is intended to communicate the Auditor's reservation on the accounts. These notes are always negative.
	The matter on which an Explanatory Note is given is one on which the Auditor has not taken an adverse view.	Qualificatory Notes on which the Auditor has taken an adverse view e.g. tax provision not made in the accounts.
	Explanatory Notes are given by the Directors or Management of the Company.	Qualifications are made by the Auditor in his Report to the Company's shareholders.
	These are usually shown under "Notes to Accounts". All Notes, wherever shown, including those required by the Schedule III constitute an integral part of the accounting statement.	These notes are included in the Auditors' Report before the Opinion Paragraph. The reader's attention is drawn to the Qualification paragraph by use of the word "Subject to".

**CONCEPT 62. DISTINGUISH BETWEEN QUALIFIED REPORT AND ADVERSE REPORT**

[June 2017 Q. 9a 4 Marks]	Situation	Auditor's Duties
	When the limitation of scope infringes the duties of the Auditor under the statute.	The Statutory Auditor should not accept the engagement.
[MTP Dec 18 Q.10d 4 Marks]	1. When the Auditor believes that limitations in the terms of a proposed engagement is of such a nature that he would need to issue a Disclaimer of Opinion.	The Auditor should not accept such a limited engagement as an Audit Engagement.
[MTP June 18 Q.9b 4 Marks]	2. Other limitations imposed by entity or by circumstances - i. When the terms of engagement specify that the Auditor will not carry out an audit procedure which he believes necessary e.g. verification of investments, or, ii. When the timing of the Auditor's work is such that he is unable to observe the counting of physical inventories, or, iii. When in his opinion the accounting records are inadequate, or, iv. When he is unable to carry out an audit procedure that he believes desirable.	(i) The Auditor should carry out reasonable alternative audit procedures to obtain sufficient audit evidence to support an Unqualified Opinion. (ii) If the Auditor is unable to carry out alternative audit procedures or is not satisfied with the evidence obtained by such alternative procedures, he should issue a Qualified Opinion or Disclaimer of Opinion. (iii) The Auditor's Report should describe the limitation and indicate the possible adjustments to the Financial Statements that might have been determined to be necessary had the limitation not existed. (iv) The Auditor cannot escape his responsibility by obtaining Management Certificates or stating that certain audit procedures were not carried out.



Qualified Report	Adverse Report
i. A Qualified Audit Report is one where an Auditor gives an opinion subject to certain reservations.	An Adverse Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements / Financial Report.
ii. The Auditor's reservation is generally Stated as: "Subject to the above, we report that the Balance Sheet shows a true and fair view."	The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and working results of the organisation.
iii. The accounts present a true and fair view subject to certain reservations.	The accounts do not present a true and fair view on the whole.
iv. A Qualification is made in the Audit Report when the Auditor has reservation on specific item(s) of material nature.	An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements.
v. Qualified report is not prima facie considered bad.	Considered bad at the first instance only.

**CONCEPT 63. DISTINGUISH BETWEEN CLEAN AUDIT REPORT AND QUALIFIED AUDIT REPORT**

Clean Audit Report	Qualified Audit Report
The Auditor issues a Clean Report (also called as unconditional opinion) when he does not have any reservation with regard to the matters contained in the Financial Statements.	A Qualified Audit Report is one where an Auditor gives an opinion subject to certain reservations.
In a Clean Report, the Auditor states that the Financial Statements give a true and fair view of the state of affairs and results for the period.	The Auditor's reservation is generally stated as - "Subject to the above, we report that the Balance Sheet shows a true and fair view."
The Auditor is justified in issuing a clean report if - (i) The accounts are prepared using generally accepted accounting principles. (ii) The Auditor has examined sufficient reliable evidence in respect of transactions recorded in the books. (iii) The transactions recorded represent a true recording of the events. (iv) The transactions are within the legal competence of the entity. (v) There are no material misstatements in the Financial Statements. (vi) The Financial Statements comply with the format and disclosure requirements as per the Statute.	A Qualified Opinion should be expressed when the Auditor concludes that - i. An Unqualified Opinion cannot be expressed, ii. The effect of any disagreement with Management is not so material and pervasive as to require an Adverse Opinion, or iii. The Limitation on scope is not so material and pervasive as to require a Disclaimer of Opinion.
There is no specific duty of Management for Clean Reports.	Management is bound to give explanation & full details in respect of each qualification in the Auditors Report. [Section 134]

**CONCEPT 64. DATE OF THE AUDIT REPORT**

Since significant events may take place from the date of Financial Statements, date of completing audit field work and date of Audit Report, the date of the Audit Report should be the actual date of completion of audit.
Any event coming to be known after the date of the Audit Report is not the responsibility of the Auditor even though it may have a highly significant effect on



	<p>the Financial Statements reported upon.</p> <p>Even though the Audit Report may be actually prepared at a date later than the date of actual completion of the audit work, it is desirable that it should be made as on the former date to limit the Auditors' responsibility.</p> <p>In relation to reporting on Company Accounts, it is possible for the Auditor to report on the same day on which the Financial Statements are approved by the Board of Directors. Though, theoretically, audit will start once the Board approves the final accounts. However, in practice the audit commences during the process of preparation of final accounts. Auditor, in any case, cannot issue the audit certificate before the accounts are approved by the Board.</p>
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**CONCEPT 65. SIGNIFICANCE OF THE PHASE "TO THE BEST OF OUR INFORMATION AND ACCORDING TO THE EXPLANATIONS GIVEN TO US" WHICH IS GENERALLY FOUND IN THE AUDITORS' REPORTS.**

<b>Narrow Interpretation:</b>	<p>The Statement "to the best of our information and according to the explanations given to us" is an expression of opinion by the Auditors.</p> <p>Such opinion is a matter of professional judgement to be exercised by the Auditors under the given situations.</p> <p>Auditors will not be held responsible if they acted on information and explanations, which they believe to be bonafide, but which are as a matter of fact untrue or incorrect. They have to exercise reasonable care and skill in the evaluation of information made available to them.</p> <p>As a narrow interpretation of the phrase, the Auditors may state that they have acted on the basis of explanations given to them. To that extent this phrase definitely restricts the scope of enquiry to be made by an Auditor.</p>
<b>Broad Interpretation:</b>	<p>The Auditors should apply professional judgment to obtain all that information and explanations, which are necessary for the performance of conducting the audit.</p> <p>Under the Chartered Accountants (CA) Act 1959, a (CA) Chartered Accountant is guilty of professional misconduct if he fails to obtain sufficient information which is necessary for the expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.</p> <p>There may be situations where – the Balance Sheet shows the correct position as per books but other information indicate that the books themselves were incorrect, the Financial Statements do not reflect proper position which could have been revealed had the Auditor obtained necessary information during the course of audit.</p>

	At a wider interpretation level, the Auditor should obtain all information and explanations, which he deems necessary, for the expression of an opinion. If he does not obtain all such information, he is entitled to issue a Disclaimer of Opinion Report.
<b>Conclusion:</b>	Hence, the given phrase is a double-edged sword, which may be interpreted either to restrict the scope of enquiry or to stretch responsibilities beyond a limit.

**CONCEPT 66. SIGNIFICANCE OF OBTAINING INFORMATION AND EXPLANATIONS FROM THE MANAGEMENT.**

<b>Legal Recognition:</b>	<p>Legal recognition is given to the process of obtaining information as part of the whole auditing process. The provisions of the Companies Act in this regard are –</p> <p>Where any particulars or information is required to be given in the Balance Sheet or P&amp;L Account of a Company or in any document required to be annexed or attached thereto, it shall be the duty of the concerned Officer of the Company to furnish without delay, to the Company, and also to the Company's Auditor, whenever he so requires, those particulars or that information in as full a manner as possible.</p> <p>The Company Auditor should state whether he has obtained all the information and explanations which to the best of his knowledge and belief, were necessary for the purpose of his audit. [Section 143]</p>
<b>Management's Responsibility and Auditor's Limitations:</b>	<p>Auditors cannot be expected to know all the technicalities and the complexities of the business deals.</p> <p>Further, the relevant papers and documents to explain the transactions may not be really available to the Auditor and, even if they are available they may still need to be explained so that one can clearly understand the impact of the transactions on the accounts.</p> <p>The Management, which actually enters into transactions on behalf of the Company, is expected to have thoroughly understood the implications of all material transactions, and hence Auditors are empowered to obtain explanations from the management.</p>
<b>Auditors' Responsibility:</b>	If any vital information is deliberately withheld from the Auditor in the ordinary course of audit, and he had no means to know the existence of such information, in

	<p>case the accounts turn to be wrong for that reason, the Auditor should not be held guilty or negligent.</p> <p>If however, the Auditor has means to know of the existence of such vital information but he ignored it, he would be held guilty on that account.</p> <p>Where the Auditor has not been able to obtain all information and explanations as required he should issue a Modified Audit Report (i.e. other than an Unqualified Report).</p>
<b>Branch Audit Reports be Considered by the Statutory Auditor</b>	Forwarding of Branch Audit Reports: Where the branch audit carried out by a person other than the Statutory Auditor, the Branch Auditor shall prepare a report on the accounts of the branch office examined by him and forward the same to the Company's Auditor who shall deal with the same in such manner as he considers necessary. [Section 143]
<b>Qualifications in Branch Audit Reports:</b>	<p>If the Branch Auditor's Report contains any qualification, the Statutory Auditors should normally include it in their own report unless they are satisfied that either - Objections raised by the Branch Auditor have been met while preparing the Company's accounts or during the conduct of the Company's audit, or</p> <p>The matter on which the qualification is made is not material in the context of the Company's Accounts as a whole, or</p> <p>In the light of information and explanations given to them, which were not available to the Branch Auditor, they are satisfied that the qualification is not called for.</p>
<b>Scope of Enquiry u/s 143(1) of the Act</b>	<p>Every auditor of the company should inquire into the following matters, namely:—</p> <p>(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;</p> <p>(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;</p> <p>(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;</p> <p>(d) whether loans and advances made by the company have been shown as deposits;</p> <p>(e) whether personal expenses have been charged to revenue account;</p> <p>(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</p>

	<p>misleading.</p> <p>Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.</p>
<b>Report:</b>	<p>(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;</p> <p>(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;</p> <p>(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;</p> <p>(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;</p> <p>(e) whether, in his opinion, the financial statements comply with the accounting standards;</p> <p>(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;</p> <p>(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;</p> <p>(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;</p> <p>(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;</p>
<b>Such other matters as may be prescribed.</b>	<p>The report of the Auditor, along with other items should include matters mentioned under Companies (Auditor Report) Order, popularly known as CARO. CARO is revised from time to time. The last revision was on 25th February, 2020. Before that CARO was revised in the year 2016.</p> <p>The February, 2020 order was made applicable from the Financial Year commencing from April, 2019. However, vide order dated 20th March, CARO, 2020 have made applicable for the accounts commencing from 1st April, 2020, i.e.,</p>

	Financial Year 2020 - 21.
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<b>CONCEPT 67. AUDITOR'S REPORT ON REVISED ACCOUNTS OF COMPANIES BEFORE CIRCULATION TO SHAREHOLDERS</b>
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<b>Introduction</b>  <b>[MTP June 18 Q.10a 4 Marks]</b>  <b>[MTP June 17 Q.10a 4 Marks]</b>	There may be instances, where the Management of a Company amends its audited accounts, and re-approves it and then requests the Statutory Auditors to make a Report once again on the amended accounts. The Auditors' duties in this regard are enumerated below;
<b>Return:</b>	Ensure that all copies of the Original Accounts and Report are returned to the Auditor.
<b>Disclosure:</b>	Ensure that the fact of Revision of accounts already approved by the Board and reported upon by the Statutory Auditors, appears as a specific Note on the amended accounts.
<b>Reporting:</b>	Reporting requirements are as under
<b>Adequate Disclosure:</b>	If the Statutory Auditor is satisfied that the disclosure made by the Company in the Notes on Accounts is adequate, there is no further need for the Auditor to refer to the revision of the Balance Sheet and/ or the Profit and Loss Account in his report.
<b>Inadequate Disclosure:</b>	If the Notes on Accounts do not contain any note on the revision or if such Note is not considered as adequately comprehensive by the Auditor, the Auditor should refer to the fact of revision of the accounts in his report. The above principles are also applicable to the audit of Government Companies.

