Unit 2 ❐ Planning and Programming of Audit

Structure

2.0 Objectives

After reading and studying this unit, the learner should able to

- Describe the elements, need, factors considered in the planning phase of the audit.
- State the feature of audit checklist.
- Know the concept of audit notes and audit working papers and their importance.
- Assess the extent of reliance that may be given on internal auditor, experts and other auditor and incidence of responsibility.

2.1 Introduction

This unit describes the matters an auditor considers in planning an audit. It explains the concept of audit notes and audit working papers and their usefulness. An auditor is generally required to depend on reports given by other auditors in respect of the enterprise under audit and sometimes he also takes advice from the experts in other fields. All these aspects have been considered in this unit systematically keeping in view the requirements of the relevant auditing and assurance standards.

2.2 Audit Planning

In order to conduct an audit effectively and efficiently, the work needs to be properly planned and controlled. The way in which the audit is conducted will vary depending on the type, size and circumstances of the particular client.

As per AAS-8, Audit Planning refers to the planning made by the auditor which enables him to conduct an effective audit in an efficient and timely manner.

AAS-1 prescribes planning as one of the basic principles of auditing which govern the auditor's professional responsibilities in carrying out the audit.

2.2.1 Need for planning

According to this standard, adequate audit planning helps to ensure that:

a) Appropriate attention is devoted to important areas of the audit.
b) Potential problems are promptly identified.
c) Work is completed timely.
d) Assistants are utilised properly.
e) Proper coordination of work done by other auditors and experts.

2.2.2 Steps/Elements of planning

Audit planning involves the following steps:

i) Developing the overall plan.

In developing the overall plan for the expected scope and conduct of the audit the auditor should consider the following matters:

- The terms of his engagement and any statutory responsibilities.
- Nature and timings of the report.
- The applicable laws and statutory requirements.
- The nature and extent of audit evidence to be obtained.
- Degree of reliance he expects to place on internal control system.
- Scope and work of internal auditor.
- The accounting policies adopted by the client and changes in those policies.
- The allocation of work to be undertaken by joint auditors.
- The involvement of experts.
- Establishing and coordinating staffing requirements.
- Setting of materility levels etc.

ii) Acquiring knowledge of the client's accounting systems, policies and internal control procedure.

iii) Obtaining knowledge of client's business. The auditor needs to obtain a level of knowledge of the client's business for efficient conduct of an audit. It helps him to make judgement about the financial information. He can acquire the knowledge about client's business from the following sources:

- Client's annual report to shareholders.
- Minutes of the shareholders, Boards of directors and other important committees.
- Discussion with clients.
- MIS Report.
- Previous year's audit working papers.
- Accounting manual and procedure manual.
- Visit to client's premises and plant facilities.
- Internal auditor's report.

Relevant publications of the Institute of Chartered Accountants of India and other professional bodies, industry, publications, trade journals, magazines, newspapers, text books.

iv) Developing the audit programme

An audit programme contains the details of audit procedure that are needed to impliment the audit plan. It mentions the steps which are to be carried out in conducting the audit including the name of the staff who will conduct the audit. It helps in controlling the execution work and specifies the following matters:

- Area of audit.

- Extent of checking.
- Details of staff with their assignments.
- Projected hours for the work.
- Checklist for audit procedure of different items.
- Checklist of auditing standards.
- Physical varification of various assets.
- Confirmation of balance and other methods of audit evidence.
- Experts to be coordinated.
- Partner in charge of the audit.

Checklist for statutory, legal compliances etc.

v) Review of the plan

The audit plan should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

2.2.3 Factors to be considered in planning an audit

The auditor may discuss the elements of his overall plan and certain audit procedure with the client to conduct the audit most efficiently and also to coordinate the audit procedure with the work of the client's personnel. In planning the audit, the auditor should consider factors such as complexity of the audit, the environment in which the enterprise operates, his previous experience with the client and knowledge of the client's business.

2.3 Audit Notes

During the course of audit the auditor has to come accross several difficulties or new points which may require discussion with the senior officials of the entity/client. Audit notes represents within record of the question made and replies required thereto. This may be of great help to the auditor preparing his audit report. If notes have been properly made through the books known as "Audit Note book", it may of great value to the auditor later on, in case a suit is filed against him for negligence or misfeasance. These notes will be considered as documentory evidence in favour of the auditor even after several years by which time the auditor might have forgotten everything about that particular audit. These notes should be clear, concise and complete so that it facilitate the audit of the accounts of the same concern next year. Some of the important matters which are noted down in an Audit Note Book are given below :-

1. List of Books of Accounts maintained by the client.
2. The points which requires further clarification and explanations.
3. Particulars of missing vouchers.

4. Mistakes and errors discovered.
5. The points which will be incorporated in the audit report.
6. Any matters which requires further discussion with the appropriate authorities.
7. Details of non-compliance, if any, as regards AS, Companies Act and other statutory and legal requirements.
8. observation towards physical verification of fixed assets and inventories.

2.4 Working Papers

Working papers are records kept by the auditor of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in the engagement. For auditors to conduct their audit properly and provide adequate support for their opinion, they must prepare audit working papers.

Although the term working papers suggests paper document, much audit evidence now exists in electronic files. A number of accounting firms are now developing paperless auditing systems. The term working papers is used here to include all audit documentation, both electronic and paper.

AAS-1, Basic Principles governing an audit, requires that the auditor should document matters which are important in providing evidence to ensure that the audit was carried out in accordance with the basic principles. So, their standard requires that the auditor must maintain adequate working papers.

AAS-3, Documentation, deals with the need, design, preparation, contents and custody of working papers and provides the following.

2.4.1 Need and importance

Audit working papers constitute the auditor's evidence of the work performed. They may be either helpful or detrimental if problems subsquently arise concerning the audited financial statements. They will become the most important documents envolved in any subsequent litigation. It facilitates supervision and review of the audit work and helps in planning and performance of the audit.

