

PAPER – 3 : ADVANCED AUDITING

QUESTIONS

1. (a) When is the revenue from service transactions recognised as per Accounting Standard on Revenue Recognition?
(b) Explain how Revenue from the following service transactions would be recognised:
 1. Advertising & Insurance.
 2. Commission for arranging Loan.
 3. Plant Installation Fees.
 4. Admission Fees for Film Festival.
2. (a) How should an incoming auditor ascertain that the company has complied with the relevant provisions of the Companies Act regarding his appointment as auditor?
(b) In what circumstances would the incoming auditor be deemed to be guilty of professional misconduct under the Chartered Accountants Act, 1949 if he accepts an appointment as the auditor of a company which was previously held by another chartered accountant?
3. (a) Mr.A, a practising Chartered Accountant is attending to the tax matters of XYZ Ltd., and for that purpose has to regularly attend to the company from 10.00 A.M. to 2.00 P.M. on all working days. He is paid Rs.5,000 p.m. for the same.
XYZ Ltd., intends to appoint Mr.A as its auditor at the ensuing general meeting.
Advise Mr.A, giving reasons whether he can accept the appointment.
(b) Mr. B is appointed auditor of PQR Ltd., at a total remuneration of Rs.50,000, which is classified as under:

(i) For X Unit of the Company	Rs.20,000
(ii) For Y Unit of the Company	Rs.20,000
(iii) For Head Office	Rs.10,000

According to the terms of appointment, Mr.B can collect his fees on progressive basis, on completion of audit of unit (i) and/or unit (ii).
Mr.B completed the audit of unit (ii) and recovered Rs.20,000 on account of the audit fees though the entire audit is not completed.
Explain whether Mr.B is indebted to the company for an amount exceeding Rs.1,000 and therefore disqualified.
(c) S.T. Limited appointed at the Annual General Meeting, E as the auditor and F as the joint auditor. The resolution provided that in the event of both or either declining the appointment, the Board may fill up the vacancy at their discretion. The Board of Directors subsequently resolved that in the event of either E or F declining to accept the appointment, G be appointed as joint auditor.
F declined the appointment and G was asked to intimate his willingness or otherwise to accept the appointment.
Advise G with reasons whether his appointment is valid.
4. A manufacturing company whose products are sold both in home market as well as in foreign market finds a substantial fall in the domestic market during the immediately preceding year and the demand so far during the current year is also found to be not encouraging.
The production department is of the view that this is due to failure of the sales department.
You have been appointed as investigator to investigate the affairs of the sales department.
State the relevant points on which you would carry out your work.
5. You are appointed as an auditor of an insurance company. Draw up an audit programme and

state the special points that you would take into consideration while drawing up programme.

6. Write short notes
 - (a) Reappointment of retiring auditor
 - (b) Performance audit
 - (c) Liability of an auditor for misfeasance under the Companies Act.
 - (d) Independence of auditor
 - (e) Balance sheet audit.
7. Write short notes on:
 - (a) The technique of probability theory in audit work.
 - (b) Flash Reports.
 - (c) Application Package.
8.
 - (a) Explain how analytical review procedures can contribute to an audit.
 - (b) Explain how the results of analytical review can influence the nature and extent of other audit work.
 - (c) Give three specific examples of analytical review procedures that might be carried out as part of the audit of a company that operates a chain of departments stores.
9.
 - (a) List three situations where the auditor would be unlikely to use audit sampling techniques.
 - (b) Explain what you understand by the following terms:
 - (i) attribute sampling
 - (ii) Monetary-unit sampling
 - (c) To describe the factors which the auditor should consider when determining the size of a sample.
 - (d) Describe to what extent statistical sampling enhances the quality of the audit evidence.
10.
 - (a) What are the characteristics of on-line computer system?
 - (b) Describe effects of on-line computer system on Audit Procedure.
11. Write short notes on the following
 - (a) Audit Committee
 - (b) Energy Audit
 - (c) Environmental Audit.
12. What are the general guidelines which the Management Auditors is expected to observe while drafting his report?
13. A government company is engaged in production of fertilizers and various nitrogenous chemicals. The company has four manufacturing units of which at present only one is operational. The company also has six marketing centres for marketing the company's products. Besides its own products, the company is also engaged in selling fertilizers and other ancillary products on consignment sales basis/outright purchase basis. As per the accounting policy of the company, expenses incurred upto Rs. 25,000 relating to a future period are expensed in the current year.