<b>CONCEPT 68. REVISION/ RECTIFICATION OF FINANCIAL STATEMENTS</b>
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<b>Qualified Report:</b>	Where past accounts have been re-opened and revised on technical grounds, and the Company has asked the Auditor to give his report u/s 143 on the revised accounts, he should issue a Qualified Report only.
<b>Format:</b>	<p>The Report should indicate that the Company has re-opened the accounts contrary to the opinion of ICAI (CA) The relevant paragraph of the Report may appear as under –</p> <p>“As per the opinion of the ICAI (CA) a Company cannot re-open and revise the accounts once adopted by the Shareholders at an Annual General Meeting (AGM). However, the Department of Company Affairs vide Circular dated 28.07.1987, has opined that for meeting technical requirements of taxation laws, the accounts can</p>

	be re-opened. The Board of Directors of the Company, contrary to the aforesaid opinion of the ICAI, has re-opened and revised the aforesaid accounts for adjusting (the matter for meeting the technical requirements of taxation laws regarding which accounts are re-opened may be specified here)."
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**CONCEPT 69. REVISION OF THE AUDIT REPORT**

<b>Revision of Financial Statements:</b>	The Auditor should issue a fresh report on the revised Financial Statements in accordance with - (a) Guidance Note on Auditor's Report on Revised Accounts of Companies before circulation to Shareholders, and (b) Guidance Note on Revision/Rectification of Financial Statements.
<b>Situations: Revision of Audit Report is required -</b>	When the Auditor considers that amendment in Financial statements is not warranted, or When the Auditor advises amendment to Financial Statements, but the Management does not intend to revise the same, or When the Management agrees for revision in the Financial Statements but is unable to do so despite its bonafide intention, but Management extends its co-operation to the Auditor and agrees to ensure that anyone in receipt of there previously issued Financial Statements together with the Audit Report thereon is informed of the situation and would be issued the revised Audit Report.
<b>Auditor's Duties:</b>	In the above situations, the Auditor should - (i) issue a Revised Report in which he should refer to the earlier report, and (ii) state the reasons for revising the report.
<b>Timing:</b>	For corporate entities, the Audit Report may be revised till the accounts are adopted at the AGM. For entities where such adoption is not required, the Auditor may consider revising the Audit Report within a reasonable time, but in any case not later than the issuance of the Audit Report for the immediately succeeding accounting period.
<b>Subsequent Financial Statements:</b>	A Continuing Auditor may consider that the revision of Financial Statements and issuance of a Revised Report is not necessary if appropriate disclosures are made in the Financial Statements of the immediately succeeding accounting period.
<b>Preventing Reliance on Earlier Report:</b>	If the management neither agrees to revise the Financial Statements nor agrees to circulate the proposed Revised Audit Report to the recipients of the earlier report, the Auditor should notify the persons ultimately responsible for the overall direction of the entity that action will be taken by him to prevent reliance on the Audit Report. The Auditor may take the following steps in this regard - Notify the client that the Audit Report must no longer be associated with the Financial Statements. Notify the regulatory agencies (ROC / Income Tax Department / SERI / RBI / IRDA etc.) having jurisdiction over the client that the Audit Report should be no longer be relied upon. Make an appropriate statement at the AGM, if requested by the Chairman.

<b>Withdrawal from Engagement:</b>	When the Management neither agrees to revise the Financial Statements nor agrees to ensure that anyone in receipt of the previously issued Financial Statements and Audit Report thereon will be informed of the situation and would be issued Devised Audit Report, the Auditor may conclude that withdrawal from the further engagement with the entity is necessary.
<b>Signature:</b>	Where a Firm is the Auditor, the Partner who signed the Original Audit Report, should also sign the Revised Report or the letter indicating preventing reliance on the Audit Report, as the case may be. In case of signing by any other Partner, the reasons thereof should be stated

**CONCEPT 70. AUDIT OF ABRIDGED FINANCIAL STATEMENTS**

<b>Legal Requirements:</b>	The Auditor should examine whether the requirements relating to Abridged Balance Sheet and Abridged Profit & Loss Account as laid down in Section 136 have been duly complied with.
<b>Subsequent Events:</b>	If the Audit Report on Abridged Financial Statements is issued on a date subsequent to the issuance of the Audit Report on Annual Accounts as per Schedule III, the Auditor's responsibility in relation to events occurring after the Balance Sheet date is limited to the events occurring up to the date of his report on the annual accounts.
<b>Unqualified Report:</b>	If the Auditor is satisfied that the Abridged Financial Statements are proper in all respects, he should issue an Unqualified Audit Report.
<b>Qualified Report:</b>	The Auditor should express a Qualified Opinion or an Adverse Opinion, as appropriate, if he has certain reservations about the Abridged Financial Statements, e.g. if a material piece of information has not been disclosed in the Abridged Financial Statements or has been disclosed in an inappropriate manner.

**CONCEPT 71. PROVISION FOR PROPOSED DIVIDEND**

<b>Audit Considerations</b>	<p>When a Company does not provide for an amount for Proposed Dividend, the attention of Shareholders should be drawn to the fact that no appropriation has been made.</p> <p>The fact that provision for Proposed Dividend has not been made should be disclosed by means of a Note in the Accounts.</p> <p>The Auditor should refer to the Note in his Report and make his Report subject thereto.</p>
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**CONCEPT 72. ACCOUNTS OF LIQUIDATORS / REPORT U/S 348 OF COMPANIES ACT, 2013**

<b>Special Considerations</b>	<p><b>Skills:</b> The professional skill and audit procedures to be applied for an audit u/s 348 are similar to that used during a normal audit of a Company.</p> <p><b>Report:</b> There should be a fair measure of uniformity in the Reports submitted by Auditors conducting an audit u/s 348 of the Companies Act, 2013. The Auditor's Report may be on the following lines –</p> <p>Whether he has obtained all the information and explanations, which to the best of his knowledge and belief, were necessary for the purposes of his audit,</p> <p>Whether in his opinion, proper books of account as required by the Companies Act, 2013 and Companies (Court) Rules, 1959 have been kept by the Liquidator, so far as appears from his examination of these books,</p> <p>Whether the Liquidator's Account relating to realisations and disbursements is in agreement with the books and records produced before him,</p> <p>Whether in his opinion, and to the best of his information and according to the explanations given to him, the Liquidator's Account including Annexures give the information required by the Companies Act, 2013, and the Companies (Court) Rules, 1959 in the manner so required and give a true and correct view of the realisations and disbursements of the Liquidator.</p>
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**CONCEPT 73. SECTION 182 OF THE COMPANIES ACT AND AUDITOR**

<b>Conditions for contribution to Political Party / Political Purpose:</b>	<p>The Board should pass a resolution authorizing such contribution.</p> <p>The aggregate of the amount contributed in any financial year should not exceed 5% of the average net profits during three immediately preceding financial years.</p>
<b>Payments covered under Political Contribution:</b>	<p>Contribution made directly to a Political Party whether in cash or in other form.</p> <p>Expenditure incurred on printing and distribution of posters and leaflets, either directly concerned or connected with elections or otherwise for a political purpose.</p> <p>Contribution made directly to a political party whether in cash or in other form for running an educational institution or for undertaking philanthropic activities.</p> <p>Donation, Contribution, or other form of support to a Trust, Society or Association in any of the under noted circumstances –</p>



	<p>If the Trust, Society, or Association has any political objectives either wholly or even partially. If the Trust, Society, or Association is formed for any political purpose either wholly or even partially.</p> <p>If the Trustees or Governing Council or Committee of the Trust, Society, Association have the discretion of using the funds wholly or partially for a political purpose or in furtherance of a political objective. On the other hand, the mere fact that some of the objects of a particular Trust, Society, or Association are similar to the objects of a particular political party but are not of a political nature should not act as disqualification.</p> <p>Expenditure incurred on remuneration (including other benefits) to employees or on other establishment where the services of the employees are made available in connection with the activities of some political party, such as elections to Legislative Assembly, Parliament etc.</p> <p>Making available vehicles owned by the Company to any political party or to any candidate seeking election to any local authority, assembly, Parliament, etc. either free of cost, or at less than market rate.</p> <p>Expenditure incurred directly or indirectly by a Company on advertisement in any publication like Souvenir, Brochure, Tract, etc by or on behalf of a Political Party or for its advantage.</p> <p>Donation, Subscription or payment by a Company to any person which can be regarded as likely to affect public support for a Political Party shall be deemed as contribution for a political purpose.</p>
<b>Disclosure:</b>	Every Company should disclose in its P&L Account, the amount contributed by it during the financial year to any political party or for any political purpose, giving the particulars of the name of the recipient party or person.
<b>Auditor's Duties:</b>	<p>The Auditor should qualify his Audit Report under the following circumstances, if he is satisfied - that the political contribution has been made in excess of the limit prescribed. (He should also indicate the amount involved.) that facts regarding such contributions are not properly disclosed.</p> <p>If the Auditor is in doubt about applicability of Section 182, he should disclose this fact in his report.</p> <p>The Auditor should obtain a certificate from the Board stating the following That all amounts of contributions to Political Parties have been properly recorded; No amounts of such nature other than those so included in the books have been paid / given directly or indirectly.</p> <p>The Auditor need not make any special inquiry to unearth cases of unauthorized political contributions if they are not readily apparent from the examination of the accounts made in the normal course of audit.</p>

