AUDITING AND ASSURANCE : A Capsule for Quick Revision

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course.

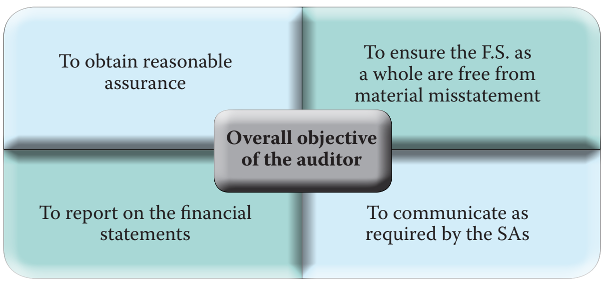
Keeping in mind this objective, BoS has decided to come out with a Crisp & Concise Capsule of each subject to facilitate students for quick revision before examination.

The third in the series of capsules is on Paper 6: Auditing & Assurance of Intermediate (IPC) Course. It may be mentioned that this capsule is a tool for quick revision of some significant areas of Auditing & Assurance & this should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the relevant Study Material, Practice Manual and RTP for comprehensive study & revision.

CHAPTER 1 : NATURE OF AUDITING

What is an Audit

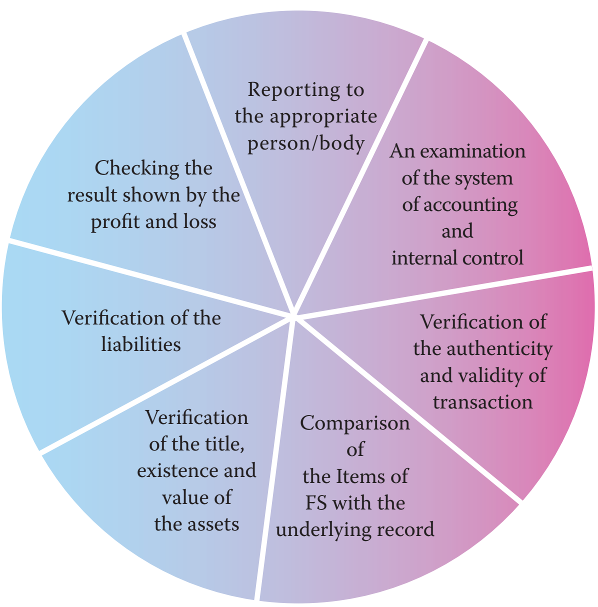
"An audit is <u>independent examination of financial information</u> of any entity, <u>whether profit oriented or not</u>, and <u>irrespective of its size or legal form</u>, when such an <u>examination is conducted</u> with a <u>view to expressing an opinion</u> thereon."

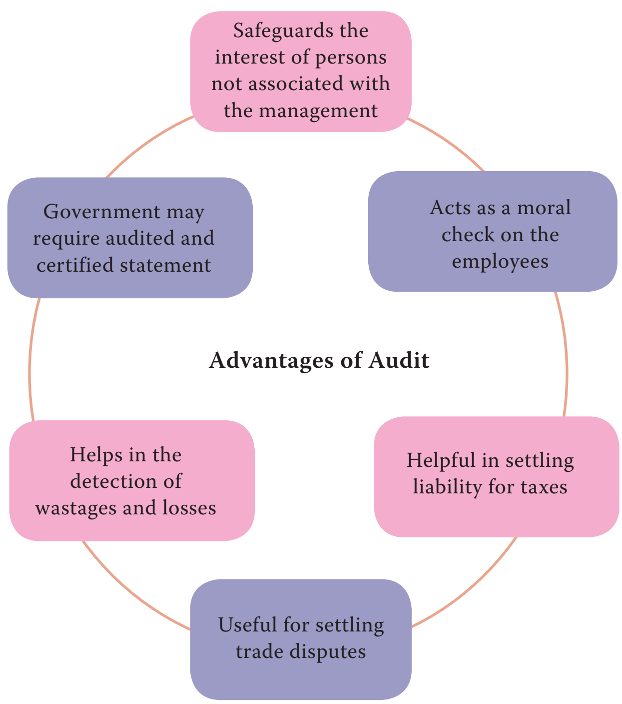


<u>SCOPE OF AUDIT</u>

- To form an opinion, ensure that the accounting information is reliable and sufficient i.e. basis for the preparation of the financial statements
- All aspects relating to Accounting and Finance of the enterprise to be covered
- Ensure whether the relevant information is properly disclosed in the financial statements
- Not to perform duties which fall outside the scope of his competence.
- Constraints on the scope of the audit that impair the auditor's ability to express an unqualified opinion should be set out in his report

Aspects to Be Covered In Audit





Inherent Limitations of Audit (SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"): The auditor is not expected to, and cannot, reduce audit risk to zero because there are inherent limitations of an audit. The inherent limitations of an audit arise from:

The Nature of Financial Reporting: The preparation of financial statements involves judgment by management.

The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence such as:

Possibility that management or others may not provide, intentionally or unintentionally, the complete information relevant for preparation and presentation of FS.	Fraud may involve sophisticated and carefully organised schemes.	An audit is not an official investigation into alleged wrongdoing.

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

Other Matters that Affect the Limitations of an Audit: Certain assertions or subject matters are particularly significant, such assertions or subject matters include:

- Fraud, particularly involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Relationship of Auditing With Other Disciplines

Types of Audit

Audit required under law: The organisations which require audit under law are the following:

(a) companies governed by the Companies Act, 2013;

(b) banking companies;

(c) electricity supply companies;

(d) co-operative societies;

(e) public and charitable trusts;

(g) corporations set up under an Act of Parliament or State Legislature.

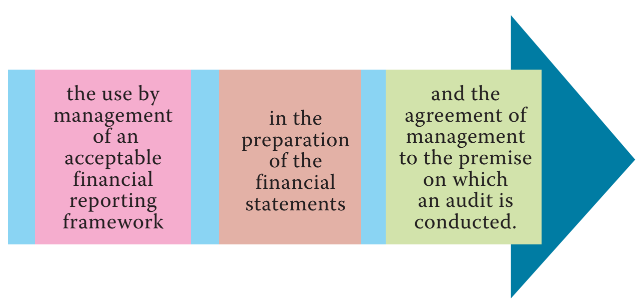
(h) Specified entities under various sections of the Income-tax Act, 1961.

In the voluntary category are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc.