2.4.2 Design and preparation of working papers

Working papers should be properly designed and arranged so that it can meet the circumstances of each audit and the requirements of the auditor in respect thereof. The organisation of working papers in a standarised manner enhances the efficiency with which they are prepared and reviewed. Working papers should contain sufficiently complete and detailed information to facilitate an auditor to obtain an overall understanding of the audit. Although the extent of documentation is a matter of

professional judgement but it is to be ensured that all significant matters which require the exercise of judgement, together with the auditor's conclusion thereon, must be included in the working papers.

2.4.3 Contents of working papers

Working papers should state
(a) Nature of engagement.
(b) Client's name.
(c) nature and complexity of the client's business.
(d) Sources of information.
(e) Form of the auditor's report.
(f) Nature and condition of the client's records.
(g) Degree of reliance on internal control.
(h) Supervision and review of work performed by assistant.
(i) Conclusions reached.

2.4.4 Types of working papers

Auditors normally maintain two types of working paper files one is referred to as a permanent or continuing audit file, and the other one is called current audit file.

Permanent audit file

The permanent audit file is composed of documents, schedules, and other data that will be of continuing significance to several years' audit. It generally includes the following :–

- Memorandum and article of association of the company.
- Extracts from or copies of important legal documents, agreements and minutes relevant to the audits on an ongoing basis.
- Record of study and evaluation of internal control.
- Record of communication with the previous auditor, if any.
- Copies of letters issued by the auditors to the management as regards weaknesses of internal control along with suggestions for improvement.
- Copies of audited financial statements of the previous year.
- Notes regarding significant accounting policies.
- Significant audit observations of earlier years.

Current audit file

The current audit files for each year contain the evidence gathered and the conclusions reached in the audit for that year. It normally includes the following -

- Correspondence relating to acceptance of annual appointments.
- Extracts of the minutes of board of directors and general meeting which are relevant to the audit.
- Audit programme.
- Evidence that work performed by the assistants was supervised and reviewed.
- Communication with client regarding audit matter.
- Letters of representation and confirmation from clients.
- Conclusions reached about significant aspects of audit.
- Copies of the financial information being reported on and the related audit reports.

Ownership and custody of working papers

Working papers prepared by an auditor in connection with the audit of a client's financial statements are generally the property of the auditor. Auditor may at his discretion can make the working papers available to his client. Unauthorised access to working papers must be prevented to maintain confidentiality of client's business.

2.5 Reliance on the work of an internal auditor

AAS-7, "Relying upon the work of an Internal Auditor", provides guidance as regards the procedures which should be applied by the external auditor in assessing the work of the internal auditor for the purpose of placing reliance upon that work.

This standard states that while the external auditor has the sole responsibility of his report however, much of the work of the internal auditor may be useful for the determination of the nature, timing and extent of the auditing procedure required in this examination of financial information.

The external auditor evaluates the internal audit function to the extent he considers necessary for the determination of the nature, timing and extent of his compliance and substantive procedure.

General evaluation of the internal audit function will assist the external auditor for determining the extent of reliance upon the work of the internal auditor. But the most important thing is that the responsibility of external auditor is not reduced by any means because of the reliance he places on the internal auditor's work. The external auditor should document his evaluation and conclusions in this report. In this context the important factors which must be considered by the external auditor are;

a) Organisational status.
b) Scope of function.
c) Technical competence.
d) Due professional care.

2.6 Reliance on the work of an expert

AAS-9, "Using the work of an expert", states the responsibility of an auditor in relation to, and the procedures the auditor should consider in, using the work of an expert as audit evidence.

The auditor while performing the audit work sometimes uses the work performed by the expert and also takes into account if necessry, the views of the expert in forming and expressing his opinion on the financial statement. However, he will be entitled to rely on worked performed by other auditors and experts provided he exercises adequate skills and care as is stated in AAS-1.

2.6.1 Evaluating the work of an expert.

The auditor should evaluate the work of an expert before acquiring it as audit evidence with reference to the following points:

- Professional qualification of the expert.
- Independence and objectivity of the expert.
- Experiance and reputation of expert.
- Expert's relationship with the client, if any.
- Assumptions/Method used by the expert on deriving the conclusion.
- Result of the expert's work in the light of auditor's overall knowledge of the business.

2.6.2 Auditors liability towards the use of work performed by an expert.

The auditor is entitled to rely on the work performed by the expert provided he exercises adequate skill and care. He cannot shift his liability on the ground that he had relied on the work of an expert. He continues to be responsible for forming and expressing his opinion on the financial statement.

2.6.3 Work of an expert and the auditor's report

On evaluation of the work of an expert, the auditor may opine that the work of the expert is inconsistent with the information in financial statements or the work does not constitute sufficient audit evidence as the expert refuses to disclose sources of the data used by him.

The auditor, in that case, should express qualified opinion or a disclaimer of opinion or adverse opinion as may be considered appropriate.

2.7 Reliance upon the work of another auditor

AAS-10, "Using the work of another auditor", prescribes the responsibility of the

principal auditor in relation to his use of the work done by the other auditor.

When one auditor does not audit the whole of the entity then for auditing the different branches situated at different locations other auditors are appointed, called as Branch auditors and the auditor who reports to the owners of the entity is called principal auditor. In such situations the branch or divisional auditor reports to the principal auditor and the principal auditor reports to the shareholders of the entity on total financial statements including these branches audited by others.

2.7.1 Audit procedure for using the work of other auditor

The principal auditor should follow the following procedure :

(i) The principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of ICAI.

(ii) Coordination with other auditor while planning the audit work.

(iii) Discussion with other auditor.

(iv) The principal auditor should consider the significant findings of the other auditor.

(v) Advise other auditor as regards significant accounting, auditing and reporting requirements.

(vi) The principal auditor through performing various audit procedures should obtain sufficient appropriate audit evidence that the work of other auditor is adequate for principal auditor's purpose in the context of the specific assignment.

2.7.2 Responsibility of Principal and other auditor

When the principal auditor makes his opinion about the financial information of an entity after relying upon the statements and reports of the other auditors, his report should clearly mention the division of responsibility for the financial statement. The report of the principal auditor must indicate the extent to which the financial statement audited by the other auditor have been included in the total financial statement of the entity. e.g., the number of branches audited by other auditor. The principal auditor can not be made responsible in respect of the work performed by the other auditors except in circumstances which should have aroused his suspicion about the reliability of the work done by the other auditors.