	Where the Auditor fails to discover cases of contraventions of Section 182, he would be responsible only to the extent it can be established that in the conduct of the audit he acted without reasonable care and skill.
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**CONCEPT 74. AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS (CFS)**

<b>Parent Company:</b>	The Parent Company (i.e. Holding Company) has the following responsibilities - (a) Identifying components, and including the financial information of the components to be included in the Consolidated Financial Statements, (b) Identifying reportable segments for segmental reporting, (c) Identifying related parties and related party transactions for reporting, (d) Obtaining accurate and complete financial information from components, and (e) Making appropriate consolidation adjustments.
<b>Objective of Audit of CFS:</b>	To satisfy that the CFS have been prepared as per the requirements of Ind AS - 27, 18 & 31. To enable the Auditor to express an opinion on the true and fair view presented by the CFS(Consolidated Financial Statement).
<b>Features of CFS:</b>	CFS are prepared using the Separate Financial Statements of the Parent, Subsidiaries, Associates and Joint Ventures and also other financial information, which might not be covered by the Separate Financial Statements of these entities. The 'other financial information' would include disclosures to be made in the CFS about the Subsidiaries, Associates and joint Ventures, proportion of items included in the CFS to which different accounting policies have been applied, adjustments made for the effects of significant transactions or other events that occur between the Financial Statements of Subsidiaries, Associates or Joint Ventures and the Parent, as the case may be, etc. The Auditor of the CFS has to use the work of other Auditors i.e. the Auditor of Financial Statements of the components, as required under SA 600.
<b>Aspect to be audited [MTP Dec 19 Q.8b 2 Marks]</b>	
<b>Completeness</b>	To ensure that all relevant Subsidiaries, Associates and Joint Ventures (JVs) have been included, the Auditor should review the following - <ul style="list-style-type: none"> <li>• His working papers for the prior years for known Subsidiaries, Associates and JVs,</li> <li>• Parent's procedures for identification of Subsidiaries, Associates and JVs,</li> <li>• Investments made, to determine the shareholding in other entities,</li> <li>• Joint Ventures and other relevant agreements entered into by the Parent,</li> <li>• Statutory records maintained by the Parent, e.g. Registers u/s 190 / 186.</li> </ul>
<b>Control</b>	Since control of the composition of the Board of Directors/ Governing Body of an enterprise also results in a Parent-Subsidiary Relationship, the Auditor should examine the minutes of Board Meetings, Shareholder Agreements with entities to which technology or know-how might have been provided, etc.

<b>Exclusion</b>	<ul style="list-style-type: none"> <li>Where a Subsidiary/ Associate /Jointly Controlled Entity is excluded from the CFS, the Auditor should examine the reasons for the exclusion.</li> <li>If it is argued that the reason for exclusion from consolidation is that the relationship of the entity with the Parent is temporary, the Auditor should examine whether the Parent had the intention to dispose of its interest at the time of making the investment.</li> </ul>
<b>Others</b>	<p>The Auditor should -</p> <ul style="list-style-type: none"> <li>Examine the relevant law and agreements to identify long-term restrictions prohibiting transfer of funds.</li> <li>Review whether the procedures and disclosure requirements laid down by the relevant AS have been followed, in preparing the CFS.</li> <li>Verify that the gross amounts of Goodwill and Capital Reserve have also been disclosed, if such Goodwill arising in respect of one Subsidiary is set-off against Capital Reserve arising in respect of another.</li> <li>See whether any impairment loss exists in respect of Goodwill arising on consolidation.</li> </ul>
<b>Permanent Consolidation Adjustments:</b>	<p>The Auditor should see whether the following adjustments have been made appropriately –</p> <p><b>Capital Reserve / Goodwill:</b> Determination of excess / deficit of the cost to the Parent of its investment in a Subsidiary over the Parent's portion of Equity of the Subsidiary, at the date on which investment in the Subsidiary is made (determination of Goodwill or Capital Reserve).</p> <p><b>Minority Interest:</b> Determination of the amount of equity attributable to minorities at the date on which investment in Subsidiary is made.</p> <p><b>Associates:</b> Determination of Goodwill or Capital Reserve arising on application of Equity Method to account for investments in Associates in CFS.</p> <p><b>Other Verification:</b> The Auditor should review the Memorandum Records to verify the adjustments entries made in the preparation of CFS including the following -</p> <ul style="list-style-type: none"> <li>Intra-group interest paid and received, or management fees, etc.</li> <li>Unrealised intra-group profits on assets acquired from other Subsidiaries.</li> <li>Intra-group indebtedness.</li> <li>Adjustments related to harmonising the different accounting policies being followed by the Parent enterprise and its Subsidiaries.</li> <li>Adjustments made for the effects of significant transactions or other events that occur between the date of the Financial Statements of the Parent and one or more of the components, if the Financial Statements to be used for consolidation are not drawn up to the same reporting date; and</li> <li>Determination of movement in equity attributable to the minorities since the date of acquisition of the Subsidiary.</li> </ul>

**CONCEPT 75. AUDIT CERTIFICATE**

<p><b>Basic Inclusion of Certificate</b></p> <p><b>[MTP June 19 Q.9b 7 Marks]</b></p> <p><b>[MTP Dec 18 Q.9b 7 Marks]</b></p>	<p>Sometimes apart from an audit report for general use, an auditor is often called upon to give a certificate for special purpose. The certificate should include the following: —</p> <ul style="list-style-type: none"> <li>• Auditor should see that there is a suitable declaration by the management about the subject matter.</li> <li>• Auditor should give the certificate on his letter head or on stationary carrying his name and address to avoid misunderstanding.</li> <li>• Auditor should clearly state his limitations and indicate the extent to which he has relied upon a technical expert if any.</li> <li>• Auditor should indicate the specific record covered by the certificate.</li> <li>• Auditor should mention the manner in which the audit was conducted.</li> <li>• Auditor should indicate in the certificate if he has made certain fundamental assumptions. Auditor should make a reference to the information and explanations obtained. Auditor should give clear title to it, indicating whether it is a report or a certificate.</li> <li>• Auditor should mention whether he has used any general purpose statement like Profit &amp; Loss Account for his investigation and also, state whether that general purpose statement has been audited by other auditors.</li> <li>• Auditor should be careful while interpreting any law related matter, he should clearly mention that he is expressing merely his own opinion.</li> <li>• Auditor should see that the certificate should be self contained documents. Auditor should clearly mention the responsibility assumed by him.</li> <li>• Auditor should, if he has referred the audited statements, clearly mention that the figures are used from the audited statements and relied upon.</li> <li>• Auditor should address the certificate to the client or the Public Authority or the person requiring it as the case may be. In appropriate circumstances it may be issued by using the words as “to whom so ever it may concern”.</li> </ul>
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**CONCEPT 76. DIFFERENCE BETWEEN AUDIT REPORT AND AUDIT CERTIFICATE [June 18 Q.9b 7 Marks]**

**[MTP Dec 19 Q.9b 8 Marks]**

**[MTP June 19 Q.9a 7 Marks]**

Basis	Audit Report	Audit Certificate
<b>Meaning</b>	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts.	While Audit Certificate is a written confirmation of the accuracy of the information stated there in.
<b>Opinion</b>	Audit Report contains the opinion of the auditor on the accounts	while Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.

<b>Basis</b>	Audit Report is made out on the basis of information obtained & books of account verified by the auditor,	while Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.
<b>Guarantee</b>	Audit Report may not guarantee correctness of financial statement in absolute terms	While Audit Certificate guarantees absolute correctness of the figures & information mentioned in the certificate.
<b>Coverage</b>	Audit Report always covers entire accounts of the concern,	While Audit Certificate covers only certain part of the accounts of the concern.
<b>Responsibility</b>	Audit Report does not hold auditor responsible for anything wrong in the accounts,	While Audit Certificate makes an auditor responsible if anything mentioned in the certificate found as wrong later on.
<b>Suggestion</b>	Audit Report may provide certain suggestions for improvement	While Audit certificate does not provide any such suggestion.
<b>Nature</b>	Audit Report is based on the vouching & verification of books of accounts, voucher, assets & liabilities,	while Audit Certificate is based on checking arithmetical accuracy of the facts.
<b>Scope</b>	Audit Report covers all transactions done during the year,	while the Audit Certificate is very specific.
<b>Characteristics</b>	Audit Report is subjective as it is opinion oriented,	while Audit certificate is objective as it is fact oriented.
<b>Form</b>	Audit Report is required to be presented in the prescribed format,	while Audit Certificate, except in few cases, is not required to be presented in any standard format.
<b>Address</b>	Audit report is addressed to the members of the company at large or appointing authority,	while Audit Certificate is addressed to particular person or sometimes may include the words like "To Whomsoever it may concern".

**CONCEPT 77. BRANCH AUDIT [ Dec 2019 Q. 10a 4 Marks] [Dec 2017 Q. 10c 4 Marks]**

[MTP Dec 19 Q.10a 4 Marks] [MTP Dec 18 Q.10a 4 Marks]

<b>Meaning of Branch Office</b>	"Branch office", in relation to a company, means any establishment described as such by the company - section 2(14) of the 2013 Act.
<b>Audit of Branch Office by company's auditor or branch auditor -</b>	Where a company has a branch office, the accounts of that office shall be audited either by the company's auditor (i.e. auditor appointed for the company in AGM) or by any other person qualified for appointment as an auditor of the company under the 2013 Act. Such 'branch auditor' shall be appointed as such under section 139 of the 2013 Act - first part of section 143(8) of the 2013 Act.
<b>Audit of branch</b>	Where the branch office is situated in a country outside India, the accounts of the

<b>offices outside India -</b>	branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country. The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as may be prescribed second part of section 143(8) of the 2013 Act.
<b>Report by Branch Auditor to company's auditor -</b>	The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the company's auditor. The company's auditor shall deal with the report of branch auditor in his report in such manner as he considers necessary proviso to section 143(8) of the 2013 Act.
<b>Duties and powers of company's auditors in connection with branch audit –</b>	Duties and powers of company's auditor (main auditor) with reference audit of branch and branch auditor shall be as contained in section 143(1) to 143(4) of the 2013 Act and Rule 12(1) of Companies (Audit and Auditors) Amendment Rules, 2015. Thus, the company's auditor is responsible even if branch auditor is appointed.
<b>Branch auditor's responsibility to report fraud -</b>	Responsibility to report fraud, as applicable to company's auditor applies to branch auditor.