Applicability of Engagement and Quality Control Standards

SAs	apply in the audit of historical financial information.
SREs	apply in the review of historical financial information
SAEs	apply in assurance engagements, dealing with subject matters other than historical financial information
SRSs	apply to engagements to apply agreed upon procedures to information and other related services engagements such as compilation engagements

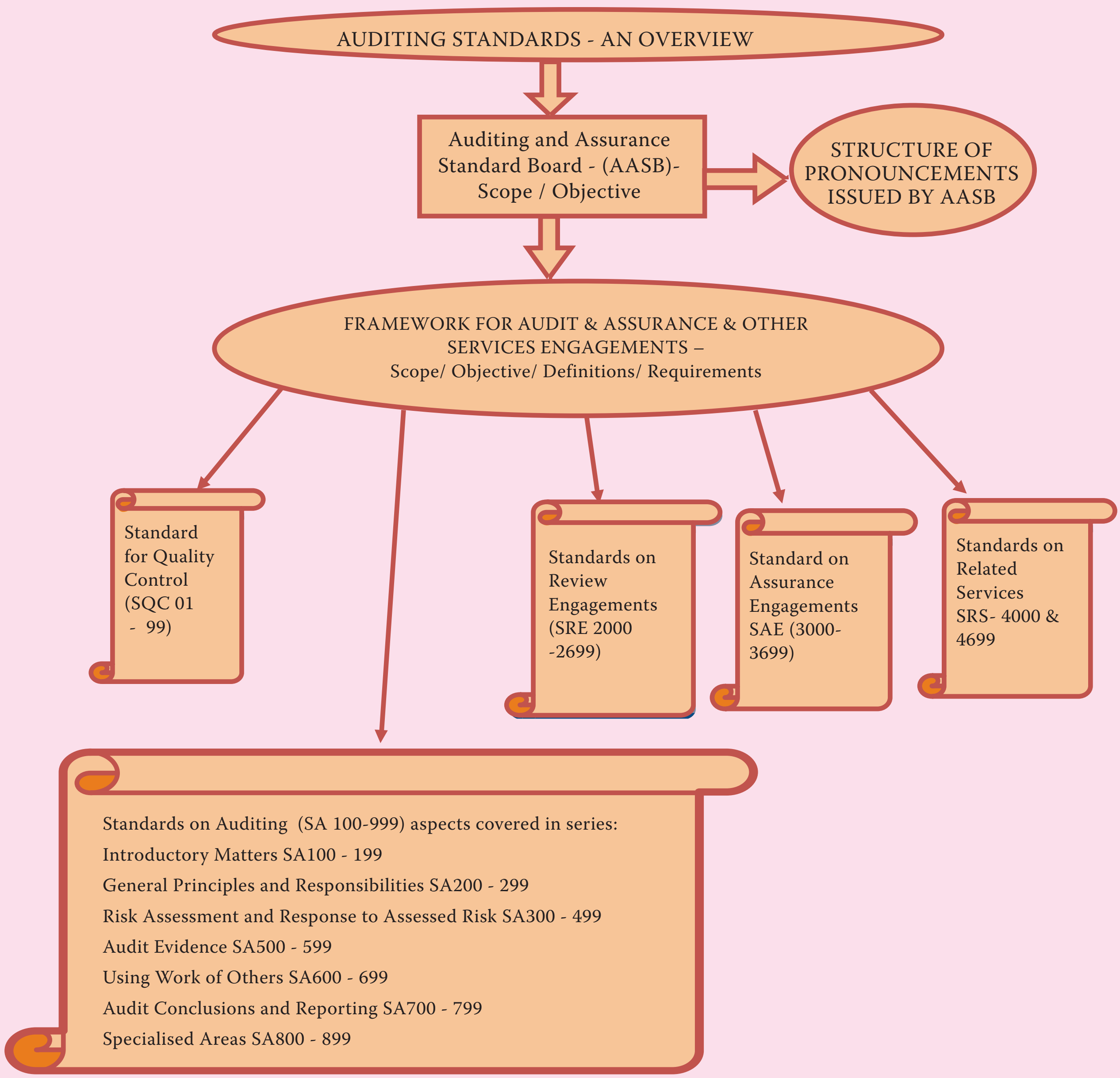
Preconditions for an Audit (SA 210 "Agreeing the Terms of Audit Engagements"):



International Auditing and Assurance Standards Board (IAASB): The IFAC Board has established the IAASB to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IAASB functions as an independent standard-setting body under the auspices of IFAC.

Auditing and Assurance Standards Board: ICAI is a member of the IFAC and is committed to work towards the implementation of the guidelines issued by the IFAC. ICAI constituted the AASB (erstwhile Auditing Practices Committee) to review the existing auditing practices in India and to develop Engagement and Quality Control Standards (erstwhile Statements on Standard Auditing Practices) so that these may be issued by the Council of the Institute.

Diagrammatic Representation of the Structure of Standards Under the New Preface



CHAPTER 2 : BASIC CONCEPTS IN AUDITING

<table>
<tr><td>Auditor's Independence</td><td>Independence is the keystone upon which the respect and dignity of a profession is based. Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self interest.


</td></tr>
<tr><td>True and Fair</td><td>The phrase “true and fair” in the auditor’s report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.</td></tr>
<tr><td>Accounting policies</td><td>Accounting policies refers to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.</td></tr>
<tr><td>Fundamental Accounting Assumptions</td><td>AS 1 states that fundamental accounting assumptions are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