2.7.3 Reporting considerations

When the principal auditor based on his audit procedures concludes that the work of the other auditor cannot be used and he has not been able to perform sufficient audit procedure in respect of the financial information of the division audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of the audit.

2.8 Questions

1. What is an audit planning? What are its need?
2. State the steps in audit planning.
3. Is it necessary for an auditor to make notes in course of the conduct of an audit? Comment.
4. What do you mean by audit working papers?
5. What information would you expect to see on a permanent audit file of a limited company.
6. What are the contents of audit working papers ? Who can claim the ownership of these papers.
7. What is the general principle as envisaged in AAS-10, regarding the reliance to be placed by the principle auditor on the work of the other auditor?
8. State the provisions of respective AAS in respect of the following :
   (1) Reliance on the work of an internal auditor.
   (2) Reliance upon the work of an expert.
9. Discuss how far the external auditor can depend upon the work of the internal auditor ?

Unit 3 ❐ Evaluation of Internal Control System and Internal Audit

Structure

3.0 Objectives

After reading and studying this unit, the learner should able to

- Understand the nature and scope of Internal Control System.
- Know the need for evaluation of Internal Control System and the technique for such evaluation.
- Prepare the internal control questionnaire and flow-charts.
- Describe the concept of internal audit and its importance in the present day business environment.
- State the role of audit committee.

3.1 Introduction

This unit deals wih the definition, nature, scope and objectives of internal control system. In view of the importance of the system of internal control as the basis for determining the extent of the audit tests the auditors are always interested in the operations of accounting and internal control systems. In line with this, the evaluation of internal control system have been discussed in detail as to its need, stages and techniques. Concept of internal audit including its scope, need, objectives are elaborately stated. It also describes the Audit Committee and its role as per the requirements of SEBI and Companies Act.

3.2 Internal Control

Internal Control is one of the basic factors in the management of an organisation. It may be compared with the nervous system of a human body as it governs all operations and policies and keep them within practicable performance ranges. It is the primary responsibility of every management that they should establish and maintain sufficiently adequate system of internal contol commensurate with the size and nature of the business.

3.2.1 Definition of internal control

According to AAS-6, "Risk Assessments and Internal Control", Internal Control System means all the policies and procedures (Internal controls) adopted by the management of an entity to assist in achieving managements objective of ensuring, as far as practicable,-

- the 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 financial information.

Internal control is a process effected by an entity's board of directors, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories :-

(a) Reliability of financial reporting.

(b) Compliance with applicable laws and regulations.

(c) Effectiveness and efficiency of operations.

3.3.2 Objectives

The management of an entity determines the objectives of internal control system taking into consideration the nature of the business, scale of operations, degree of profesionalisation of the management, etc. AAS-6 specefies the following objectives of internal controls relating to the acounting system.

1. Transactions are executed with management's general or specific authorisation.
2. Assets and records are safeguarded from unauthorised access, use or disposition.
3. All transactions and other events are promptly recorded in an appropriate manner that may facilitate preparation of financial statement as per applicable laws, policies, standards and help in maintaining accountability for assets.
4. Assets are physically verified at reasonable intervals and appropriate action is taken with regard to any differences.

3.2.3 Scope of internal control

According to the council of the Institute of Chartered Accountants of England and Wales, "Internal Control means the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records."

Thus, the scope of internal control extends beyond accounting controls and includes all operational controls such as -

- Quality Controls
- Work Standards
- Projectory Controls
- Periodic Reporting
- Policy appraisal
- Quantitative Controls etc.

AAS-6 recognises that internal control system extends beyond these matters which

relate directly to the functions of accounting and finance departments and includes control envorinment and control procedures. Control environment basically reflects management phylosophy and attitude. Control procedure are the policies and procedure established by the management to achieve the entity's specific objectives.

The term internal control may be classified into two broad categories, i.e. accouniting controls and administration controls. Accounting controls implies the plan of organisation and the procedure and records that are concerned with the safeguarding of assets and the reliability of financial records. Such controls ensure that transaction have been executed with proper management's authorisation, the assets are properly maintained and financial records are in comformity with GAAP. Administrative controls comprise all other controls concerned with decision making process leading to management's authorisation of transactions. An auditor primarily reviews the accounting controls as it has direct and significant bearing on the reliability of financial statements and evaluates only those administrative controls which have a bearing on the reliability of the financial records.

3.2.4 Need for evaluation of internal control

The evaluation of internal control is fundamental to an audit. AAS-1, 'Basic Principles governing an Audit', states that the auditor should have an understanding of the accounting system and related internal controls. It also requires that the auditor should study and evaluate the operation of these internal controls. It is on the basis of this evaluation the auditor

a) Determines the nature and extent of his audit procedures.

b) Drafts his letter of weakness, drawing the attention of management to weakness in the system.

The enormous growth in size and complexity of modern business organisations also require an effective system of internal control as it is not possible by the auditor to verify the large number of transactions of an organisation due to time and resource constraints. Remarkable development in the field of information technology and its increasing use in maintaining of accounts has enhanced the need for evaluation of internal control system in an organisation. EDP system of accounting has changed the flow of documents and transactions. The auditor may not have the intermediary documents and links required for audit and in such a situation he has to rely largely on the in-built control in the system.

3.2.5 Stages in evaluation of accounting and internal control systems

AAS-6 prescribes the stages involved in the evaluation of accounting and internal control systems. These stages help the auditor to assess control risk.

The stages are stated below:

1. Understanding the system:

The auditor should obtain an understanding of the accounting system sufficient to identify and understand:

a) Major classes of transactions in the entity's operations:

b) How such transactions are initiated

c) Significant accounting records. Supporting documents and specific accounts in the financial statement; and

d) the accounting and financial reporting process from the initiation of significant transactions and other events to their inclusion in the financial statements. At this stage the auditor should develop an integrated understanding of the accounting and internal control system sufficient to make an overall audit plan. The auditor should also obtain an understanding of the control environment sufficient to assess managements attitude, awareness and actions regarding internal controls and their importance in the entity. Understanding of the systems is obtained in the following ways:

- Previous experience with the entity
- Discussions with the personnel at different levels
- Going through the documents like organisation charts, procedure manuals, job descriptions, systems description and flow charts
- Inspection of documents and records
- Observations of the entity's activities and operations including computer operations and data procesing.