The statutory auditors of the company, are of the view that the company has not complied with Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', issued by the Institute of Chartered Accountants of India, and section 209 (3) (b) of the Companies Act, 1956, which prescribes accrual basis of accounting.

Whether the aforesaid accounting policy of the company violates the provisions of AS 1 and section 209 (3) (b) of the Companies Act, 1956.
14.
 - (a) Under what circumstances can a change in an accounting policy be justified?

- (b) How will you distinguish a change in an accounting estimate from a change in the accounting policy. Does the former need any disclosure?
 - (c) Do you think that a contingent loss or a contingent gain need to be provided in the accounts?
 - (d) A company's accounting year ends on March 31. One of its subsidiaries has declared dividend in April, 2005 in respect of its accounting year ending November 30, 2004. The company concerned is to receive a dividend of Rs.10,000. The auditing of the company for the year ended March 31, 2005 is in progress. Do you think that the dividend can be accounted for by the company in its accounts for the year ended March 31, 2005?
15. What is the responsibility of an auditor when he relies on the work performed by another expert, for forming and expressing his opinion on the financial statement? How should he evaluate the work of an expert?
16. (a) For what purpose, and in what circumstances, would you consider it desirable for the auditor of a limited company to attend at stock taking?
- (b) What overall audit tests may be appropriate when assessing the reliability of records of stock-in-trade and work-in-progress.
17. Explain in detail the audit procedures to be followed in case of reporting on the following requirements of CARO, 2003.
- (a) Whether the company has been regular in depositing undisputed statutory dues?
 - (b) In case certain dues have not been deposited on account of dispute, the amount involved and the form where dispute is pending.
 - (c) Entry of particulars of controls or arrangements in Register maintained u/s 301.
 - (d) Transaction in respect of contracts entered into Register u/s 301 are reasonable.
18. A limited company, established in 1873, is engaged in the manufacture of diversified value added jute goods mainly to cater to the sophisticated needs of the international market. For producing such items, the company has been carrying out continuous modernisation and renovation of its plant and machinery by replacing major components on regular basis. This routine replacement of components increases the standard performance of the machine in a way that the recoverable amount of the machine is enhanced. As per the management, the recoverable amount is not decided on the basis of net selling prices but it depends on the economic value of the assets also. In most cases, the company has identified such costs as separate components of the machine representing major overhaul and has already depreciated those components to reflect the consumption of benefits, which are replaced or restored by the subsequent major overhaul. As these original machines were installed long ago, the said overhaul/renovation has helped the machines to increase their economic lives and maintain efficiency in production.
- Whether the expenditure on renovation/overhauling, which enhances the life and productivity of the machines, should be treated as an addition to the block of plant and machinery, or should be charged to revenue as normal repair expenses?

SUGGESTED ANSWERS / HINTS

1. (a) Accounting Standard-9 on 'Revenue Recognition' issued by the ICAI states that the revenue from service transactions is usually recognised either by the proportionate completion method or by the completed service method. The methods are discussed as under:
- (i) **Proportionate completion method:** If the performance consists of the execution of more than one act, revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line

basis over the specific period unless there is evidence that some other method would better represent the pattern of performance.

- (ii) **Completed service contract method:** Normally this method is applied when performance consists of the execution of a single act, and the services remaining to be performed are so significant in relation to the transaction taken as whole that performance can not be deemed to have been completed until the execution of those acts, the completed service contract method become applicable. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

- (b) (1) **Advertising and Insurance Agency Commission:** Revenue from advertising and insurance agency commission should be recognised when the service is completed. For advertising agencies, media commissions will normally be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency. However in case of production of advertisement material, revenue will be recognised when the project is completed. Insurance agency commissions should be recognised on the effective commencement or renewal of the related policies.