Going Concern → Consistency → Accrual</td></tr>
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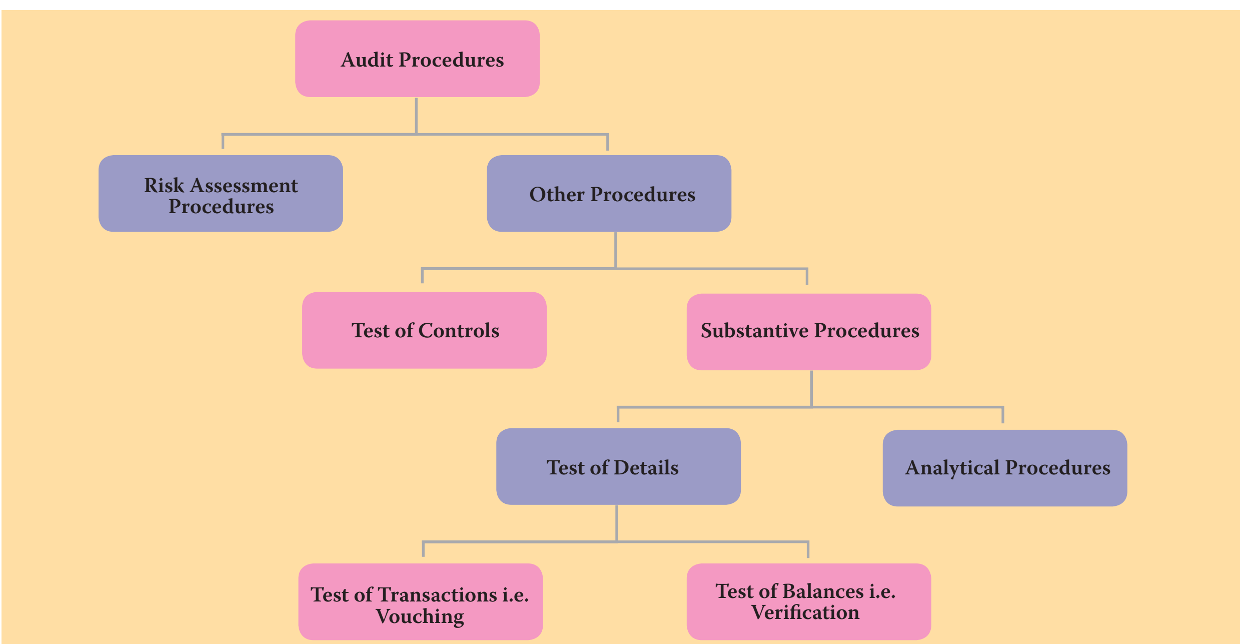
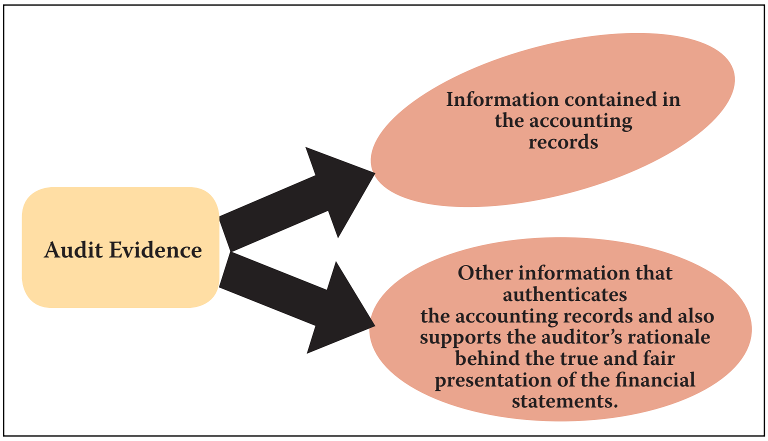
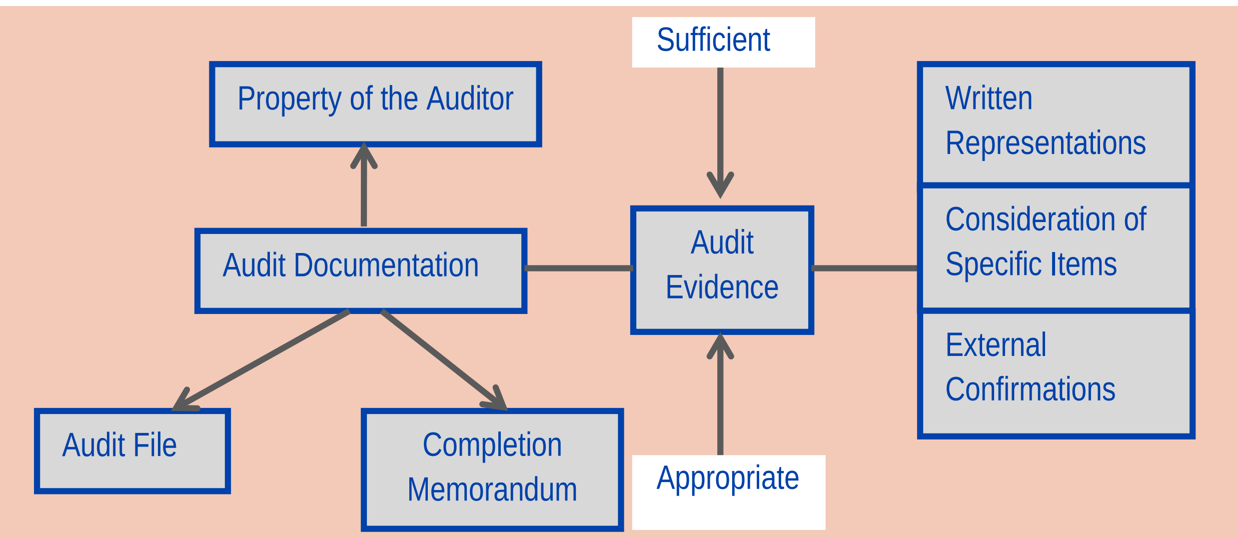


AUDIT EVIDENCE is information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit Evidence includes both information contained in the accounting records underlying the financial statements and other information.



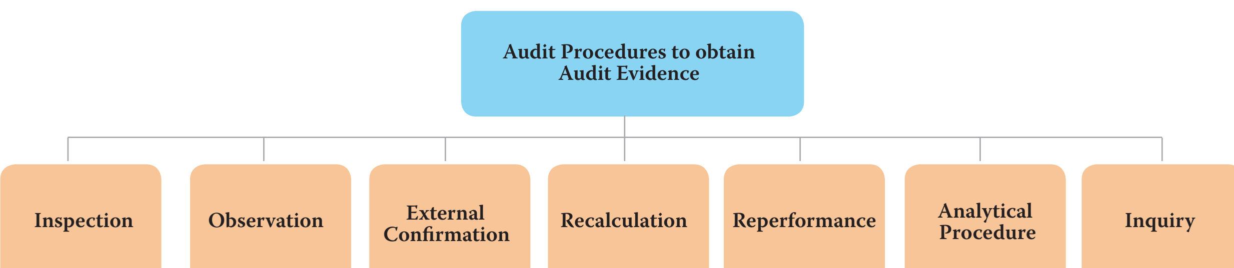


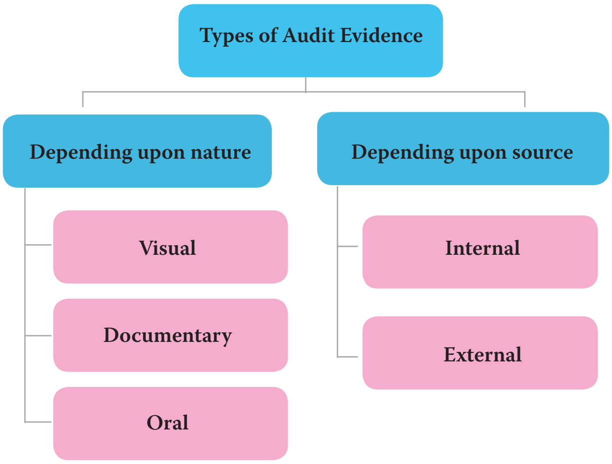
Auditor should obtain sufficient and appropriate audit evidence.
Sufficiency of audit evidence : Sufficiency is the measure of quantity of audit evidence. Auditor's judgment as to sufficiency may be affected by the factors such as :