2. Assessment of control risk

After obtaining an understanding of the accounting system and internal control system, the auditor should make preliminary assessment of control risk for each material account balance or class of transactions.

The assessment of control risk is the process of evaluating the likely effectiveness of an entity's accounting and internal control systems in preventing or detecting and correcting material misstatements.

3. Tests of control

The auditor should obtain audit evidence through tests of control to support any assessment of control risk which is less than high. The lower the assessment of control risk, the more evidence the auditor should obtain that accounting and internal control systems are suitably desgined and operating effectively.

Control risk is the risk that internal control structure will fail to detect errors equal to the tolerable limit. For example suppose it is system of the organisation that whenever an employe goes on tour taking advance the same is debited to staff advance account

in which other advances like car advance, festival advance is also debited. On submission of travelling expenses after completing the tour, staff advance account is adjusted and the amount is charged to travelling expenses account. In this system of internal control of travelling advance there is possibility that it will remain unadjusted and not debited as travelling expense if the employee does not submit or forget to submit the travelling bill. Thus there is a risk that travelling expenses of a particular period may be understated materally. It is a kind of control risk because internal control system may fail to detect the understatement of travelling expenses.
Tests of control is the process of obtaining evidence that accounting and internal control system designed by the management is working effectively throughout the year. It may include

- Inspection of documents, supporting transactions and examining in depth with regard to procedural and control aspects.
- Inquiries about and observation of internal controls which have no audit trail.
- Re-performance of internal control (for example reconciliation of bank accounts)
- Testing of internal control operating on specific computerised applications (for example, access or program change controls)

4. Documentation

The auditor should document in the audit working papers:

a) the understanding he has obtained in the entity's accounting and internal control system and

b) the assessment of control risk.

If the assessment of control risk is less than high the auditor should also document the basis of such conclusion. The form, extent and design of documentation depends on the size, complexity of the entity as well as the nature of accounting and internal control system prevailing in the entity.

5. Communication of weaknesses

The auditor should communicate to the management, at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to his attention. The communication of weaknesses to the management would generally be in writing but if the auditor consists appropriate oral communication may be done but in that case such oral communication must be documented in the audit working papers.

3.2.6 Techniques for evaluation of internal control system

For evaluation of internal control system different techniques are used. Selection of a particular technique depends on the auditor's judgement. Two most common techniques of internal control evaluation are internal control quastionnaires and flow charts.

Flowcharts

Flowcharts are graphic descriptions of the information flow in a system. It helps to obtain a visual overview that may not be acuired from reading a narrative description of that same system. Thus, the auditor can often see control procedure in the system design more quickly and easily.

Flowcharts can be obtained from the client's personnel, if available, or the auditor can create them from observations, questions, and other available information.

Well-designed flowcharts should have the following **advantages:**

(1) The diagrammatic presentation of a complex system should be easier to comprehend than narrative ratio. This is of great value to members of the auditor's staff coming onto the audit for the first time;

(2) In order to depict the system in this form, the auditor is compelled to understand it fully.

(3) Each part of a complex system can be fully depicted by breaking the system down into a large number of seperate charts. These charts can be cross-referenced to each other to show the connection betwen different parts of the system.

(4) The depiction of the system in diagrammatic form should make the absence of controls or checks that the auditor would expect to find readily apperent.

(5) It helps the auditor to analyse the system to find out how effectively it works and to detect easily the weaknesses in the system.

(6) It enable an auditor to record information regarding systems accuracy and comprehensively.

The following **problems or limitations** relating to flowcharting should be recognised:

(1) If flowcharts are used in relation to small enterprise with simple acounting systems, they may well involve cost and effort out of proportion to the benefit.

(2) Audit staff must be properly trained to prepare and interpret them, and standard charting techniques must be in use throughout a term; and

(3) They do not indicate all the internal controls in operation, particularly those relating to the custody of assets. This is not a disadvantage provided they are used in combination with an internal control questionnaire or equivalent checklist to which they are referred.

Internal Control Questionnaires (ICQ)/checklists:

An internal control questionnaire (ICQ) is basically a comprehensive list of questions that an auditor may ask in order to assess the existance and efficiency of an internal control system. It is considered to be the most convenient method of collecting information regarding the internal control system and since it is pre-designed, it can ensure coverage of all aspects of control. To facilitate the assessment the questions are asked in a form that the answer can be given by merely ticking the appropriate word (yes/no/not applicable). There must be sufficient space below each question so that answer can be

amplified where necessary. The list of questions must be logical and should follow a sequential pattern. Whichever method is followed, care must be taken to ensure that answers given truly represent the system as it actually exists. This should be done by means of observation, and by listing a limited number of items through the system, known as "work-through checks". It can be kept in audit working papers as a record of the auditor's evaluation of the internal control system.

An illustrative questionnaire regarding wages and salaries is given below although it is not possible to establish a comprehensive standards of internal control as it varies in different business situations.

Internal control questionnaire
Wages and salaries

1. Who has authority?
   (a) to engage
   (b) to dismiss employees?
2. Are history cards maintained of all employees, containing the employee's signature?
3. Who authorises (a) overtime and (b) general and individual increase in pay?
4. Is such authority always evidence in writing?
5. Is the person with such authority seperate from the salaried personnel?
6. What records are maintained in respect of:
   (a) time work
   (b) piece-work?
7. How are piece-work quantities checked and how is partly finished work dealt-with at the end of each week?
8. If job cards or piecework cards are produced, who authenticates these?
9. Are these authenticating records on the shop floor independent of the wages department?
10. Who prepare the payroll?
11. Is the work so allocated that no one aspect of the compilation of the payroll is carried out completely by one member of staff?
12. Is the payroll checked periodically with the history records as to names and details of payment?
13. Is this carried out by a person independent of those preparing the payroll?
14. Are all calculations and additions checked independently?
15. Is the payroll authorised by a responsible official when completed and before the cheque is drawn?
16. How are wages packets prepared? Is the cash counted twice by independent persons before putting it in the envelopes? Are there automatic reconciliations of cash drawn and cash put in wage packets?