**CONCEPT 78. JOINT AUDIT**

<b>Introduction</b>  <b>[MTP Dec 19 Q.10a 4 Marks]</b> <b>[MTP June 19 Q.10a 4 Marks]</b>	<p>In big corporate more than one persons or firm of Chartered Accountants are appointed as a Joint Auditor for conducting the audit of the company. This practice of appointing joint auditor accrues great advantages to the company. In a big organisation the task of carrying audit cannot be accomplished with single individual so for overcoming such situation joint auditor wheres appointed.</p>
<b>Advantages of Joint Audit:</b>  <b>[June 17 Q.10d 4 Marks]</b>  <b>[MTP June 19 Q.10a 4 Marks]</b>  <b>[MTP Dec 18 Q.10a 4 Marks]</b>  <b>[MTP June 18</b>	<p>The various advantages that accrue out of Joint Audit are enumerated below;</p> <ul style="list-style-type: none"> <li>● Lower workload</li> <li>● Timely completion of work</li> <li>● Sharing of expertise</li> <li>● Improved quality of services</li> <li>● Healthy competition</li> <li>● Quality of performance</li> <li>● Knowledge pool</li> </ul>

Q.10a 4 Marks]	
[MTP Dec 17 Q.10a 4 Marks]	
<b>Disadvantages of Joint Audit:</b>	<p>The disadvantages of Joint Audit are enumerated below;</p> <ul style="list-style-type: none"> <li>• Superiority complex of some auditor</li> <li>• Costly for small entity</li> <li>• Lack of coordination in work</li> <li>• Uncertainty about liability of each auditor</li> <li>• Adjustment / Psychological problem amongst the auditor</li> <li>• Difficulty in fixation of work among other</li> </ul>
<p><b>SA 299 issued by The Institute of Cost Accountants of India on "Responsibility of Joint Auditor" lay down the responsibilities on joint auditors.</b></p> <p>[June 18 Q.10a 4 Marks]</p> <p>[MTP Dec 20 Q.10a 4 Marks]</p>	<p>Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.</p> <p>In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –</p> <ul style="list-style-type: none"> <li>• in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;</li> <li>• in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature,</li> <li>• timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;</li> <li>• in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;</li> <li>• for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and</li> <li>• for ensuring that the audit report complies with the requirements of the relevant statute.</li> </ul>

**CONCEPT 79. AUDIT OF SHARES [MTP Dec 19 Q.10d 4 Marks]**

Allotment of Securities by Company [Section	"Securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.
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39]	<p><b>How to check the allotment of Securities of a Company:</b></p> <ul style="list-style-type: none"> <li>• Study of the contract pursuant to which the issue is made to determine how many shares are agreed to be issued and for what value and the nature and other details of the consideration.</li> <li>• Examination of the prospectus to see the substance of the contract and the relevant terms of the issue including the mode of payment of the purchase consideration in case of an issue to a vendor of the business or payability of commission to the underwriters or payability of the preliminary expenses.</li> <li>• To check whether minimum amount has been subscribed or not as stated in the prospectus.</li> <li>• To check whether the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.</li> <li>• To check whether the amount payable on application on every security shall not be less than five per cent. of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.</li> <li>• Examine the Board meeting minutes for the purpose for which securities is issued and utilized for the same.</li> <li>• Check whether the amount is refunded to the applicant within prescribed time period in case of minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus.</li> <li>• To check whether the company has file with the Registrar a return of allotment or not, where the Company having a share capital makes any allotment of securities.</li> <li>• To check whether the Company has defaulted under sub-section (3) or sub-section (4). In case the company is found default under above provision then the same should be reported by the auditor in his report.</li> </ul>
<p><b>Alteration of Share Capital [Section 61]</b></p> <p><b>[June 19 Q. 10d 4 Marks]</b></p> <p><b>[MTP Dec 20 Q.10d 4 Marks]</b></p>	<ul style="list-style-type: none"> <li>• Confirm that alteration was authorised by articles.</li> <li>• Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.</li> <li>• Verify that alteration had been effected in copies of Memorandum, Articles, etc.</li> <li>• Obtain the reasons for which the memorandum of the company is altered.</li> <li>• Check whether there is any change in the voting percentage of shareholders due to consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.</li> <li>• To confirm that the alter share capital's denomination should be more than R1.</li> <li>• Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein.</li> </ul>
<p><b>Issue of Bonus Shares [Section 63]</b></p> <p><b>[Dec 2017 Q. 10a 4 Marks]</b></p>	<ul style="list-style-type: none"> <li>• Confirm that issue of Bonus Share was authorized by articles.</li> <li>• Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.</li> <li>• Check that the company has issued fully paid-up bonus shares to its members only.</li> <li>• Confirm that the issue of bonus shares shall not be made by capitalising reserves</li> </ul>



<p><b>[MTP Dec 20 Q.10d 4 Marks]</b></p> <p><b>[MTP June 18 Q.9a 8 Marks]</b></p> <p><b>[MTP June 17 Q.9a 8 Marks]</b></p>	<p>created by the revaluation of assets.</p> <ul style="list-style-type: none"> <li>• Check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.</li> <li>• Check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.</li> <li>• Whether the partly paid-up shares are made fully paid-up.</li> <li>• Check whether the bonus shares shall not be issued in lieu of dividend.</li> </ul>
<p><b>Power of company to Purchase its Own Securities [Section 68]</b></p>	<ul style="list-style-type: none"> <li>• Confirm that Buy-Back was authorized by articles.</li> <li>• Verify the minutes of the Board meeting and special resolution passed in the general meeting in which the approval of members is obtained.</li> <li>• Where the buy-back has been authorised by the Board by means of a resolution passed at its meeting then check that the buy-back is not more than ten per cent. or less of the total paid-up equity capital and free reserves of the company.</li> <li>• Check that the no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.</li> <li>• To check that the buy-back shall not be more than twenty-five per cent. of the aggregate of paid-up capital and free reserves of the company. In case of buy-back of equity shares in any financial year, the reference to twenty-five per cent. in this clause shall be construed with respect to its total paid-up equity capital in that financial year.</li> <li>• To check that the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves.</li> <li>• To check that all the shares or other specified securities for buy-back should be fully paid-up.</li> <li>• To check whether the buy-back is made as per SEBI regulations in case of buy-back of the shares or other specified securities listed on any recognized stock exchange.</li> <li>• To check that no offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back.</li> <li>• To ensure that buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board under clause (b) of sub-section (2).</li> <li>• Ensure that the buy-back has been done only out of the company's free reserves or its securities premium account or out of the proceeds of any shares or other specified securities other than out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.</li> <li>• Ascertain that declaration of solvency was filed with the SEBI and/or the Registrar of Companies before making buy-back but subsequent the passing of the special resolution.</li> <li>• To ensure that company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.</li> </ul>

	<ul style="list-style-type: none"> <li>• To ensure that the company shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of a bonus issue.</li> <li>• Whether the company has maintained any register of the shares or securities so bought.</li> <li>• Check whether that the after the completion of the buy-back under this section the company file with the Registrar and the Securities and Exchange Board a return containing such particulars relating to the buy-back within thirty days of such completion.</li> </ul>
<b>Splitting of shares of face value from ₹ 10 to ₹ 1 per share</b>	<ul style="list-style-type: none"> <li>• Confirm that alteration was authorised by articles.</li> <li>• Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.</li> <li>• Verify that alteration had been effected in copies of Memorandum, Articles, etc.</li> <li>• Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein.</li> </ul>
<b>Share Transfer Audit:</b>	<p>The following aspects are required to be examined by the auditor in conducting the share transfer audit:</p> <ol style="list-style-type: none"> <li>i. Inspection of the Articles of Association regarding the prescribed form of transfer and other provisions, particularly the time limits laid down by the Articles or law.</li> <li>ii. Notification by transferor of the lodgement made by the transferee and inspect the objections received, if any. Also see, where calls due or not paid, whether transfer can be refused under the articles and whether any transfer was so refused.</li> <li>iii. Examining in the case of particularly partly-paid shares, where the application for registration was made by the transferor, a notice was sent to the transferee and registration was effected only on receipt of 'non-objection' received from him.</li> <li>iv. Scrutiny of transfer forms, noting specially: <ul style="list-style-type: none"> <li>• That in every case, the application for transfer was made in the prescribed form and the prescribed authority had stamped the date on which it was presented to it; also that it was delivered to the company within 60 days of exaction.</li> <li>• That each transfer form is properly executed and bears the proper stamp duty.</li> <li>• That the name of the company is correctly stated on the form.</li> <li>• That where the consideration for transfer appears to be inadequate, an inquiry was made by the company for ascertaining the reasons therefor. (This is not necessary if the transfer form bears the seal of the Collector of Stamps.)</li> <li>• That the alterations, if any, have been suitably initiated; and</li> <li>• That the name and address of the transferee have been recorded completely and fully for purposes of correspondence.</li> </ul> </li> <li>(v) Comparison of the signatures of each transferor on the transfer form with his signature on the original application for shares or on the transfer form (if the shares were acquired on a transfer).</li> <li>(vi) Ascertaining that none of the transferees is disqualified from holding shares in the company.</li> <li>(vii) Vouching the entries in the Shares Transfer Journal by reference to the transfer forms, noting in each case: <ul style="list-style-type: none"> <li>• the name of transferor;</li> <li>• the name and address of the transferee;</li> </ul> </li> </ol>

	<ul style="list-style-type: none"> <li>• the number and class of shares transferred; and</li> <li>• the distinctive numbers, if any, of the shares transferred.</li> </ul> <p>(vii) Verification of postings from the Share Journal to the Register of Members.</p> <p>(viii) Inspection of each transfer as to names, addresses, occupations, form of document, description, number (in words), distinctive number of shares, stamp, date, signature, witnesses, etc.</p> <p>(ix) Check whether the transfer to firms, etc. have been rejected or not and whether notes of trust has been entered in the share register.</p> <p>(x) Noting transferor's name, etc. and class, number and distinctive number of shares, as stated in the transfers, with old certificates and Register of Members. See that old certificates were cancelled.</p> <p>(ix) Inspection of the power of attorney and specimen signatures if transfer executed by an agent.</p> <p>(x) Inspection of letters of indemnity for lost certificates and ensuring that duplicate certificates have been issued on proper authority.</p> <p>(xi) Where part of the shares have been transferred, the issue of balance certificates to the transferors should be seen and confirm that the distinctive number of shares have been correctly stated.</p> <p>(xii) Refer to the minutes book to ensure that all transfers recorded in the share transfer journal have been approved by the Board.</p> <p>(xiii) Checking of counterfoils of new certificates.</p> <p>(xiv) Reconciliation of the amount of transfer fees collected with the total number of transfers lodged and verifying that the amount of transfer fees have been accounted for.</p> <p>(xv) Reconciliation of the total number of shares of different classes issued by the company with the total amount of capital issue and its sub-divisions by extracting balances of shares held by different members from the Register of members.</p> <p>(xvi) Ensuring that, in case of any share transactions by directors, corresponding entries have been made in the Register of Directors' shareholding.</p>
<b>Re-issue of forfeited shares</b>  <b>[MTP June 19 Q.10c 4 Marks]</b>  <b>[MTP June 18 Q.10d 4 Marks]</b>	<p>i. The auditor should ascertain that the board of directors has the authority under the Articles of Association of the company to reissue forfeited shares. Check the relevant resolution of the Board of Directors.</p> <p>ii. Vouch the amounts collected from persons to whom the shares have been allotted and verify the entries recorded from re-allotment. Auditor should check the total amount received on the shares including received prior to forfeiture, is not less than the par value of shares.</p> <p>iii. Verify that computation of surplus amount arising on the reissue of shares credited to Capital Reserve Account and</p> <p>iv. Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 is essential.</p>