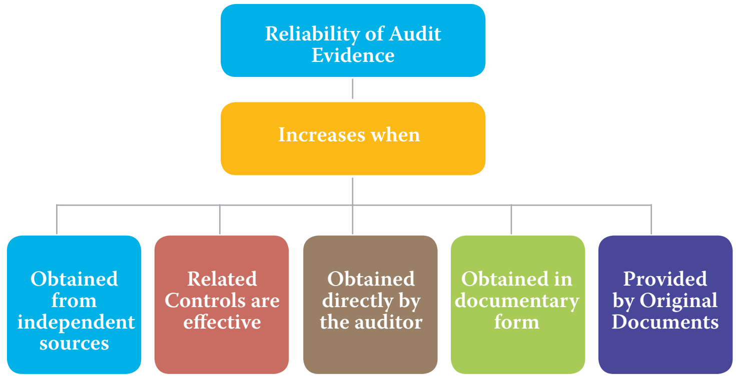
(i) Materiality	**(ii) Risk of material misstatement**	**(iii) Size and characteristics of the population.**

Appropriateness of Audit Evidence: Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

Audit Procedures to Obtain Audit Evidence: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

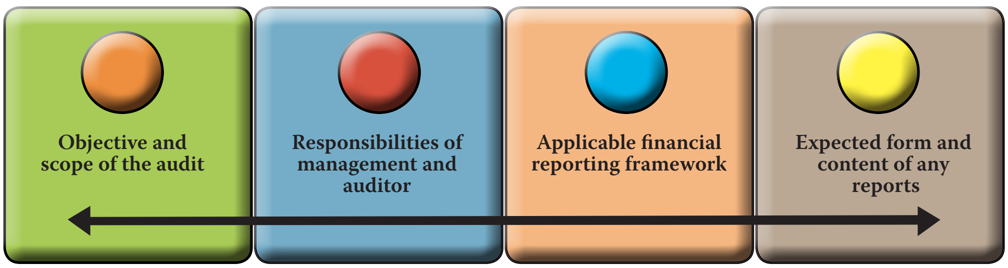






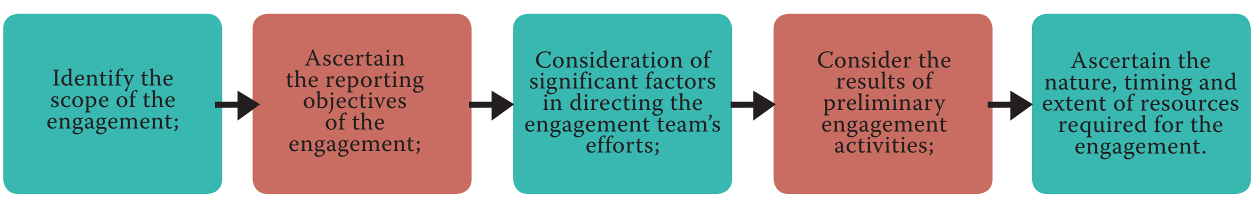
CHAPTER 3 : PREPARATION FOR AN AUDIT

Agreement on Audit Engagement Terms {(SA 210) agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement)} shall include:

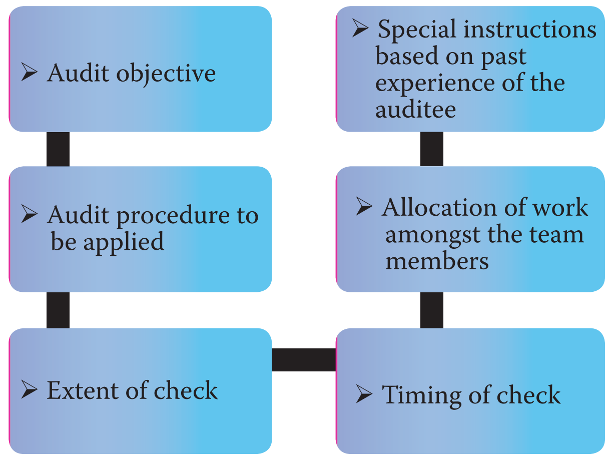


DEVELOPMENT OF AN OVERALL PLAN:	
➢ The terms of his engagement and statutory responsibilities. ➢ Nature and timing of reports. ➢ Applicable legal or statutory requirements. ➢ Accounting policies adopted by the client. ➢ Effect of new accounting or auditing pronouncements on the audit. ➢ Identification of significant audit areas. ➢ Setting of materiality levels for audit purposes. ➢ The degree of reliance on accounting system and internal control.	➢ Possible rotation of emphasis on specific audit areas. ➢ The nature and extent of audit evidence to be obtained. ➢ The work of internal auditors and the extent of their involvement. ➢ The involvement of other auditors. ➢ The involvement of experts. ➢ The allocation of work between joint auditors. ➢ Establishing and coordinating staffing requirements.

In establishing the overall audit strategy, the auditor shall:



AN AUDIT PROGRAMME is a detailed plan and consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements. For framing an audit programme, some points should be kept in view:



<u>Audit Techniques:</u> For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques

The two terms, procedure and techniques, are often used interchangeably. However, a distinction does exist. Procedure may comprise a number of techniques and represents the broad frame of the manner of handling the audit work; techniques stand for the methods employed for carrying out the procedure.

For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

AUDIT DOCUMENTATION (SA 230) refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (term such as "working papers" is also sometimes used).

Examples of Audit Documentation.

- Audit programmes.
- Letter of confirmation and representation.
- Correspondence (including e-mail) concerning significant matters.
- Checklists.

Form and Content of Working Papers depend on factors such as:
• Size and complexity of the entity.
• Nature of the audit procedures to be performed.
• Identified risks of material misstatement.
• Significance of the audit evidence obtained.
• Nature and extent of exceptions identified.
• Need to document a conclusion not determinable from audit evidence.
• The audit methodology and tools used.

Audit documentation serves a number of purposes:

- Assists the engagement team to plan and perform the audit.
- Assists team members to discharge their review responsibilities as per SA 220.
- Accountability of engagement's team.
- Record of future audits.
- Quality control reviews and inspections as per SQC 1.
- External inspections as per legal requirements.

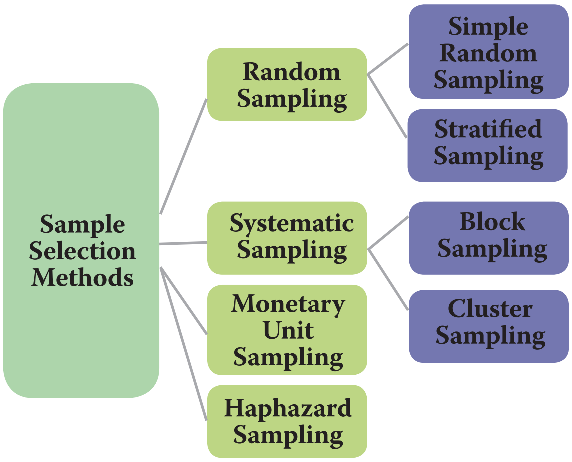
AUDIT SAMPLING (SA530) refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

Approaches to Sampling

- **Statistical Sampling**
- **Non-Statistical Sampling**

Statistical Sampling is more scientific than testing, based entirely on the auditor's own judgment as it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.