1. Are wages disbursed on fixed days and timings?

18. Are those who distribute wages independent of those who prepare the payroll?

19. Is authority in writing required before a representative of an employee is paid?

20. Are proper identifications and receipts procured before disbursement of wages.

21. What arrangements are in force to deal with any disagreement as to the amount paid out?

22. When are unclaimed wages recorded?

23. Who retains unclaimed wages?

24. How long are they retained before being paid into the bank?

25. Who authorises the payment of unclaimed wages?

26. Is there proper identification of person claiming unclaimed wages? Are these paid through a seperate voucher?

27. Are the deductions on account of employee's state insurance and provident fund deposited within the stipulated period?

28. Are the amounts determined on account of income tax and under compulsory deposit schems, deposited in the relevant accounts?

29. Are payroll records subjected to internal audit periodically ? Do the reports of the internal auditor show any material errors or weaknesses in the system?

3.3 Internal Audit

Internal audit is an audit involving an examination and evaluation of various activities of an enterprise conducted on behalf of the management with the objective of assisting the management to discharge its responsibilities effectively.

Internal audit involves conducting a systematic examination of the record, systems, procedures and operations of an organisation as a service of the management.

Internal audit is conducted on behalf of the management to ensure that :

(a) The exising internal controls are effective and adequate

(b) The financial and other records and reports show the results of the operations accurately and promptly.

(c) Each division / unit of the organisation follows the policies and procedures laid down by the top management.

(d) The assets of the organisation were adequately sefeguarded and properly accounted for.

Modern concept :

The Institute of Internal Auditors (IIA), USA has defined internal auditing ''as an independent and objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectivenes of management control and governance process''. Internal audit can be done by persons

within or outside the organisation. Internal auditor is appointed by the management and is a part of overall organisation system of internal control.

3.3.1 Scope and Objectives

As per AAS-7 "Relying upon the work of Internal auditor", the scope and objective of internal audit vary depending upon the size and structure of the organisation and the requirements of the management.

Generally it operates in one or more of the following areas :

(a) Review of accounting system and related internal controls.
It is the responsibility of the management to establish an adquate accounting system and related internal controls. The internal audit function is assigned the specific responsibility for reviewing the accounting system and related internal control system and their operation and recommending suggestions for thier improvements.

(b) Examination for management of financial and operating information
It includes review of the methods used to identify, measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.

(c) Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organisation.

(d) Physical examination and verification
It includes examination and verification of physical existence and condition of the tangible assets of the entity.

As per the recommendations of Institue of Internal Auditors (IIA), USA the emphasis of modern internal auditing should be on (i) Risk management and control, and (ii) Governance.

Risk Management and Control :

The internal audit function should contribute towards improvementof risk management and control through evaluation of the following :

* Reliability and Integrity of Financial and Operational Information.
* Compliance with laws, Regulations and Contracts
* Safeguarding of assets.
* Effectiveness and efficiency of operations.
* Accomplisment of objectives and goals for operations or Programms.

Governance :

The internal audit, for the improvement of governance process, should evaluate and make appropriate recommendations. It helps to achieve the following :

* Promotion of ethics and values within the organisation.
* Effective organisational performance management and accountability

* Effective communication of risk and control information to appropriate areas of the organisation.
* Effective coordination of the activities and communication of information among the board, external and internal auditors, and management.

3.3.2 Internal Control and Internal Audit

As per AAS-6 the internal control system is defined as all the policies and procedures adopted by the management of an entity to assist in achieving management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business including adhererence to management policies, the safeguarding of assets, the presentation and deletion of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

As mentioned earlier, the internal audit is defined as an independent and objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplis its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

Internal control is the whole system of controls while internal audit is one of its important constituents. Internal audit is essentially a post-transaction review to evaluate the records, controls and operations in an organisation. For example, in case of the purchase department, internal control system would include allocation of managerial authorities, procedures of carrying out the various functions, post-transaction audit, performance appraisal and periodic reporting. This post-transaction audit must be internal audit involving a review of what actually happened, e.g. whether purchase order have been placed in the best competitive manner and whether there was a proper follow up of orders. Thus internal audit is a part of overall system of internal control.

3.3.3 Internal control, Internal Audit and Companies Act

According to section 227 (4A) of the Companies Act, Companies (Auditor's Report) Order, 2003 an auditor requires to report, on internal control and internal audit.

According to section 227 (4A) of the Companies Act, the Companies (Auditor's Report) order 2003, requires an auditor to include a statement in his audit report containing the following in respect of internal control and internal audit matters.

1. Whether there is an adequate internal control procedure commensurate with the size of the company and the nature of its business for the purchase of inventory and fixed assets and for the sale of goods. Whether there is a continuing failure to correct major weaknesses in internal control.

2. Whether the company has an internal audit system commensurate with its size and nature of its business in the case of listed companies and / or other companies having

a paid-up capital and reserves exceeding Rs. 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned.

This provision is, however, not applicable to (i) a private limited company with a paid up capital and reserves not more than fifty lakh rupees and has not accepted any public deposit and does not have loan outstanding ten lakh rupees or more from any bank or financial institution and does not have a turnover exceeding five crore rupees.

(ii) a company listed to operate under section 25 of the Act and

(iii) a banking company.

(iv) an insurance company.

3.4 Audit Committee

An audit committee is a committee of the board of the directors of a company entrusted with the responsibility of overseeing the company's financial reporting process, reviewing the financial and risk management policies of the company, considering various issues relating to audit function like recommendations on appointment and remunaration of auditor, review of audit findings etc.

3.4.1 Requirements under the Companies Act

In India, the section 292A of Companies Act, 1956 (inserted by Companies (Ammendment) Act, 2000) provides for the constitution of Audit Committee. It requires the following in respect of composition, powers, functions etc, of the audit committee.

1. Every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as "Audit Committee". The Committee should consist of not less than three directors of which two-thirds of the total number of members shall be directors, other than managing or whole time directors.
2. The committee should act in accordance with terms of reference as specified in writing by the Broad.
3. The members of the Committee should elect a chairman from amongst themselves.
4. The annual report of the company must disclose the composition of the audit committee
5. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at the meetings of the audit committee but shall not have the right to vote.
6. The audit committee should have discussions with the auditors periodically about the internal control systems, the scope of audit including the observations of the

auditors and review of the half-yearly and annual financial statements before submission to the board and also ensure compliance of internal control systesm.