**CONCEPT 80. AUDIT OF DEBENTURES [MTP Dec 19 Q.10d 4 Marks]**

<b>Meaning</b>	<p>“Debenture” includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not;</p>
<b>Issue of Debenture</b>  <b>[June 18 Q.10d 4 Marks]</b>	<p>A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting. No company shall issue any debentures carrying any voting rights. Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.</p> <p>Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures. Appointment debenture trustee is mandatory for the following –</p> <ul style="list-style-type: none"> <li>• The offer of issue of debenture is made to public</li> <li>• The company makes the offer to members exceeding five hundred in number.</li> </ul> <p>The purpose of appointment of debenture trustee is for the protection of interest &amp; redress grievances of debenture holders.</p> <p>Now a days, the share accounting is done by Registering and Transfer Agents (RTA)/ The auditor may have to check the records of RTA with dematerialisation and electronic record keeping, the concept of audit has changed.</p> <p><b>Auditor's Duty:</b></p> <ul style="list-style-type: none"> <li>• The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.</li> <li>• He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.</li> <li>• He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.</li> <li>• If the debentures are covered by a mortgage or a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.</li> <li>• Compliance with SEBI guidelines should also be ensured.</li> <li>• Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.</li> </ul>
<b>Interest on</b>	A predetermined fixed rate of interest is payable on debentures irrespective of the

<b>Debentures:</b>  <b>[Dec 2019 Q. 10d 4 Marks]</b>  <b>[MTP Dec 18 Q.10d 4 Marks]</b>	<p>fact that company has earned the profit or not. Debenture holders are creditors of the company, they are not the owners. They have no voting powers and cannot influence the management but their claim of interest rank ahead of the claims of the shareholders.</p> <p><b>Auditor's Duty:</b></p> <ol style="list-style-type: none"> <li>The payment of interest should be vouched by the auditor with the acknowledgement of the debenture-holders, endorsed warrants and in case of bearer debentures with the coupons surrendered.</li> <li>The auditor should reconcile the total amount paid with the total amount due and payable with the amount of interest outstanding for payment.</li> <li>He should ensure that the interest paid on debenture like that on other fixed loans, must be disclosed as a separate item in the profit &amp; loss account.</li> </ol>
<b>Redemption of Debentures:</b>  <b>[MTP June 19 Q.10b 4 Marks]</b>  <b>[MTP June 18 Q.10b 4 Marks]</b>  <b>[MTP Dec 17 Q.10b 4 Marks]</b>  <b>[MTP June 17 Q.10b 4 Marks]</b>	<p>A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. If debentures are redeemable it can be redeemed in any of the following way:</p> <ul style="list-style-type: none"> <li>• By way of periodical drawing i.e. by creating Debenture Redemption Reserve Account.</li> <li>• By way of payment on fixed date.</li> <li>• By payment whenever the company desires to do so.</li> </ul> <p><b>Auditor's Duty:</b></p> <ol style="list-style-type: none"> <li>The auditor should inspect the debentures or trust deed for the terms and conditions regarding redemption of debentures.</li> <li>He should see the Director's minute book authorizing the redemption of debentures.</li> <li>He should also vouch the redemption with the help of debenture bonds cancelled and the cash book.</li> <li>He should also examine the accounting treatment thoroughly.</li> </ol>
<b>Debenture issued as Collateral Security</b>	<p>If the debentures are issued as collateral security to the banks or creditors then auditor needs to ensure that such issue is approved by Board of Directors and very by the term as per loan agreement.</p>

**CONCEPT 81. AUDIT OF DIVISIBLE PROFITS AND DIVIDEND**

<b>Declaration of dividend [Section 123]</b>  <b>[Dec 2017 Q. 10d 4 Marks]</b>	<p>Final dividend is declared in the general meeting. Board of Directors have to recommend a dividend. Declaration of dividend is 'Ordinary Business' in general meeting.</p> <p>No dividend shall be declared or paid by a company for any financial year except —</p>
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<p><b>[MTP Dec 20 Q.10a 4 Marks]</b></p>	<ul style="list-style-type: none"> <li>• out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both; or</li> <li>• out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.</li> </ul> <p>Provided that a company may, before the declaration of any dividend in any financial year, transfer such percent-age of its profits for that financial year as it may consider appropriate to the reserves of the company.</p> <p>Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.</p> <p>Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.</p> <p>Provided also that no company shall declare dividend unless carried over previous losses and depreciation not pro-vided in previous year or years are set off against profit of the company for the current year.</p> <p>For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.</p>
<p><b>Interim Dividend:</b> <b>[June 19 Q.10a 4 Marks]</b></p>	<p>The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.</p>
<p><b>Declaration of interim dividend if company has incurred losses in current financial year:</b></p>	<p>In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.</p>
<p><b>Legal Provisions applicable to interim dividend:</b></p>	<p>The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate ac-count within five days from the date of declaration of such dividend.</p>

<b>Entitlement of Dividend:</b>	<p>No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash.</p> <p>Provided that nothing in this sub-section shall be deemed to prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.</p> <p>Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.</p>
<b>Consequences on non-compliance:</b>	A company which fails to comply with the provisions of sections 73 and 74 shall not, so long as such failure continues, declare any dividend on its equity shares.
<b>Unpaid Dividend Account [Section 124] Transfer of unpaid dividend to separate account:</b>	Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.
<b>Information about unpaid dividend on Company's website:</b>	The company shall, within a period of ninety days of making any transfer of an amount under sub-section (1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.
<b>Effect of non-transfer:</b>	If any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent. per annum and the interest accruing on such amount shall enure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.
<b>Transfer of unclaimed dividend and also shares to Investor Education and</b>	<ul style="list-style-type: none"> <li>Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under sub-section (1) of section 125 and the company shall send a statement in the prescribed form of the</li> </ul>



<b>Protection Fund:</b>  <b>[Dec 18 Q. 10a 4 Marks]</b>	<p>details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.</p> <ul style="list-style-type: none"> <li>• All shares in respect of which dividend has not been paid or claimed for seven consecutive years or more under sub-section (5) shall also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed.</li> <li>• Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.</li> <li>• If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.</li> </ul>
<b>Investor Education and Protection Fund</b> <b>[Section 125]</b>  <b>[MTP Dec 17 Q.10b 4 Marks]</b>  <b>[MTP June 17 Q.10b 4 Marks]</b>	<p>The Central Government has established a Fund called as the Investor Education and Protection Fund (herein referred to as the Fund).</p> <p><b>There shall be credited to the Fund—</b></p> <ul style="list-style-type: none"> <li>• the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;</li> <li>• donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;</li> <li>• the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;</li> <li>• the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;</li> <li>• the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;</li> <li>• the interest or other income received out of investments made from the Fund;</li> <li>• the amount received under sub-section (4) of section 38;</li> <li>• the application money received by companies for allotment of any securities and due for refund;</li> <li>• matured deposits with companies other than banking companies;</li> <li>• matured debentures with companies;</li> <li>• interest accrued on the amounts referred to in clauses (h) to (j);</li> <li>• sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;</li> <li>• redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and</li> </ul>



- such other amount as may be prescribed:

Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

**The Fund shall be utilised for—**

- education, awareness and protection;
- the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon; promotion of investors'
- distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
- reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
- any other purpose incidental thereto, in accordance with such rules as may be prescribed:

Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

**Authority to administer the fund:**

- The Central Government shall constitute, by notification, an authority for administration of the Fund consisting of a chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.
- Any person claiming to be entitled to the amount referred in sub-section (2) may apply to the authority constituted under sub-section (5) for the payment of the money claimed.

**Administration and procedures of the fund:**

- The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.
- The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.
- The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor-General of India.

iv. It shall be competent for the authority constituted under sub-section (5) to spend money out of the Fund for carrying out the objects specified in sub-section (3).

**Books of Accounts:**

- The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government.
- The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

**CONCEPT 82. STATUTORY AUDITOR VS INTERNAL AUDITOR [Dec 18 Q.10d 4 Marks] [June 17 Q.10b 4 Marks]**

**Difference**  
[MTP Dec 19  
Q.10d 4 Marks]

[MTP Dec 17  
Q.9b 7 Marks]

Statutory Audit is the act of checking books of accounts as per the provision of Companies Act, whereas Internal Audit is conducted by the either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board of the Company to detect weakness in internal control system and for their improvement. However both of these types of audit check books of accounts, detect frauds & errors however they differ from each other which is reproduced below;

SL No.	Basis	Statutory Audit	Internal Audit
i.	Appointing Authority	Statutory Auditor is appointed by the shareholder in the general meeting.	Internal Auditor is appointed by the Board.
ii.	Scope of the work	The scope of work is defined in the Companies Act.	The scope of work includes the adherence of management policies and procedures and identifies the weakness in the internal control. Board may specify thrust areas while issuing engagement letter.
iii.	Removal of Auditor	Statutory Auditor can be removed by the shareholders.	Internal Auditor can be removed by the Board.
iv.	Remuneration	It is fixed by the shareholders.	It is fixed by the board.
v	Audit Report	It is submitted to the appointing Authority.	It is submitted to the Board as a suggestion to improve weakness in the internal control.