In Non-statistical Sampling approach auditor's opinion determines the sample size but it cannot be measured how far the sample size would fulfill the audit objective.



Random Sampling: Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables.

Systematic sampling: It involves selecting items using a constant interval between selections, the first interval having a random start.

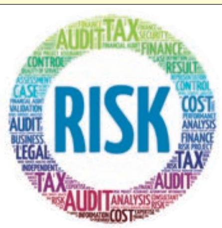
Monetary Unit Sampling: It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

Haphazard sampling: Auditor selects the sample without following a structured technique.

ADVANTAGES OF STATISTICAL SAMPLING IN AUDITING:

(1)	The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
(2)	The sample selection is more objective and thereby more defensible.
(3)	The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
(4)	It provides a means for deriving a "calculated risk" and corresponding precision (sampling error).
(5)	It may provide a better description of a large mass of data than a complete examination of all the data.

AUDIT RISK means the risk that the auditor gives an inappropriate audit opinion when the financial statement are materially misstated. SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.



Audit risk is a function of the risks of material misstatement and detection risk

Audit Risk = Risk of Material Misstatement x Detection Risk------(1)

Risk of Material Misstatement= Inherent Risk x Control Risk------(2)

From (1) and (2), we arrive at-

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

(A) **Inherent risk**—The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(B) **Control risk**—The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

(C) **Detection Risk:** The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Assessment of Risks - Matter of Professional Judgement

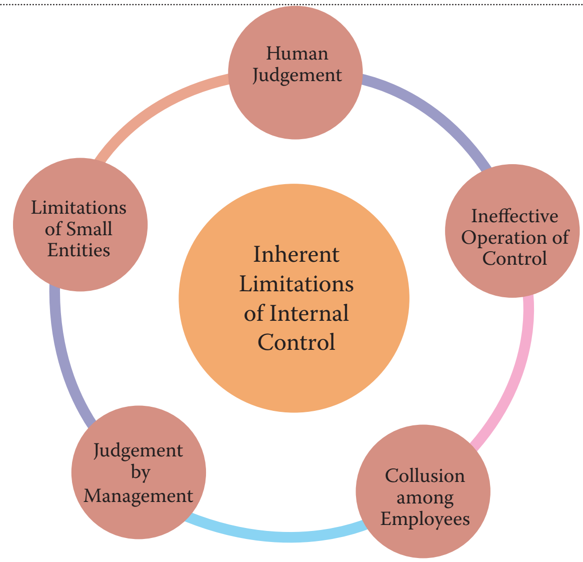
Surprise Checks: are a part of normal audit procedures. An element of surprise can significantly improve the audit effectiveness. Wherever practical, an element of surprise should be incorporated in the audit procedures. The element of surprise in an audit may be, both in regard to the time of audit, i.e. selection of date, when the auditor will visit the client's office for audit and selection of areas of audit.

Areas where Surprise Checks can Significantly Improve the Effectiveness of an Audit: Surprise checks constitute an important part of normal audit procedure. An element of surprise both with regard to the time of checking and selection of items, significantly improves the effectiveness of an audit. Normally, areas over which surprise check can be employed are-

(i) Verification of cash and investments.
(ii) Inventory.
(iii) Internal control and internal checks.
(iv) Books of prime entries and statutory registers, etc.

CHAPTER 4 : INTERNAL CONTROL

CONCEPT OF INTERNAL CONTROL: "The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control."



Benefits of IT in an Entity's Internal Control

- Processing of large volumes of transactions or data becomes simple
  - ❒ Enhances the timeliness, availability, and accuracy of information
- Facilitates the additional analysis of information
  - ❒ Enhances the ability to monitor the performance of the entity's activities and its policies and procedures
- Reduces the risk that controls will be circumvented; and
  - ❒ Effective segregation of duties through security controls

IT poses Specific Risks to an Entity's Internal Control

- Reliance on systems or programs processing inaccurate data
- Unauthorised access to data that may result in destruction of data
- Breaking down segregation of duties through access privileges
- Unauthorised changes to data in master files
- Unauthorised changes to systems or programs
- Failure to make necessary changes to systems or programs
- Inappropriate manual intervention
- Potential loss of data or inability to access data as required

Review of Internal Control with the help of

- **Narrative Record-** complete and exhaustive description of the system
- **Check List-**series of instructions and/ or questions
- **Questionnaire-** comprehensive series of questions
- **Flow Chart-** graphic presentation

INTERNAL AUDIT

"Internal Audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's risk management and internal control system."

Applicability of Provisions of Internal Audit: (section 138 of the Companies Act, 2013 & Rule 13 of Companies (Accounts) Rules, 2014) :	
(a) every listed company;	
(b) every unlisted public company having- (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or (ii) turnover of two hundred crore rupees or more during the preceding financial year; or	(iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
(c) every private company having- (i) turnover of two hundred crore rupees or more during the preceding financial year; or	(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

The auditor shall include significant deficiencies in internal control in written communication

- A description of the deficiencies and their effects; and
- Sufficient information to TCWG and management in this regard:
  - Purpose of audit
  - Consideration of internal control
  - Deficiencies reported and concluded are of sufficient importance to merit being reported to TCWG

CHAPTER 5 : VOUCHING

VOUCHING

The act of examining vouchers to establish the authenticity of the transactions with the relevant documentary evidence and the authority and to ensure the amount of voucher posting to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account.

On these considerations, the essential points to be borne in mind while examining a voucher are that the :

(i) date of the voucher falls within the accounting period;

(ii) voucher is made out in the client's name;

(iii) voucher is duly authorised;

(iv) voucher comprised all the relevant documents, i.e., the voucher is complete in all respects; and

(v) account adjusted as per voucher is disclosing the character of the receipts or payments posted thereto on its inclusion in the final accounts.

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

SALE OF SCRAP:
- Review the internal control as regards generation, storage and disposal of scrap.
- Check whether the organization is maintaining reasonable record for generation of scrap.
- Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- Check the rates at which scrap has been sold and compare the rate with previous year.
- Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- Ensure the existence of proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- Make an overall assessment of the value of realization from scrap as to its reasonableness

PURCHASE RETURN:
- Examine debit note issued to the supplier which in turn may be confirmed by corresponding credit note issued by the supplier acknowledging the same.
- Verify by reference to relevant corresponding record in good outward book or the stores records. Compare the figures in documentary evidence with the supplier's original invoices for rates and other charges and calculation should also be checked.
- Examine in depth to eliminate the possibility of fictitious purchase returns for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.
- Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

BAD DEBTS:
- Check that amount of bad debts should be traced to the schedule of bad debts written off during the year.
- Major amount of bad debts in the schedule be taken for scrutiny.
- Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files.
- Check the authority for write off and the level of authority is sufficiently higher than the executive involved in collection.
- The bad debts should be properly disclosed in Statement of Profit and Loss according to its materiality.
- If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released.