- (2) **Commission for arranging loan:** The commission for arranging loan may be rendered as a single act or may be rendered over a period of time. Similarly, charges for arranging loan and other financial services may be made as a single amount or in stages over the period of the service or the life of the transaction to which it relates. Such charges may be settled in full when made, or added to a loan or other account and settled in stages. The recognition of such revenue should therefore have regard to:

- (a) Whether the service has been provided "once and for all" or is on a "continuing" basis;
- (b) The incidence of the costs relating to the service; and
- (c) When the payment for the service will be received.

In general, commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into. Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the service provided and the timing of the costs relating thereto.

- (3) **Plant Installation Fees:** Plant installation fees are generally incidental to the sale of the machinery. Therefore, it should be recognised as revenue only when the machinery is installed and accepted by the customer.
- (4) **Admission fees for film festival:** Accounting Standard-9 states that revenue from artistic performances, banquets and other special events should be recognised when the events take place. Therefore, revenue from the admission fees for film festival should be recognised only when the film festival has been organised. As there would be a large number of films being shown in the film festival and there would be many category of films such as documentary, information section, competition section etc., admission fee should be allocated to various categories on a systematic and rational basis.

- 2. (a) Guidance Note issued by the Council of the ICAI on Clause 9 of Part I of the First Schedule to the Chartered Accountants Act, 1949 prescribes the procedure to be followed by the incoming auditor to ascertain whether the company has complied with the relevant provisions of the Companies Act regarding his appointment as auditor. The procedure contained therein is discussed hereunder.

At the outset, the guidance note clarifies that it would not be sufficient for the incoming auditor to accept a certificate from the management of the company that the relevant provisions of the Act have been complied with. The incoming auditor should verify the relevant records of the company in order to enable him to ascertain the compliance of various provisions of the Companies Act before accepting the audit assignment. The incoming auditor should verify the following records of the company:

- (i) If the appointment of the auditor is being made for the first time after incorporation of the Company, the auditor should verify as to whether the Board of Directors have passed the resolution for his appointment within one month of the date of registration of the company.
- (ii) If the Board of Directors have not appointed the first auditor but the appointment is being made by a general meeting of the company, the auditor should verify as to whether a proper notice convening the general meeting was issued by the company and whether the resolution appointing him was validly passed at the general meeting of the company.
- (iii) If the appointment is being made to fill a casual vacancy, the incoming auditor should verify as to whether the Board of Directors have powers to fill the particular casual vacancy and whether the Board of Directors have passed the resolution filling the casual vacancy.
- (iv) If the casual vacancy has arisen due to resignation of the auditor, the incoming auditor should see as to whether a proper resolution appointing him to fill the vacancy has been passed at the General Meeting of the Company.
- (v) If the vacancy has arisen as a result of removal of the auditor before the expiry of his term of office, the incoming auditor should see that proper resolution to appoint him has been passed at the General Meeting of the Company.
- (vi) If the provisions of Sections 224A apply to the company, the incoming auditor should verify as to whether a special resolution as required under the said section has been duly passed.
- (vii) Where the incoming auditor is proposed to be appointed in the annual general meeting in place of the retiring auditor, he should ascertain whether the provisions of Sections 225 have been complied with. These provisions equally apply where an auditor who was jointly holding office with another auditor or auditors and any one or more of such joint auditors has not been reappointed. For the purpose of ascertaining whether the company has complied with the provisions of Sections 225 of the Companies Act, the incoming auditor should verify the records of the company in respect of the following matters:
 - (a) Whether a member of the Company has given special notice of the resolution as required under Section 225(1) at least 14 days before the date of the General Meeting. A true copy of this notice should be obtained by the incoming auditor.
 - (b) Whether this special notice has been sent to all the members of the Company as required under Sections 190(2) at least 7 days before the date of the General Meeting.
 - (c) Whether this special notice has been sent to the retiring auditor forthwith as required under Section 225(2).
 - (d) Whether the representation if any received from the retiring auditor has been sent to the members of the company as required under Section 225(3).
 - (e) Whether the representation if any received from the retiring auditor has been considered at the general meeting and the resolution proposed by the special notice has been properly passed at the general meeting.
- (viii) A copy of the relevant minutes of the annual general meeting, where the above

resolution is passed duly certified by the Chairman of the meeting should also be obtained by the incoming auditor for his records.