**CONCEPT 83. AUDITING AND ASSURANCE STANDARDS RELATING TO AUDIT OF INVENTORIES**

**Meaning**

[Dec 18 Q.10b 4]

Inventories are tangible property held for sale in the ordinary course of business, or in the process of production for such sale, or for consumption in the production of goods or services for sale, including maintenance supplies and consumable stores

<b>Marks]</b>  <b>[June 17 Q.10c 4 Marks]</b>  <b>[MTP Dec 19 Q.10a 4 Marks]</b>  <b>[MTP Dec 19 Q.10b 4 Marks]</b>	<p>and spare parts meant for replacement in the normal course.</p> <p>Inventories normally comprise raw materials including components, work-in-process, finished goods including by-products, maintenance supplies, stores and spare parts, and loose tools.</p> <p>Inventories normally constitute a significant portion of the total assets, particularly in the case of manufacturing and trading entities as well as some service rendering entities. Audit of inventories, therefore, assumes special importance.</p>
<b>Distinctive Features of Inventories</b>  <b>[MTP Dec 20 Q.10b 4 Marks]</b>  <b>[MTP June 19 Q.10c 4 Marks]</b>  <b>[MTP Dec 18 Q.10b 4 Marks]</b>  <b>[MTP June 18 Q.10b 4 Marks]</b>  <b>[MTP June 17 Q.9b 7 Marks]</b>	<p><b>The following features of inventories have an impact on the related audit procedures:</b></p> <ul style="list-style-type: none"> <li>• By their very nature, inventories normally turn over rapidly.</li> <li>• Inventories are susceptible to obsolescence and spoilage. Further, some of the items of inventory may be slow-moving while others may follow a seasonal pattern of movement.</li> <li>• Inventories are normally movable in nature, although there may be some instances of immovable inventories also, e.g., in the case of an entity dealing in real-estate.</li> <li>• All the items of inventory may not be located at one place but may be held at different locations such as factories and warehouses, or with third parties such as selling agents.</li> <li>• The individual items of inventory may not be significant in value, but taken together, they normally constitute a significant proportion of total assets and current assets of manufacturing, trading and certain service entities.</li> <li>• Physical condition (e.g., stage of completion of work-in-process in certain industries) and existence of certain items of inventories may be difficult to determine.</li> <li>• Valuation of inventories may involve varying degrees of estimation, including expert opinions, e.g., in the case of jewelry.</li> </ul>

**CONCEPT 84. AUDITING AND ASSURANCE STANDARDS RELATING TO AUDIT OF FIXED ASSETS**

<b>Audit of Fixed Assets</b>  <b>[June 19 Q.10b 4 Marks]</b>  <b>[MTP Dec 20 Q.10b 4 Marks]</b>  <b>[MTP June 19</b>	<p><b>i. The term Property, plant and equipment in respect of those entities which are required to comply with the relevant Revised AS refers to such tangible items that:</b></p> <ul style="list-style-type: none"> <li>• are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and</li> <li>• are expected to be used during more than one period.</li> </ul> <p><b>ii. An asset can be classified as a PPE or otherwise, depending upon the use to which it is put or intended to be put.</b></p> <p>For example, assets which are classified as PPE in one type of business may be</p>
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<b>Q.10d 4 Marks]</b>	<p>considered as current assets in another. Similarly, the same asset may be classified differently in an entity at different points of time.</p> <p>The recognition of Property, Plant and Equipment should be done as per the principles laid down in the “relevant applicable AS”.</p>
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**CONCEPT 85. EDUCATIONAL INSTITUTION**

<p><b>Special Steps involved</b></p> <p><b>[June 18 Q.10c 4 Marks]</b></p> <p><b>[MTP Dec 19 Q.10c 4 Marks]</b></p>	<p>The special steps involved in the audit of an educational institution are the following:</p> <ol style="list-style-type: none"> <li>1. • Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.</li> <li>2. • Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.</li> <li>3. • Check names entered in the Students’ Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.</li> <li>4. • Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.</li> <li>5. • Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.</li> <li>6. • Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.</li> <li>7. • See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.</li> <li>8. • Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.</li> <li>9. • Confirm that hostel dues were recovered before students’ accounts were closed and their deposits of caution money refunded.</li> <li>10. • Verify rental income from landed property with the rent rolls, etc.</li> <li>11. • Vouch income from endowments and legacies, as well as interest and dividends from investment;</li> <li>12. also inspect the securities in respect of investments held.</li> <li>13. • Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.</li> <li>14. • Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.</li> </ol>
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	<ol style="list-style-type: none"> <li>15. • Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.</li> <li>16. • See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.</li> <li>17. • Verify that the Provident Fund money of the staff has been invested in appropriate securities.</li> <li>18. • Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.</li> <li>19. • Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.</li> <li>20. • Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.</li> <li>21. • See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.</li> <li>22. • Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.</li> <li>23. • Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.</li> <li>24. • Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.</li> <li>25. • Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.</li> </ol>
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**CONCEPT 86. AUDIT OF HOSPITAL**

<b>Points to be considered</b>  <b>[June 2017 Q. 10a 4 Marks]</b>  <b>[MTP Dec 19 Q.10c 4 Marks]</b>	<p>Following points are to be considered necessary for conducting an audit of Hospital.</p> <ol style="list-style-type: none"> <li>1. • Check the letter of appointment to ascertain the scope of responsibilities.</li> <li>2. • Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.</li> <li>3. • Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.</li> <li>4. • Vouch the entries in the Patient's Bill Register with a copies of bill issued. Test check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.</li> <li>5. • Vouch the collection from patients with copies of bills and entries in Bills Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.</li> <li>6. • Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.</li> </ol>
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	<ol style="list-style-type: none"> <li>7. ● In case of legacies and donations which are received for specific purposes, it should be ensured that any income there from is not utilized for any other purposes.</li> <li>8. ● Where receipts of subscription show significant deviations from budgeted figures, it should be thoroughly inquired into and the matter be brought to the notice of the trustees or the Managing Committee.</li> <li>9. ● Government grants or grants from local bodies should be verified with the reference to the correspondence with the concerned authorities.</li> <li>10. ● Clear distinction should be made between the items of capital and revenue nature.</li> <li>11. ● The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.</li> <li>12. ● Verify the system of internal check as regards purchases and issue of stores, medicines etc.</li> <li>13. ● Examine that the appointment of the staff, payment of salaries etc. are duly authorized.</li> <li>14. ● Physically verify the investments, fixed assets and inventories.</li> <li>15. ● Check that adequate depreciation has been provided on all the depreciable assets.</li> </ol>
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**CONCEPT 87. CO-OPERATIVE SOCIETIES [Dec 18 Q.10c 4 Marks]**

<b>Definition:</b>  <b>[MTP Dec 20 Q.10c 4 Marks]</b>	<p>A Co-operative society may broadly be defined as an association of persons who have voluntarily joined together to achieve a common economic objective through the formation of a democratically-controlled business organization, making equitable contributions to the capital as required, and accepting a fair share of risks and benefits of the undertaking. Elimination of middlemen and sharing of gains of economic activities seems to be the hallmark of a co-operative society.</p> <p>A co-operative society may be formed for different purposes. Accordingly, there may be consumers' co-operative societies, housing co-operative societies, industrial co-operative societies, urban and rural co-operative banks, etc.</p>
<b>Audit as per Section 17 of the Co-Operative Societies Act, 1912</b>	<ul style="list-style-type: none"> <li>● The Registrar shall audit or cause to be audited by some person authorised by him by general or special order in writing in this behalf the accounts of every registered society once at least in every year.</li> <li>● The audit under sub-section (1) shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.</li> <li>● The Registrar, the Collector or any person authorised by general or special order in writing in this behalf by the Registrar shall at all times have access to all the books, accounts, papers and securities of a society, and every officer of the society shall furnish such information in regard to the transactions and working of the society as the person making such inspection may require.</li> <li>● "Registrar" means a person appointed to perform the duties of a Registrar of Co operative Societies under this Act.</li> </ul>

	<p>The following points should be kept in mind where awains of an Co-operative society;</p> <ul style="list-style-type: none"> <li>• Qualifications of auditor: generally, only a chartered accountant within the meaning of the Chartered Accountants Act 1949, can be appointed as the auditor of a co-operative society. However, in certain State Co-operative societies Act, a person holding a government diploma in co-operative accounts, or in co-operation and accounts, or a reason who has served as an auditor in the Co-operative Department of Government, may also be appointed as the auditor.</li> </ul> <p>The auditor should ensure that he is duly qualified to act as auditor of the society.</p>
<b>Appointment of the Auditor:</b>	<p>An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies-and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited. For example, the audit fees of co-operative credit society and Urban Co-operative Banks are to be calculated with reference to working capital at the prescribed rates. 'Working Capital' here means funds at the disposal of the society inclusive of paid up share capital, funds built up out of profits and monies raised by borrowing and by other means.</p>
<b>Aspects to be audited</b>	<p><b>Books of accounting records:</b> Under section 43(h) of the Co-operative Societies Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society.</p> <p>For example In Maharashtra the co-operative societies are required to maintain cash book, general ledger, personal ledger, stock register, property register, etc.</p> <p><b>Cash book.</b> It may be maintained to record particulars regarding cash receipts and expenses under suitable heads, with clear distinction between capital and revenue items of receipts and expenses.</p> <p><b>Stock register.</b> It may contain detailed information as regards receipts, issues and balances of stock-in-trade, date-wise. In a producers' co-operative society, perpetual inventory records may be maintained based on an appropriate costing method.</p> <p><b>Register of assets and investments.</b> It will contain detailed particulars regarding the various immovable and movable assets belonging to the society, such as, types of assets, location, date of acquisition, cost, depreciation provided, and so on.</p> <p><b>Register of fixed deposits.</b> In the case of a co-operative credit society, or a co-operative bank, or any other society which is authorised by its bye-laws to accept deposits from members/non-members, a register of fixed deposits may be maintained giving details as regards the dates of acceptance, maturity, interest accrual, repayment, etc.</p> <p><b>Register of sureties.</b> In the case of a co-operative credit society, loans are given against personal security of members as also surety (guarantee) provided by two other members. The Register of Sureties will give particulars about the number of borrowers in respect of which a member has stood surety, and show whether it is within the overall limit of surety-ship that may.</p> <p><b>Restriction on shareholding:</b> Shareholding in a co-operative society is subject to the limit prescribed in Sec. 5 of the Co-operative Societies Act 1912. Accordingly, no member of the society, other than a registered society, can hold more than twenty per cent of the total number of shares of the society, or such number of shares which in value exceeds Rs. 1,000. A co-operative society cannot prescribe any other limit in</p>



	<p>its bye-laws which is violative of this provision. In addition to this, the Acts passed by the states may also passed by the States may also prescribe other restrictions as regards shareholding.</p> <p>The auditor should see that the provision regarding shareholding is duly followed.</p> <p><b>Restriction on Loan:</b> As per section 29 A registered co-operative society can only grant loans to its members though, with prior approval of the Registrar, it may grant loans to other registered co-operative societies. The auditor should see that the loans granted by the society are in conformity with this provision.</p> <p><b>Restriction on Borrowing:</b> Subject to the restrictions imposed by its bye-laws, a co-operative society may accept loans and deposits from its members as well as non-members. It is the, auditor's duty to ascertain that the restrictions, if any, laid down by the bye-laws are carefully observed</p> <p><b>Investment of Funds:</b> There are restrictions on investment of funds belonging to a co-operative society. Accordingly, a society may invest its funds in any of the following (Sec.32 of the Central Co-operative Societies Act):</p> <ul style="list-style-type: none"> <li>• Central or State Co-operative Bank,</li> <li>• Any securities specified in Section 20 of the Indian Trusts Act, 1882.</li> <li>• Any shares, securities, bonds or debentures of any other Co-operative society with limited liability.</li> <li>• Any bank, or person carrying on banking business or a Co- operative bank, other than a Central or State co-operative bank, as duly approved by the Registrar;</li> <li>• In any other manners as duly permitted by the requisite authority.</li> </ul> <p><b>Auditor's duty:</b> The auditor should ascertain whether the requirement as to investment of the society funds are being observed.</p> <p><b>Appropriation of profits:</b> According to the Central Co-operatives Societies Act, 25% of the profits of a co-operatives society should be transferred to a Reserve Fund before distribution of dividend or payment of bonus to its members. However, the Registrar may, having regard to the financial position of the society, reduce the percentage of profits to be transferred to the Reserve Fund. But in any case, he cannot reduce it to less than 10% of the profits of the society.</p> <p>Apart from the above mandatory provision, a co-operative society may, subject to the provisions of its bye-laws, appropriate its profits by way of transfer to other reserves, distribution of dividends to members, etc. However, appropriation of profits must be duly approved by the members of the society in the general meeting called for the purpose.</p> <p><b>Contributions to charitable Purposes:</b> According to Section 34, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose as defined in section 2 of the Charitable Endowments Act, 1890.</p>
<b>SPECIAL POINTS IN A CO-OPERATIVE SOCIETY</b>	<p><b>General Points: -</b></p> <p>In general while conducting audit of Co-operative society 'The auditor need to look into the followings: -</p> <ul style="list-style-type: none"> <li>• The auditor should carefully go through the bye-laws of the society and see that they are being observed both in letter and spirit.</li> <li>• He should examine the Register of Members of the society and individual shareholdings.</li> <li>• He should test-check the internal check and control system operated by the society</li> </ul>