RENTAL RECEIPTS:
- Check copies of rent receipt issued to the tenant and bills of charges paid by the landlord on behalf of tenants.
- The entries in the rental register for accrued rent be traced with reference to rental bills copies.
- Scrutinize the account of collecting agent when the rent is collected by such agent.
- Vouch the entries for rent received in advance and ensure proper adjustment is made.
- Investigate into abnormal rent outstanding. Reconcile the outstanding rent and see that proper provision is made if unrecoverable.
- If rent is received net of TDS, see that rent income is shown at gross and TDS is shown in Balance Sheet as advance Tax.

AUDIT OF CASH TRANSACTIONS

General Considerations	Casting or Totalling:	Bank Reconciliation Statement
(i) Internal Control System. (ii) Correctness of book-keeping records. (iii) Observance of accounting principles. (iv) Evidence of Transactions. (v) Validity of Transactions. (vi) Disclosure in the Final Accounts.	Where totals of the cash book or the ledger are found to have been made in pencil, the book keeper should be asked to ink the totals before their verification has commenced.	Important accounting control. A copy of the statement duly signed by the accountant of the client after it has been checked, should be kept in record by the auditor along with other working papers, for future reference.

General Consideration while Vouching Trading Transactions are: (i) Correctness of book-keeping record (ii) Observance of accounting principles (iii) Checking of inventory and records
Cut-off Arrangement: It is the arrangement where the transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained.
Balance Sheet Audit: A Balance Sheet Audit consists of the verification of all includible Balance Sheet items, together with the examination of expense and income accounts which are so closely related to these items that it cannot be properly verified without such analysis and test.

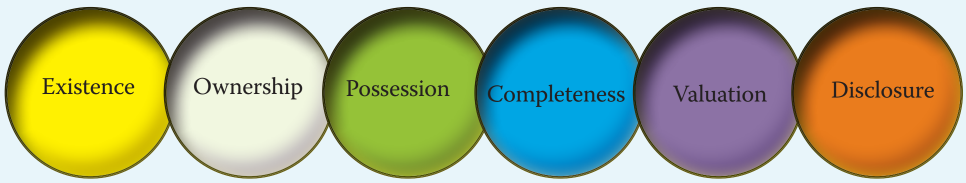
CHAPTER 6 : VERIFICATION OF ASSETS AND LIABILITIES

VERIFICATION: is a process to verify the ownership, valuation, possession and existence of a particular Asset or Liability.

Verification relates to the assets and liabilities appearing in the balance sheet.

Verification is generally carried out at the end of year.

To confirm the following for items relating to balance sheet.



Verification is based on observation as well as documentary examination.

Verification requires experienced people and done by the senior staff. Verification includes valuation.

TRADE PAYABLES
(i) Check the adequacy of cut off procedure to ensure that transactions of next period are not accounted and all transactions at year-end are accounted.
(ii) Check posting in the bought ledger from books of prime entry.
(iii) Compare the balances in the schedule of trade payables with balances in bought ledger.
(iv) Compare the balances with the confirmation or statement of account received from trade payables.
(v) Pay special attention to long outstanding items and enquire about the reason thereof.
(vi) Verify subsequent payments and reversal entries in the bought ledger of year-end entries.
(vii) See that trade payables are classified and shown in the balance sheet as per requirement of Schedule III to the Companies Act, 2013.

BANK BALANCES

Verify bank balance by reference to bank statements

Examine the BRS and verify whether cheques issued but not presented for payment, and cheques deposited for collection but not credited in the bank account, have been duly debited/credited in the subsequent period

Pay attention to outstanding items in the reconciliation statements for an unduly long period and required adjustment done for the same

Examine relevant certificates for fixed or other type of deposits duly supported by bank advices

Check the disclosure requirement in the form of Balance Sheet as per Part I of Schedule III

CHAPTER 7 : COMPANY AUDIT - I

Appointment of Auditor

Appointment of Auditor (Section 139)

- First Auditor
  - Other than Government Company [Section 139(6)]
    - Appointment by BOD - within 30 days from DOR → in case of failure: Members in EGM within 90 days.
    - Hold the office till the conclusion of the first AGM
  - Goverment Company defined u/s 2 (45) [Section 139(7)]
    - Appointment by C&AG within 60 days from the DOR → in case of failure BOD within 30 days → in case of failure Members in EGM within 60 days
    - Hold the office till the conclusion of the first AGM
- **Subsequent Auditor**
  - Other than Government Company [Section 139(1)]
    - Appointment by Members in GM
    - Hold the office from 1st AGM to 6th AGM subject to fulfillment of certain conditions
  - Goverment Company defined u/s 2 (45) [Section 139(5)]
    - Appointment by C & AG within 180 days from the commencement of year
    - Hold the office till the conclusion of the AGM

Eligibility, Qualifications and Disqualifications of an Auditor (Section 141 of The Companies Act, 2013)

Who can be appointed as an Auditor?

A person shall be **eligible for appointment** as an auditor of a company **only if he is a chartered accountant:** In case of a firm, whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Where a firm including a limited liability partnership is appointed as an auditor of a company, partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

DISQUALIFICATIONS OF AN AUDITOR :

Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 following persons shall not be eligible for appointment as an auditor of a company

(a) a body corporate other than a limited liability partnership registered under the LLP Act, 2008

(b) an officer or employee of the company;

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

(d) a person who, or his relative or partner -

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;(relative may hold security or interest in the company of face value not exceeding rupees one lakh the condition of rupees one lakh shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities. Student may note that the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.	(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh; 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, in excess of one lakh rupees.

(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 may be prescribed;

(f) a person whose relative is a Director or is in the employment of the Company as a director or Key Managerial Personnel.

(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 person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies

(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.

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

- Accounting and book keeping services;
- Internal audit;
- Design and implementation of any financial information system;
- Actuarial services;
- Investment advisory services;
- Investment banking services;
- Rendering of outsourced financial services;
- Management services; and
- Any other kind of services as may be prescribed.

Certain services not to be rendered by the Auditor as per section 144 of the Companies Act 2013

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above, 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.