7. The audit committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice if necessary.
8. The recommendation of the audit committee on any matter relating to the financial management including the audit report, shall be binding on the Board.
9. If the Board does not accept the recommendation of the audit committee, it shall record the reasons therefor and communicate such reasons to the shareholders.
10. The chairman of the audit committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.
11. If a default is made in complying the provisions of this section, the company, and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, a with fine which may extend to fifty thousand rupees, or with both.

3.4.2 Requirements of Listing Agreement

Every listed private and public sector company, to which clause 49 of the listing agreement applies, shall have to comply with the provisions of clause 49, in adiition to provisions of sectron 292A, which are as follows :-

Composition

A qualified, independent audit committee should be set up by the company with the following compliances :

(i) The audit committee shall have minimum three members, all being non-executive directors, with the majority of them being independent, and with atleast one director having financial and accounting knowledge.

(ii) The chairman of the committee shall be an indepedent director.

(iii) The chairman shall be present at annual general meeting to answer shareholders queries;

(iv) The audit committee invites such of the executives, as it considers appropriate (and paricularly the head of the finance function) to be present at the meeting of the committee, but on occasions it may also meet without the presence of any exceutives of the company.

(v) The company secretary shall act as the secretary to the commiteee.

Meetings

The audit committee shall meet atleast four times a year and not more than four months shall elapse between tow meetings. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

Powers

The audit committee should have sufficient powers which should include the following :

1. To investigate any activity within its terms of references.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

3.4.3 Role of Audit Committee

The role of audit commitee should include the following :

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending the appointment and removal of external auditor, fixation of audit fee and also approval of payment for any other services.

3. Reviewing with management the annual financial statements before submission to the board, focusing primarily on.

(a) Any changes in accounting policies and practices and reas an for the same
(b) Major accounting entries based on exercise of judjement by management.
(c) Qualifications in draft audit report
(d) Significant adjustments arising out of audit
(e) The matters required to be included in the Directors Responsibility Statement.
(f) Compliance with accounting standard
(g) Compliance with stock exchange and legal requirements concerning financial statements
(h) Any related party transaction of the company of material nature, with promoters of the management, thier subsidiaries or relatives etc. that may haver potential conflict with the interest of company at large.

4. Revewing with the management, performance of external and internal auditors, the adequacy of internal control system.

5. Revewing the adequacy of internal audit function, including the structure of internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

6. Discussions with internal auditors on any significant findings and follow-up thereon.

7. Reviewing the findings of any internal investigation by the internal auditors into matters where there is suspected fraud or irregularity on a failure of internal control system of a material nature and reporting the matter to the Board.

8. Discussions with external auditors before the commencement of audit about nature and scope of the audit as well as post audit discussion to ascertain any area of concern.

9. Reviewing the company's financial and risk management practices.

10. Looking into the reasons for substantial default in the payment to depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

11. Reviewing with the management the quarterly financial statements before sub mission to the board for approval.

3.5 Questions

1 Define an internal control system.
2. State the objective of internal control system.
3. Explain the scope of internal control system.
4. What is the need for evaluation of internal control.
5. Describe the stages in evaluation of internal control system.
6. What is a flowchart? What are its advantages?
7. What is an internal control questionnaire (ICQ) or checklists? Prepare an ICQ or checklist for wages and salaries in respect of huge manufacturing organisation?
8. Define Internal audit, what are its scope and objectives?
9. "Internal audit is a part of overall system of internal control"–explain.
10. What is an audit committee? Discuss the requirements of the Companies Act and SEBI with respect to such committee.
11. Is internal audit compulsory for every company?
12. State the role of audit committee?

Unit 4 ❐ Statements / Standards and Guidance Notes

Structure

4.0 Objectives

After Studying this unit, you should be able to :

- Understand the importance of 'accounting standard' and 'auditing and assurance standards.'
- Explain the ideas of generally accepted accounting principles (GAAP)
- State the details of accounting standards and auditing and assurance standards issued by ICAI
- Learn the compliance aspects of accounting standards, AAS and standards issued under the Income tax Act.

4.1 Introduction

It is the primary concern for every auditor to determine whether generally accepted accounting Principles (GAAP) in India have been properly applied in preparation and presentation of financial statements. Therefore a thorough knowledge of GAAP and its compliance requirements is essential for the auditor. Accounting standards, the guidance notes on accounting matters issued by ICAI and Income-tax Standard, all are considered to be the most important elements of Indian GAAP. The auditor should also keep in mind the auditing and assurance standards (AASs) issued by ICAI to ensure quality and effective audit performance. So, this unit deals with the concept of Indian GAAP and presents a summarised view of ASs and AASs issued by ICAI, standards as issued by income tax authorties and their compliance requirements.

4.2 Generally Accepted Accounting Principles (GAAP)

Generally Accepted Accounting Principles (GAAP) comprises of accounting conventions, rules, procedures, statutory requirements of various acts, accounting standards, accepted accounting practices both promulgamated and non-promulgamated. GAAP are those principles which have substantial authorative support.

GAAP denoted a set of accounting rules or directive guidelines or code of action which are accepted in general by the accourding bodies of different countries.

In Indian context GAAP includes the following :

- Accounting conventions, rules, procedures
- Accounting standards issued by ICAI
- Statements, guidance notes issued by ICAI
- Requirements of Companies Act,
- Requirements of Income tax Act, & other relevant acts like FEMA etc.

- Requirements of SEBI
- Standards issued by ICWAI, Income Tax Authorities etc.
- Other acceptable accounting practices etc.

4.2.1 Global Accounting Harmonisation

Harmonisation in the accounting context may be defined as the process aimed at enhancing the comparability of financial statement produced by different organisation situated in different countries on the basis of their respective accounting regulation. Globalisation of business, capital markets highly demands the harmonised set of accounting rules and regulation in respect of preparation and disclosure of financial information.