	<p>and model his audit examination based on its strengths and weaknesses.</p> <p><b>Audit of income:</b> He should carefully vouch the receipt of cash. Cash receipts on account of share capital should be vouched with the Register of Members. Cash received against sales should be vouched with the cash memos and invoices issued to customers as also Sales Account. Receipt of cash in respect of payment of interest and repayment of loans advanced by the society should be vouched with the loan agreements. Cash received from members towards construction of houses or their maintenance, should be vouched with the Register of Members, demands made by the society from time to time, and money receipts.</p> <p><b>Audit of Expenditure:</b></p> <ul style="list-style-type: none"> <li>• He should vouch all expenditure with reference to authorisation from the Managing Committee, particularly in the case of large capital expenditure, as also the bills received from individual parties, the money receipts obtained from them, and entries in the Bank Pass Book along with counter-foils of cheques.</li> <li>• He should vouch the payment of loans from the loan agreements entered into with borrower-members.</li> <li>• He should vouch establishment expenses with reference to the resolutions of the Managing Committee, agreements with the persons concerned, and money rec( :pts obtained from them.</li> </ul>
<b>Other aspects points:</b>	<ul style="list-style-type: none"> <li>• He should appropriately classify overdue debts for a period from six months to five years and more, and report them to the members, with a note regarding the effects these might have on the financial position of the society. He should also put a note regarding the probability of recovery of such debts.</li> <li>• Similarly, he should make a special reference to the overdue amount of interest from members. Generally, interest on overdue debts should not be credited to Interest Account but to the Overdue Interest Reserve Account.</li> <li>• Writing off of bad debts should be after prior authorisation from the Managing Committee of the society. According to the Maharashtra Co-operative Societies Rules, a bad debt can be written off only when it is certified to be irrecoverable by the auditor. This casts a special obligation on the auditor to ascertain whether the debt in question was created within the Rules of the society, and whether it has now really become bad and irrecoverable.</li> </ul>

**CONCEPT 88. BANK AUDIT**

<p><b>Type of Banking institutions prevailing in India:</b></p> <p>[MTP June 19 Q.10d 4 Marks]</p> <p>[MTP June 18</p>	<ul style="list-style-type: none"> <li>• Commercial banks;</li> <li>• Regional Rural banks;</li> <li>• Co-operative banks;</li> <li>• Development banks (more commonly known as 'term-lending institutions');</li> <li>• Payment Banks; and</li> <li>• Small Finance Banks</li> </ul>
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<b>Q.10c 4 Marks]</b>	
<b>Financial Statements of a bank</b>	As per the Third Schedule to the Banking Regulation Act, 1949, the Balance Sheet of a Bank should be presented in the prescribed manner, with comparative figures for previous financial year.
<b>Auditing aspects of banking of financial Statement.</b>  <b>[MTP Dec 20 Q.10c 4 Marks]</b>  <b>[MTP Dec 18 Q.10c 4 Marks]</b>  <b>[MTP June 18 Q.10c 4 Marks]</b>  <b>[MTP Dec 17 Q.10c 4 Marks]</b>  <b>[MTP June 17 Q.10c 4 Marks]</b>	<p><b>Advances:</b> In relation advances made by bank an auditor need to review the followings:</p> <ul style="list-style-type: none"> <li>• Ensure the internal control is in place in relation to advances made.</li> <li>• To scrutinise the subsidiary, ledger, &amp; control accounts</li> <li>• To ensure the proper documentation of account.</li> <li>• To scrutinising the overdue account and scheme for recovery of such amount.</li> <li>• Cash balance with RBI and other bank and money at call and short Notice.</li> </ul> <p><b>Cash in hand:</b></p> <ul style="list-style-type: none"> <li>• Ensure that the Internal control is in place.</li> <li>• Visit the bank branch and inspects physical cash and ensure that it will tallies with the banks cash book balance.</li> <li>• To verify the amount of foreign currency held by bank and its translation at make rate on the date at which financial statement is prepared.</li> </ul> <p><b>Balance with RBI:</b></p> <ul style="list-style-type: none"> <li>• Inspect the ledger balance in each account with</li> </ul> <p>(a) bank confirmation certificates from Reserve Bank of India and (b) Reconciliation Statement.</p> <p><b>Balance with other bank:</b></p> <p>Inspection of reconciliation statement to ensure that no debit or credit for interest have been taken to Revenue account to the year. To examines the large transition and balances with banks outside India. Ensure that they are converted at market rate as on financial statement preparation</p> <p><b>Money at call &amp; short notice:</b></p> <ul style="list-style-type: none"> <li>• Examines the system of authorisation for unding money at short and call notice</li> <li>• The call loan made by bank are not nettled off against call loan received by it.</li> <li>• Ensure that money market lending's for more than 6th days are not classified under this head but as a deposit or advance based on their nature of learning.</li> </ul> <p><b>Fixed and other Assets: -</b></p> <p>The auditor has to ensure the following while audit of F .A (Fixed Assets) held by banks</p> <ul style="list-style-type: none"> <li>• Accounting method of bank</li> <li>• Ownership document</li> <li>• To examine with reference to schedule of fixed assets to find neew assets acquired.</li> <li>• To examine sale deed in relation to sale of assets by bank.</li> <li>• To ensure appropriateness of basis of revaluation of fixed assets.</li> <li>• Ensure compliance of sec 9 of banking Regulation Act.</li> </ul>

**Borrowings:**

- To ensure that amount have been property disclosed for
- Barrowing in India farm RBI.
- Barrowing outside India.
- Ensure the rate of interest paid payable with duration of borrowing.
- Verity whether the barrowings of maney at call and short notice are property authorized.

**Deposits: -**

- To ensure the interest accered but not due on deposits is not under other liabilities and provision
- See Whether there is any instances of window dressing reporting in LFAR.

**Capital:**

- Examine the opening balance of capital
- Examine with special resolution of shareholder or MOA about increase in authorized capital durig the year.
- Examine with prospectus about increase in subscribed/ paid up capital
- Examine with Government notification for any fresh contribution from them.

**Reserve and Surplus:**

To examine the opening balance of different type of Reserve.

- Addition/ deduction from reserves.
- Reason for appropriation of any fund from such account.
- Dividend paid by bank
- In respect of foreign branch ensure compliance with foreign laws.

**Other Liabilities and provision:**

The auditor may verify the various items under the head “other liabilities and provisions’ in the following manner.

**Bills Payable**

The auditor should evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following:

- Drafts, mail transfers, traveller’s cheques, etc., should be made out in standard printed forms.
- Unused forms relating to drafts, traveller’s cheques, etc., should be kept under the custody of a responsible officer.
- The bank should have a reliable private code known only to the responsible officers of its branches coding and decoding of the telegrams should be done only by such officers.
- The signatures on a demand draft should be checked by an officer with the specimen signature book.
- AW the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.
- If the paying branch does not receive proper confirmation of any telegraphic

transfers or demand draft from the issuing branch, it should take immediate steps to ascertain the reasons.

- In case an instrument prepared on a security paper, e.g., draft, has to be cancelled (say, due to error in preparation), it should be examined whether the manner of cancellation is such that

the instrument cannot be misused. (For example, in the case of drafts, banks generally cut the distinctive serial number printed on the form and paste it in the book in which drafts issued are entered.) Cases of frequent cancellation and reissuance of drafts, pay orders, etc., should be carefully looked into by a responsible official.

#### **Others (Including Provisions)**

It may be noted that the figure of advances and investments in the balance sheet of a bank excludes provisions in respect thereof made to the satisfaction of auditors. The issue of determining the adequacy of provision for doubtful advances is discussed in detail under advances chapter of this Guidance Note. The auditor should examine other provisions and other items of liabilities in the same manner as in the case of other entities. Specifically, in case of tax deducted by the bank and payable to the government authorities before the due date, this function may be centralized or decentralized. While verifying this, the auditor must check whether tax has been correctly deducted from payments as per the provisions of the Income Tax /Act, 1961 and paid on or before the due date as specified under the /Act or Rules therefore. Many a times in case of branch audit, reporting has to be done before the due date of paying tax deducted at source for the month of March. In such cases the auditor should report delays observed till the date of his verification and clearly bring out the fact that he has not verified the payment of tax, due date of which would be after the date of the audit report.

#### **Contingent Liabilities and Bills for Collection:**

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. To this end, the auditor should, generally follow the audit procedures given below:

- The auditor should verify whether there exists a system whereby the non fund based facilities to parties are extended only to their regular constituents, etc.
- Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorised to do so and in accordance with the laid down procedures.
- The auditor should also examine whether in case of LCs for import of goods, as required by the abovementioned Master Circular on guarantees and co-acceptances, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs.
- Ascertain whether the accounting system of the bank provides for maintenance of adequate records in respect of such obligations and whether the internal controls ensure that contingent liabilities are properly identified and recorded.
- Performs substantive audit tests to establish the completeness of the recorded obligations. Such tests include confirmation procedures as well as examination of relevant records in appropriate cases.