Filling of casual vacancy {u/s 139 (8)}

- **Other Companies**
  - To be filled by BOD within 30 days
  - In case of resignation, appointment by BOD should be approved by Co. at GM
- **Govt Companies**
  - To be filled by C&AG within 30 days
  - ↓
  - In case of failure in above, BOD shall fill within 30 days

CEILING ON NUMBER OF AUDITS (Section 141(3)(G) of the Companies Act, 2013)

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 person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than rupees 100 crore, shall not be eligible for appointment as an Auditor of a Company.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

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

Rotation of Auditor (SECTION 139(2) ROTATION OF AUDITOR)

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies:-

Class of Companies for Rotation of Auditor
↓
including Listed Companies
+
excluding OPC (One Person Company) and Small Companies

- All unlisted public companies having paid up share capital ≥ ₹ 10 crore
- All private limited companies having paid up share capital ≥ ₹ 20 crore
- All companies having paid up share capital of below threshold limit mentioned, but having public borrowings from financial institutions, banks or public deposits ≥ ₹ 50 crore

Fraud Reporting
[Section 143(12) of Companies Act, 2013 & Rule 13 of CAAR, 2014]

Fraud involving amount of less than ₹ 1 crore

- **Auditor to Report Board/ Audit Committee**
  - Within 2 days of knowledge of fraud,

    Report the following matters:
    (a) Nature of Fraud with description;
    (b) Approximate amount involved; and
    (c) Parties involved.
- **Company bound to disclose certain specified details in Board's Report as:**
  (a) Nature of Fraud with description;
  (b) Approximate amount involved;
  (c) Parties involved, if remedial action not taken; and
  (d) Remedial actions taken.

Fraud involving amount of ₹ 1 crore or above

- **Auditor to Report Central Government in following manner:**
  - Within 2 days of knowledge of fraud,

    Report to Board/ Audit Committee
  - Seeking reply within 45 days
  - **Reply/observations received within stipulated time**
    - Forward Report+Reply/ observations+Comments to CG within 15 days of receipt of such reply/observations
  - **Reply/observations not received within stipulated time**
    - Forward Report+Note containing details of report for which failed to receive any reply/observations to CG

Rights of Auditor	Duties of Auditor
Right of access to books, etc. Right to obtain information and explanation from officers Right to receive notices and to attend general meeting Right to report to the members of the company on the accounts examined by him Right to Lien	Duty to Inquire on certain matters Duty to Sign the Audit Report Duty to comply with Auditing Standards Duty to report on S.S. Duty to report on frauds Duty to report on any other matter specified by Central Government Duty to state the reason for qualification or negative report

Basic Elements of the Auditor's Report: As per SA 700 "Forming an opinion and reporting on financial statements":

- Title
- Addressee
- Introductory Paragraph
- Management's Responsibility for the Financial Statements
- Auditor's Responsibility
- Auditor's Opinion
- Other Reporting Responsibilities
- Signature of the Auditor
- Date of the Auditor's Report
- Place of Signature

Types of Modified Opinions (SA 705)

- Qualified Opinion
- Adverse Opinion
- Disclaimer of Opinion

Auditor's Report is considered to be Modified when it includes

- Matters That Do Not Affect the Auditor's Opinion
  - Emphasis of matter
  - Other matter
- Matters That Do Affect the Auditor's Opinion
  - Emphasis of matter
  - Adverse opinion
  - Disclaimer of opinion

As per section 143 (3) of the Companies Act, 2013, the auditor's report shall state the matters relating to–		
(a) obtained all the information and explanations to the best of his knowledge and if not, the details thereof;	(d) balance sheet and profit and loss account are in agreement with the books of account and returns;	(g) any director is disqualified to be appointed as director;
(b) proper books of account as required by law have been kept by the company;	(e) financial statements comply with the accounting standards;	(h) any qualification, reservation or adverse remark relating to maintenance of accounts;
(c) whether the branch auditor's report has been sent to him and manner of dealing with that ;	(f) the observations or comments on matters which have any adverse effect on the functioning of the company;	(i) adequate internal financial controls system is in place and the operating effectiveness of such controls;
(j) such other matters prescribed in Rule 11 of the CAAR 2014 namely:-		
(i) disclosed the impact of pending litigations;	(ii) provided for material foreseeable losses	(iii) delay in transferring the amounts to IEPF Account

Reporting under Companies (Auditor's Report) Order, 2016 (CARO, 2016)

Applicability: CARO specifically **exempts**, a banking company, an insurance company, a company licensed to operate under section 8 of the Companies Act; a One Person Company and a small company and a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

Matters To Be Included In The Auditor's Report

Clause (i) (a) whether the company is maintaining proper records of fixed assets;

b) whether these fixed assets are physically verified; whether any material discrepancies, if any, have been properly dealt with;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

Clause (ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies, if any have been properly dealt with;

Clause (iii) whether the company has granted any loans to parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) 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;

Clause (iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

Clause (v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of the Companies Act, 2013 in this regard and the rules 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?

Clause (vi) whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

Clause(vii) (a)whether the company is regular in depositing undisputed 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 dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

Clause (viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported.

Clause (ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans 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;

Clause (x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

Clause (xi) whether managerial remuneration has been paid or provided in accordance with the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

Clause (xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

Clause (xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the F.S., as required by the applicable accounting standards;

Clause (xiv)	whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;
Clause (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 the Companies Act, 2013 have been complied with;
Clause (xvi)	whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

CHAPTER 8 : COMPANY AUDIT - II

Financial Statements as per section 2(40) of the Companies Act, 2013, includes

a) a balance sheet as at the end of the financial year;	(b) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;	(c) cash flow statement for the financial year;	(d) a statement of changes in equity, if applicable; and	(e) any explanatory note annexed to, or forming part of, any document referred above.

However, the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Section 129 prescribes norms for financial statements which are as under:

(i) Form of Financial statements [Section 129(1)]:The financial statements shall-

(a) give a true and fair view of the state of affairs of the company or companies

(b) comply with the accounting standards notified under section 133 and

(c) be in the form or forms as may be provided for different class or classes of companies in Schedule III

(ii) **Consolidated Financial Statements:** According to Section 129(3), where a company has one or more subsidiaries (including associate company and joint venture), it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Authentication of Financial Statements, {Section 134(1)} shall be approved by the board of directors before they are signed on behalf of the board at least by the following-

(a) The chairperson of the company where he is authorised by the Board; or

(b) By two directors out of which one shall be managing director and

(c) The Chief Executive Officer, if he is a director in the company,

(d) The Chief Financial Officer, wherever he is appointed; and

(e) The company secretary of the company, wherever he is appointed.

Verification of the Constitution and Powers - A company can function within the limits prescribed by the documents on the basis of which it has been registered. It is essential that the auditor, prior to starting the audit of a company, shall examine:

The Memorandum of Association;	The Articles of Association;	Contracts with vendors and other persons for purchase of property, payment of commission, etc.

CHAPTER 9 : AUDIT OF DIFFERENT TYPE OF ENTITIES

AUDIT OF GOVERNMENT EXPENDITURE is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

Audit against Rules & Orders: 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 regulations framed by the competent authority.

Audit of Sanctions: The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.