In Indian context the main organisations involved in global accounting harmonization are :—

- International Accounting Standard Board (IASB).

–Which issues International Accounting Standards (IAS)

- Combination of statements/ opinion/ interpretation issued by the following main organisations of IAS are termed as IAS GAAP.

– Financial Accounting Standard Board (FASB)
– American Institute of Certified Accountants (AICA)
– Emerging issues Task Force (ETF)
– Securities and Exchange Commission (SEC)

- The Institute of Chartered Accountants of India

Statements, standards, guidance notes issued by the ICAI.

4.2.2 Importance of GAAP

GAAPs stand for the broad framework of accounting rules within the boundary of which the accountants enjoy independence of deciding upon their courses of action to solve definite accounting problems. GAAPs have gained tremendous importance in present day accounting. If there is no GAAP the accountants of different countries would follow their own principles of accounting resulting in disorder and indiscipline. So GAAP, are regulatory codes which bring unformity in accounting practices, GAAPs aim to provide material, verifiable and less complex financial information to the users of financial statements, GAAPs are expected to achieve the following objectives :

(a) Providing a significant and reliable meaning to the financial statements prepared in the accounting process.

(b) Providing guidelines for making verifiable measurement of accounting income and valuation of assets and liabilities.

(c) Fixing up acceptable standards helpful for bringing uniformity in accounting action and making possible easier inter-firm comparison by ignoring time and distance barriers.

4.2.3 Significance of GAAP in Audit

Sub-sections (1) and (2) of section 211 of the Companies Act, 1956 state the fundamental characteristics of the financial Statements. As per this section every Balance Sheet would give a true and fair view of the Statement of affairs of the company at the end of the financial year and every Profit and Loss Account should give a true and fair view of the profit and loss of the company for the financial year. This qualitative characteristics of true and fairness can be ensured if such financial statement have been prepared and prescribed in compliance with generally accepted accounting principles.

Section 227 of the Companies Act requires that an audit on examination of financial statements should make an opinion about the true and fairness of the financial information contained in balance sheet and profit and loss account. Also an auditor is required under this section to opine that whether profit and loss account and balance sheet comply with the accounting standard as referred in sub-section (3C) of section 211.

Therefore the auditor is primarily concerned with the verification of compliance aspect of GAAP in preparation and presentation of financial statements made by the companies.

4.3 Professional Pronouncements in India : Publications of ICAI

From time to time, ICAI issues various documents on specific matters of importance to accountants and auditors. These documents may be classified into six categories as follows :

1. Accounting Standards (ASs) and Accounting Standards Interpretations (ASIs).
2. Auditing and Assurance Standards (AASs).
3. Other Statements on accounting and auditing.
4. Guidance Notes on matters relating to accounting, auditing, taxation, company law, ethics and other related matters.
5. Opinions on specific quaries.
6. Research Studies, monographs and other miscellaneous publications.

4.4 Accounting Standards

4.4.1 What is AS ?

Accounting Standards are the policy documents issued by recognised expert accountancy body, by government or other regulatory body relating to various aspects

of recognisation, measurement, treatment, presentation and disclosure of accounting transaction in the financial statements. Accounting standards in India are issued by the Institute of Chartered Accountants of India (ICAI).

4.4.2 Objective of Accounting Standards

The purpose of accounting standards is to standarise diverse accounting policies with a view to eliminate to the extent possible, incomparability of financial statements, information and provide a set of standard accounting policies, valuation norms and disclosure requirements, to discourage pursuance of accounting policies which are not in conformity with the generally accepted accounting policies. It adds the reliability to the financial statements.

4.4.3 Indian Accounting Standards

In India the Institute of Chartered Accountants of India, recognizing the need to harmonize the diverse accounting policies and practices, constituted an Accounting Standard Board (ASB) on 21 April, 1977 with the function of formulating accounting standards. ICAI has been issuing Accounting Standards on significant accounting issues. These standards are formulated in the light of the International Accounting Standards and the conditions and practices prevailing in the country.

Following are the accounting standards as has been issued by the ICAI.

AS 1 Disclosure of Accounting Policies
AS 2 Valuation of Inventories
AS 3 Cash Flow Statements
AS 4 Contingencies and Events Occuring after the Balance Sheet date
AS 5 Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies.
AS 6 Depreciation Accounting
AS 7 Construction Contracts
AS 8 Accounting for Research and Development (This AS stands withdrawn from the date AS 26 becomes mandatory)
AS 9 Revenue Recognition
AS 10 Accounting for Fixed Assets
AS 11 The effect of changes in Foreign Exchange Rates
AS 12 Accounting for Government Grants
AS 13 Accounting for Investments
AS 14 Accounting for Amalgamations
AS 15 Accounting for Retirement Benefits in the Financial Statements of Employers.
AS 16 Borrowing costs
AS 17 Segment Reporting

AS 18 Related Party Disclosures
AS 19 Leases
AS 20 Earnings Per Share
AS 21 Consolidated Financial Statements.
AS 22 Accounting for Taxes on Income.
AS 23 Accounting for Investments in Associates in Consolidated Financial Statements.
AS 24 Discontinuing Operations
AS 25 Interim Financial Reporting
AS 26 Intangible Assets
AS 27 Financial Reporting of Interest in Joint Ventures
AS 28 Impairement of Assets
AS 29 Provisions, Contigent Liabilities and Contigent Assets

4.5 Auditing and Assurance Standards

4.5.1 Introduction

Auditing involves collection and evaluation of evidence to determine and report as to whether the financial information have complied with all established criteria and whether it exibits true and fair view. To ensure consistent, objective, reliable and quality audit services a large number of Standards have been developed over period of time which are known as generally Accepted Auditing Standards. In USA generally Accepted Auditing Standards were first issued in 1939 with 10 Standards, called as ‘‘Rule of the Road’’, governing the quality of professional work.

4.5.2 What is AAS?

AAS are the benchmarks by which the quality of audit performance can be measured and the achievement of objective can be documented, with AAS an auditor can determine the professional qualities necessary for effective audit performance. AAS prescribes the way the auditing should be conducted.