- (ix) It is also necessary for the incoming auditor to satisfy himself that the notice provided for in Sections 224 and 225 has been effectively served on the outgoing auditor e.g. by Regd. Post with A.D.). In particular, production of a certificate of posting by the Company would not be adequate for the purpose of the incoming auditor satisfying himself about compliance with Sections 224/225. Acknowledgement received from the outgoing auditor would be one of the forms in which such satisfaction can be obtained.
- (b) The incoming auditor would be deemed to be guilty of professional misconduct under the Chartered Accountants Act, 1949, if he accepts an appointment as the auditor of a company which was previously held by another Chartered Accountant under the following circumstances:
 - (i) **Failure to communicate in writing:** Clause 8 of Part I of First Schedule requires that a chartered accountant in practice should not accept a position as auditor previously held by another chartered accountant in practice should not accept a position as auditor previously held by another chartered accountant without first communicating with him in writing. The main reason for communicating with the previous auditor is to ascertain from him whether there are any professional circumstances which warrant him not to accept the appointment. The professional reasons for not accepting an audit include undercutting of fees and issuance of a qualified audit report, apart for non-compliance etc. of auditor in case of a Company.
 - (ii) **Non-compliance of the provisions of Sections 224 and 225 of the Companies Act:** Clause 9 of Part I of the First Schedule provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without ascertaining from it whether the requirements of Sections 224 and 225 of the Companies Act, 1956 in respect of such appointment have been duly complied with. Under this clause, it is obligatory on the incoming auditor to ascertain from the company that the appropriate legal procedure in the matter of his appointment has been complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.
 - (iii) **Undercutting of Fees:** Clause 12 of Part I of First Schedule provides that the incoming auditor would be deemed to be guilty of professional misconduct in case he accepts a position as auditor previously held by some other chartered accountant in such conditions as to constitute undercutting. This rule seeks to avoid the undignified situations of chartered accountants competing with each other to get more work by charging lower fee for a given audit assignment. This also seeks to maintain professional fees at a reasonable level for the members of the profession.
 - (iv) **Issuance of a qualified audit report:** Strictly speaking, there is no rule written or unwritten which would prevent the incoming auditor from accepting the appointment offered to him in case the previous auditor is being removed on account of issuance of a qualified audit report. It is, however, expected that the incoming auditor would accept the audit only if he is satisfied that the attitude of the retiring auditor was not proper and justified. The auditor should ascertain the full facts of the case before accepting the assignment in this situation and in any case, should not accept too readily.
- 3. (a) An employee or an officer of a company cannot be appointed as the auditor of that company by virtue of provision of Section 226(3) of the Companies Act. In the instant case, it is not clear whether Mr. A is an officer or employee of the company on a part-time basis or is a retainer for tax matters. An auditor may render services to the company in matters relating to the taxation, finance, management consultancy or other related area as long as his contract is "for services" and not "of service". Further, "Statement of Payments to Auditors for Other Services" issued by the Institute gives an illustrative list in respect of other services which might be usefully rendered by an auditor of a company against payment of additional

fees which includes services on taxation matters as well.