Audit against Provision of Funds: 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 appropriations made.

Propriety Audit: To ensure compliance with general principles of financial propriety and to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

Performance Audit: This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them.

Role of C&AG in the Audit of a Government company:

Audit of Government Companies

Role of C&AG is prescribed under sub-section (5), (6) and (7) of section 143 of the Companies Act, 2013.)

Section 143(5)

↓

Appointment of auditor by C&AG as per section 139(5) or 139(7)

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Directions by C&AG, the manner in which accounts shall be audited

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Submission of Auditor's Report to C&AG including-

* Directions issued, if any
* Action taken thereon
* Impact on Accounts

Section 143(6)

↓

C&AG's right to-

* Conduct supplementary audit
* Comment upon or supplement such audit report

Section 143(7)

↓

C&AG may, by an order, cause test audit

Audit of Different Entities

(major points that must be kept in mind while performing the audit of Educational Institution, Charitable Institutions, Cinema, Hospital etc., are:)

- Constitution of the organisation
  - Examine the constitution of the organisation.
  - Examine the bye laws or rules and regulations or trust deed.
  - Examine the powers of the members of the management and other officers.
  - Examine the minute books of managing committee and of members' general meeting as the case may be.
- Evaluate the internal Control System in the organisation.
- Examine the accounting policies followed and the accounting records maintained.
- Check the various receipts of the organisation in the form of fees, rent, income on investment, donations and grants.
- Check the various expenditures of the organisation like to staff, common expenses.
- Verification of assets and liabilities.

Special Points in Audit of a Partnership Firm:
Confirming that the letter of appointment signed by a partner duly authorised clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.
Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.
Verifying that the business in which the partnership is engaged is authorised by the partnership agreement.
Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.
Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like Section 44AB of the Income-tax Act, 1961 have been complied with.
Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

While planning the **Audit of a Non-Governmental Organisation (NGO)**, the auditor may concentrate on the following-

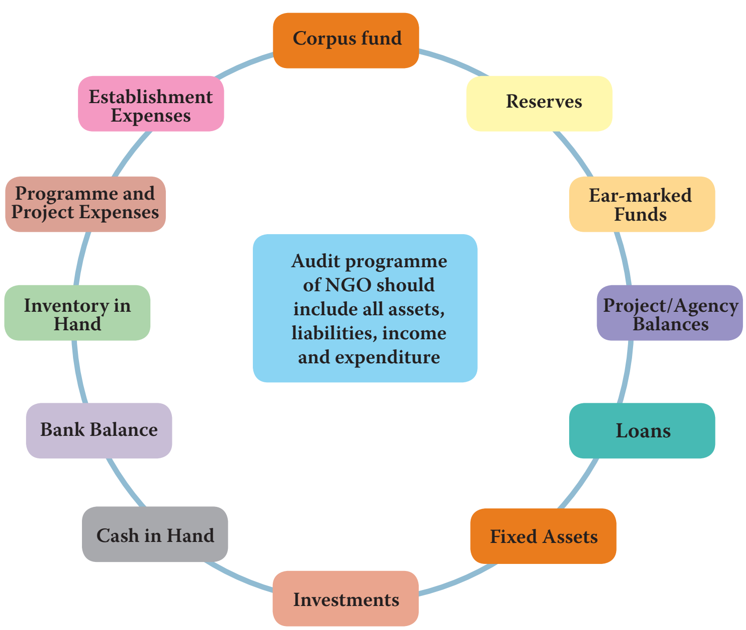
(i) Knowledge of the NGO's work

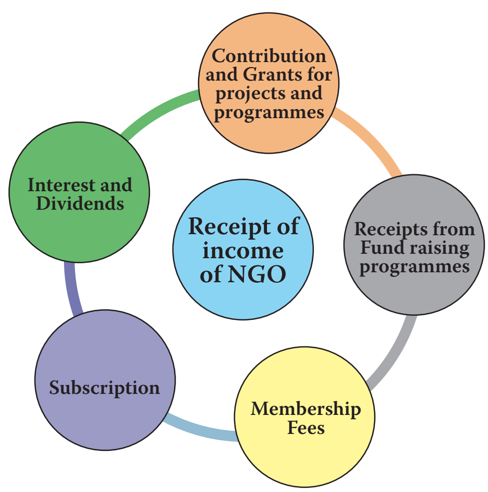
(ii) Reviewing the legal form of the organisation

(iii) Reviewing the NGO's Organisation chart, Manuals, Guidelines, etc

(iv) Examine minutes of the Board/Managing Committee/Governing Body/Management

(v) Study the accounting system, procedures, internal controls and internal checks





Accounting

Voluntary adoption of Integrated Reporting by Listed Entities

SEBI vide its circular no. SEBI/HO/CFD/CMD/CIR/P/2017/10February 6, 2017 has advised top 500 companies [to whom Business Responsibility Report ('BRR') have been mandated under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("SEBI LODR")], to adopt Integrated Reporting on a voluntary basis from the financial year 2017-18. The objective behind recommending voluntary adoption of Integrated Reporting is to improve disclosure standards. An integrated report aims to provide a concise communication about how an organisation's strategy, governance, performance and prospects create value over time so that interested stakeholders may make investment decisions accordingly.

The International Integrated Reporting Council ('IIRC') has prescribed Integrated Reporting Framework at following web link:http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf

The Framework prescribes the Guiding Principles which underpin the preparation of an integrated report, specifies the content of the report and its presentation. These are as follows:

- **Strategic focus and future orientation:**
  An integrated report should provide insight into the organization's strategy and how it relates to the organization's ability to create value in the short, medium and long term, and to its use of and effects on capital.

- **Connectivity of information:**
  An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time.

- **Stakeholder relationships:**
  An integrated report should provide insight into the nature and quality of the organization's relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

- **Materiality:**
  An integrated report should disclose information about matters that substantively affect the organization's ability to create value over the short, medium and long term.

- **Conciseness:**
  An integrated report should be concise.

- **Reliability and completeness:**
  An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.

- **Consistency and comparability:**
  The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization's own ability to create value over time.

- **Disclosure of various forms of capital:**
  IIRC has categorized following forms of capital to be disclosed to stakeholders to enable informed investment decision making as follows:
  - √ Financial capital
  - √ Manufactured capital
  - √ Intellectual capital
  - √ Human capital
  - √ Social and relationship capital
  - √ Natural capital.

The above information related to Integrated Reporting may be provided in the annual report separately or by incorporating in Management Discussion & Analysis or by preparing a separate annual report prepared as per IR framework.

In case the company has already covered the relevant information in any other report, it may provide appropriate reference to the same in its Integrated Report so as to avoid duplication of information.

The companies may also host the Integrated Report on their website and provide appropriate reference to the same in their Annual Report.

(Source: www.sebi.gov.in)