4.5.3 Auditing and Assurance Standards issued by ICAI

In India Auditing and Assurance Standards Board was constituted in 1982 with the function of formulating Auditing and Assurance Standards (AASs). ICAI has been issuing a series of AASs in the line of corresponding International Standards on auditing as well as the applicable laws, customs, usages and business environment in India, ICAI has so far issued the following AASs :

AAS 1 Basic Principles Governing an Audit.
AAS 2 Objective and scope of the audit of Financial Statements.
AAS 3 Documentation
AAS 4 The Auditor's Responsibility to consider fraud and error in an audit of financial Statements.
AAS 5 Audit Evidence.
AAS 6 Risk Assessments and Internal Control.
AAS 7 Relying upon the work of an Internal Auditor
AAS 8 Audit Planning.
AAS 9 Using the work of an Expert.
AAS 10 Using the work of another auditor.
AAS 11 Representations by Management.
AAS 12 Responsibility of Joint Auditors.
AAS 13 Audit Materiality
AAS 14 Analytical Procedures
AAS 15 Audit Sampling
AAS 16 Going Concern
AAS 17 Quality Control for Audit Work.
AAS 18 Audit of Accounting Estimates
AAS 19 Subsequent Events
AAS 20 Knowledge of the Business.
AAS 21 Consideration of Laws and Regulations in an audit of Financial Statements.
AAS 22 Initial Engagements—Opening Balances
AAS 23 Related Parties
AAS 24 Audit considerations relating to entities using Service Organisations.
AAS 25 Comperatives
AAS 26 Terms of Audit Engagement.
AAS 27 Communications of audit matters with those changed with governance
AAS 28 The Auditors Report on Financial Statements
AAS 29 Auditing in a computer Information System Environment.
AAS 30 External Confirmations
AAS 31 Engagements to compile Financial Information
AAS 32 Engagements to Perform Agreed-upon Procedures regarding Financial Information.

4.6 Income Tax Standards

Under Section 145 of the Income-tax Act, (IT) 1961 the Central Government has been empowered to notify 'Accounting Standards'. These are to be followed by any

class of assessees or in respect of any class of income. The central government has notified the following two Accounting Standards :

- AS (IT) I– Disclosure of Accounting Policies
- AS (IT) II– Disclosure of prior period items, extraordinary items and changes in accounting policies.

The Accounting Standards of ICAI is applicable to all enterprises whereas the Standards issued by central government as per section 145 of the IT Act is applicable only to those assessees who follow the mercantile system of accounting.

4.7 Compliance Requirements of Accounting Standards and Income-Tax Standards

(1) In respect of mandatory accounting standard, the duty of the members of the Institute, while discharging their function, will be to examine whether Accounting Standard is complied with in the persentation of financial statements covered by their audit. In the event of any deviation from the Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviation.

(2) Section 211 (3A) of the Companies Act 1956 requires that every profit and loss account and balance sheet of the company shall comply with the accounting standards.

Section 211 (3C) defines 'accounting standards' as standards of accounting which is recommended by ICAI and prescribed by the central government in consultation with the National Advisory Committee on Accounting Standards constituted by the Central Government under section 210A of the Act. The accounting standards specified as mandatory by ICAI would have to be complied with until as per the National Advisory Committee.Thus it is the responsibility of the company to comply with the requirements of the accounting standards.

(3) Section 211(3B) provides that in case of non-compliance the company should disclose the following in the financial statements :

(a) The deviation from the accounting standard

(b) The reason for such deviation.

(c) The financial effect, if any, arising from such deviation.

(4) As per section 227(3)(d) of the Companies Act, 1956 the auditor must also state in his audit report whether in his opinion the Profit and Loss Account and Balance Sheet comply with the accounting standards as referred in section 211(3C) of the Act.

(5) The Securities and Exchange Board of India also requires the compliance of accounting standards issued by ICAI to be one of the stipulations of the listing agreement between the stock exchanges and such companies.

(6) The auditor should also examine compliance with the accounting standard issued by ICAI while conducting the audit of financial statements under section 44AB of the Income Tax Act.

(7) As per the view of the Central Broad of Direct Taxes that standards under section 145 of IT Act will be issued in conultation of ICAI. If there is any diference in opinion between the standards then financial statements will be prepared as per accounting standards issued by ICAI. But in such a case adjustments are required to be made considering the requirements of Income tax Standard in the statement of computation of income for tax purposes.

(8) A tax auditor, as per clause 11(d) of form No 3CD, is required to report of the details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect there of the on profit or loss.

(9) Compliance with mandatory accounting standards is examined by auditors in auditing general perpose financial statements when such audit is conducted under any law irrespective of structure of the organisation.

(10) Form No. 3CD (Statement of particulars annexed to tax audit report) requires reporting of details of deviation from accounting standard (IT standards) prescribed under section 145 and effection thereof on the profit or loss.

Section 217 (2AA) of the Companies Act, 1956 requires that Directors' Responsibility Statement must specify that accounting standards had been followed in the preparation of annual accounts and / or explanation for material departure from accounting standards.

4.8 Compliance requirements of Auditing and Assurance Standards

Compliance with auditing standard is necessary in normal circumstances. Auditing Standards are expresed to be observed by the auditor when he seeks to express an opinion on the financial Statements.

It is the duty of the auditor being a member of ICAI to ensure that the audit is conducted in accordance with these AASs and material departure there from whenever necessary. In this context, clause 9 of part I of the Schedule to the Chartered Accountancy Act, 1949 is important which provides that a practicing Chartered Accountant shall be guilty of professional misconduct if he fails to invite attention to any material departure from the generally accepted audit procedure i.e. AASs applicable to the circumstances.

Auditor in his report has to mention that he has conducted the audit in accordance with 'generally accepted auditing standards'. The generally accepted auditing standards in Indian context means the AASs as issued by ICAI.

4.9 Questions

1. What do mean by GAAP? What is Indian GAAP?
2. What is the importance of GAAP?
3. What is Accounting Standard? State its objectives.
4. What is AAS (Auditing and Assurance Standard)?
5. State the compliance requirements of AS and Income-Tax Standard.
6. State the relevance of GAAP in relation to audit.
7. State the compliance requirements of AAS.
8. Write short notes on :
   (1) Harmonisation of global accounting.
   (2) Income-Tax Standards.