	<ul style="list-style-type: none"> <li>● Review the reasonableness of the year-end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities.</li> <li>● Review whether comfort letters issued by the bank has been considered for disclosure of contingent liabilities.</li> </ul> <p><b>Bills for Collection</b></p> <ul style="list-style-type: none"> <li>● The auditor should examine whether the bills drawn on other branches of the bank are not included in bills for collection.</li> <li>● Inward bills are generally available with the bank on the closing day and the auditor may inspect them at that time. The bank dispatches outward bills for collection soon after they are received. They are, therefore, not likely to be in hand at the date of the balance sheet. The auditor may verify them with reference to the register maintained for outward bills for collection.</li> <li>● The auditor should also examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection.</li> <li>● In regard to bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc. This procedure is in consonance with the nature of obligations of the bank in respect of bills for collection.</li> </ul> <p><b>Treasury Operation-Foreign Exchange and Derivatives:</b></p> <ul style="list-style-type: none"> <li>● While innovative products and ways of trading create new possibilities for earnings for the bank, they also introduce novel and sometimes unfamiliar risks that must be identified and managed. Failure to do so can result losses entailing financial and reputational consequences that linger long after the loss has been recognized in financial statements. Hence, auditor should assess controls as part of audit work.</li> <li>● It is imperative that an auditor obtains a complete overview of the treasury operations of a bank before the commencement of the statutory audit. After conducting appropriate risk assessment of the treasury processes, the audit program needs to be designed in a manner that it dovetails into not just the control assessments of the treasury process but there is an assurance that the figures appearing in the financial statements as well as the disclosures are true and reflect fairly the affairs of the bank treasury.</li> </ul>
<b>Reports to be given to be given by bank Auditors:</b>	<ul style="list-style-type: none"> <li>● The Auditors' Report should state whether the Balance Sheet, Profit and Loss Account and Cash Flow Statement of the Bank, show a true and fair view of the financial position / result of operations / cash flows respectively, for the period under audit. This is applicable in respect of Nationalised Banks, as well as Banking Companies.</li> <li>● <b>Unaudited Branches:</b> Information relating to number of unaudited Branches should be given. Also, information in respect of Advances, Deposits, Interest Income and Interest Expense for such unaudited Branches should be collected and disclosed in the Audit Report.</li> </ul>
● <b>Additional</b>	Sec.30 (3) of Banking Regulation Act requires the Auditor to state the following-

**Matters:**

- Whether or not the information and explanations required by him have been found to be satisfactory,
- Whether or not transactions of the Company fall within the powers of a Banking Company,
- Whether or not the returns received from the Branch Offices of the Company have been found adequate for the purposes of his audit,
- Whether the Profit & Loss Account shows a true balance of Profit or Loss for the period covered by such account, &
- Any other matter, which the Auditor considers should be brought to the notice of Shareholders of the Company.
- **LFAR:** Auditors of Public Sector Banks, Private Sector Banks & Foreign Banks (as well as their Branches), are required to submit Long Form Audit Report (LFAR) on various matters specified by RBI.
- **Certificates:** In addition to Reports, the Auditors of Bank Branches as well as Central Statutory Auditors of Banks, have to furnish / issue various "Certificates" as required by RBI and other Regulations.

**CONCEPT 89.****AUDIT OF TRUSTS****Matters to be considered in Audit of Trusts**

[June 19 Q.10c 4 Marks]

When conducting the audit of a charitable institution, the auditor should consider the following matters:

- **Constitution:** The auditor should study the constitution of the charitable institution, for example, whether it is set up under the Societies Registration Act or as per section 8 of the Companies Act or as a trust.
- **Interest of members:** Obtain a list of members of the governing body. This will help the auditor in identifying whether any of the members of the governing body has any interest in the charitable institution.
- **Budget:** The auditor should obtain a copy of the budget sanctioned or the financial statement. This would enable him to acquaint himself with the different heads of income and expenditures of incomes and expenditures of the institution.
- **Internal Check:** Examination of the system of internal check, especially as regards the accounting of the amounts collected.
- **Collection & Deposit of income:** Check that the amounts received towards income have been duly collected, received and deposited into the bank regularly and promptly.
- **Subscription and donation:** These institutions receive subscriptions and donations which form the major part of their collections. Therefore the auditor should check the following:
  - ▶ The amount or the rate of the annual subscription.

	<ul style="list-style-type: none"> <li>▶ Any instructions given by the donors as to the specific utilization of donation.</li> <li>▶ Adequacy of internal controls existing as regards unused receipt books, counter foils, etc.</li> <li>▶ Where subscriptions are received in advance these should be properly dealt with in the accounts.</li> </ul> <ul style="list-style-type: none"> <li>● <b>Legacies received:</b> Verify the amounts of legacies received by reference to correspondence with any figures and other available information's.</li> <li>● <b>Income from Investment:</b> Where the institution has made any investments or given loans, the amount of dividend and interest should be properly vouched with reference to the counterfoils or dividend warrants received. It should be ensured that such loans or grants are given under proper authorizations.</li> <li>● <b>Rent:</b> If some property is given or taken on rent, then the auditor should check the tenancy agreement, the rent slips and the authorized person for the collection or payment, as the case may be, of the rent.</li> <li>● <b>Income/Expenditure relating to concert:</b> Most of the organisations organize special functions such as concert etc. The auditor should be careful in such cases. All the gross receipts and outgoings are to be properly vouched by him. It should be ensured that proper internal check was maintained as regards the receipts and outgoings. For example, the person responsible for collection and disbursements should be separate persons.</li> <li>● <b>Expenditure-a major area of concern:</b> The expenditure of charitable institution is also one of the major areas of concern. Thus the auditor should verify that the expenditure is made only for the charitable purpose. If the expenditure is not for the charitable purpose, then the auditor should examine the implications of applicable law and document for the same.</li> <li>● <b>Physical verification:</b> The auditor should physically verify the cash in hand, inventories and fixed assets.</li> </ul>
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**CONCEPT 90. AUDIT OF MUNICIPALITIES AND PANCHAYATS (LOCAL BODIES)**

<b>Major Objective of audit of Local Bodies</b>  <b>[Dec 2019 Q. 10c 4 Marks]</b>  <b>[Dec 2017 Q. 10a 4 Marks]</b>	<p>The major objective of audit of Municipalities and Panchayats are enumerated below;</p> <ul style="list-style-type: none"> <li>● To ensure on the fairness and correctness of contents in the Financial Statement</li> <li>● To report on adequacy of Internal control</li> <li>● To ensure value of money is fully received on amount spent.</li> <li>● To detect the frauds and errors.</li> </ul>
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<p>[MTP June 19 Q.10b 4 Marks]</p> <p>[MTP Dec 18 Q.10c 4 Marks]</p>	
<p><b>Points to be considered during their Audit</b></p>	<p>The following points are to be considered necessary for carrying on audit of Municipalities and panchayats (Local Bodies);</p> <ul style="list-style-type: none"> <li>● To ensure that the expeditors incurred conform to the relevant provision of the law and is in accordance with the financial Rules and regulation formed by the compliant authority.</li> <li>● To encase that sanction is accorded by the competent authority either special or general.</li> <li>● To encase that there is provision of funds for expenditure and is authorized by competent Authority.</li> <li>● To ensure that where huge financial expenditure is made is run economically and is expected to contribute growth.</li> </ul>

#### LIST OF SELF EXAMINATION QUESTIONS AS GIVEN IN CMA STUDY MATERIAL

1. Is an auditor entitled to attend the general meetings? Discuss the rights of an auditor while he is present in general meeting? **CONCEPT 51**
2. Discuss the procedure of appointment of the first auditor of a company. **CONCEPT 44**
3. State the procedure of for removal of statutory auditor before the expiry of his term. **CONCEPT 45**
4. Discuss the provision of section 140 of the companies Act 2013. **CONCEPT 45**
5. Who are qualified to act as auditor of the company? Discuss the person who is disqualified to become as an auditor of a company. **CONCEPT 46**
6. State the provision relating to audit of branch office of a company in India and Abroad. **CONCEPT 48**
7. Discuss the reporting requirement of Frauds by Auditor. **CONCEPT 48**
8. List down the certain services which are not to be rendered by the Auditor of the Company. **CONCEPT 49**
9. Write short notes on Audit Committee. **CONCEPT 53**
10. Why Central Government permission is required, when the auditor is to be removed before the expiry of their term? **CONCEPT 45**
11. Which Rules govern maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013? **CONCEPT 48**
12. What is the applicability of the Companies (Cost Records and Audit) Rules, 2014 and what is the date on which it becomes effective and applicable? **CONCEPT 54**
13. The Rules state that cost records are to be maintained in Form CRA-1. However, CRA-1 does not prescribe any format but only provides principles to be followed for different cost elements. What are the role and status of Cost Accounting Standards/GACAP and its applicability vis-à-vis CRA-1? **CONCEPT 54**
14. What is the procedure for appointment of cost auditor under the Companies Act, 2013? **CONCEPT 54**
15. Who can be appointed as a cost auditor? **CONCEPT 54**



16. What are the eligibility criteria for appointment as a cost auditor? **CONCEPT 54**
17. The Companies Act, 2013 has introduced provision regarding rotation of auditors. Is the provision of rotation of auditors applicable to cost auditors also? **CONCEPT 54**
18. What is the procedure to be followed for fixing the remuneration of a cost auditor? **CONCEPT 54**
19. Who can conduct the Secretarial Audit and which company have to undergo such? **CONCEPT 55**
20. Discuss the procedures of appointment of Secretarial Auditor. **CONCEPT 55**
21. Describe the procedure of submission of Cost Audit report by the Auditor of the Company. **CONCEPT 54**
22. Distinguish between the followings
  - a) Qualified Report and Adverse Report **CONCEPT 63**
  - b) Explanatory Notes and Qualificatory Notes **CONCEPT 62**
23. Write short notes on signing the Audit Report. **CONCEPT 50**
24. Write short notes on Qualification of Company Auditor under section 141 of the Companies Act 2013. **CONCEPT 46**
25. Explain the matters that do and do not affect the auditor's opinion. **CONCEPT 56**
26. What do you mean by Qualified Audit Report and Piecemeal Opinion? **CONCEPT 58 & 60**
27. What consideration should an auditor bear in mind when he is drafting a certificate for a special purpose? Discuss the scope and contents of such reports. **CONCEPT 76**
28. What are the various types of opinion that an auditor can express as a result of his audit? Under what circumstances should an auditor express an adverse opinion or disclaimer of opinion? **CONCEPT 56**
29. Explain the nature of verification the auditor should conduct before issuing report or certificate on financial information in offer documents. **CONCEPT 48**
30. Write short notes on Branch and Joint Audit. **CONCEPT 78 & 79**
31. What are the factors to be considered while carrying on audit of Share and Debentures? **CONCEPT 80 & 81**
32. Precautions to be taken care of while carrying on audit of divisible profits and dividends. **CONCEPT 82**
33. Distinguish between Statutory and Internal Audit. **CONCEPT 83**
34. Discuss the Auditing and Assurance Standards relating to audit of Inventories and Fixed Assets. **CONCEPT 84 & 85**
35. Mention the special steps involved in conducting the audit of college? **CONCEPT 86**
36. What are the points which you as an Auditor would look into while auditing the accounts of a Hospital? **CONCEPT 87**
37. Discuss the important points in an audit of Co operative Society. **CONCEPT 88**
38. While carrying an audit of a Bank what are the special factors considered by you. **CONCEPT 89**
39. Write short notes on audit of Local Bodies. **CONCEPT 91**