With regard to charging of monthly fees by the statutory auditor of a company for other services on retainership basis, there is no specific prohibition in the Chartered Accountants Act, 1949, the Regulations and the relevant pronouncements made by the Institute in this regard. Further, another fact which has to be borne in mind that Mr. A is attending regularly the office from 10.00 A.M. to 2.00 P.M. on all working days. It should be seen that he is not bound by the office timings but is attending to tax matters regularly during office working hours according to his own convenience. Therefore, having regard to the exact nature of Mr. A's existing relationship as may be seen from the terms of appointment with XYZ Ltd., Mr. A has to decide whether he can be validly appointed as it statutory auditor. If it is a part-time service contract, he cannot be appointed. On the other hand, if it is a retainership, he may be appointed.

- (b) The Guidance Note on "Independence of Auditors" issued by the Institute clarifies that the auditor cannot be said to be indebted to the company at any stage if he recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job provided such fees is recovered in accordance with the terms of his engagement with the client. In this light, Mr. B cannot be considered to be indebted to the company and is qualified to act as a statutory auditor.
 - (c) The Board of S.T. Ltd. has been authorised by a specific resolution that in the event of both E and F or either of them declining the appointment, the Board may fill up the vacancy at their discretion. It may be noted that under the Companies Act, the Board of Directors could appoint an auditor only under the circumstances contemplated under sub-section (5) and under the sub-section (6a) of Section 224. Further in this specific case, the refusal of F to accept the appointment as joint auditor did not create a vacancy either casual or by resignation since F's appointment has not been become effective. Therefore, appointment of G by the Board would not be valid.
4. Relevant points on which to carry on the investigation of sales department's work
1. Details of the products, technical specifications, scale of production and the method of sales.
 2. Extent of awareness of the sales department about economic trends, customer spending patterns and competitors' activities.
 3. Market share of various products, trend of domestic sales and the extent of the loss of domestic market for the products.
 4. Details of efforts made to maintain customer patronage to the products of company by advertisement campaign, participation in trade fairs etc.
 5. Re-organisation of the sales department staff in the recent past.
 6. Any change in the method of sales or price of the product.
 7. Whether the sales representative were sufficiently knowledgeable and motivated.
 8. Whether there was negligence in attending to and executing customers' orders.
 9. Whether adequate market research, sales analysis and forecasting were done to trace changing trends and whether steps have been taken by incorporating the changes in product features.
 10. Whether the company had any bulk customers who had stopped purchasing.
 11. Whether the performance in the sales front is inter-related to the production department. Are there failure in production in quantity range and products or otherwise that give rise to problems in executing sales orders?

5. Audit programme for the audit of an insurance company:

General:

- (1) Verify the system of internal control in operation.
- (2) Different categories of insurance business carried on by the company should be ascertained and it should be seen whether separate accounts in respect of each category is maintained.
- (3) It should be confirmed that Registers of policies, claims and licensed agents are properly maintained.

Specific:

- (4) **Premium:** This should be vouched with copies of insurance policies and cover notes of premium receipts. Under the Code of Conduct, premium is payable in advance except where the insured maintains an appropriate deposit with the insurance company. Variation in the amount of premium should be verified by reference to proper authorisation based on change in the conditions of the policy. There cannot be any outstanding premium except for those policies which are covered by bank guarantee.
- (5) **Claims:** Payments on account of claims should be verified by reference to payee's receipt, discharge of liabilities signed by the claimants and other supporting evidence like survey report, repairer's bill etc. In checking the computation of the claim admitted and paid, care should be taken to see that the value of salvaged materials has been deducted. Also see that the claim amount has been paid only by a crossed or order cheque. The admission and payment of the claim should be in terms of the policy.
- (6) **Commissions:** It should be vouched with the acknowledgement of the agent and authorised vouchers. The commission should be seen to have been paid in cheque except when it is for a very small sum. The amount of the commission should not exceed the amount calculated at the rate approved for different types of business and the category of agent. Adequate provision should be made for commission accrued but not paid. Any commission received against re-insurance should be checked with credit note, borderauz or other similar evidence. Care should be taken to see that commission is paid against policies executed through the concerned agent.
- (7) **Re-insurance:** Verify that premium and commission payable or receivable against re-insurance, ceded or accepted, have been properly accounted for and settled by payment or receipt or adjustment. See that claim receivable on reinsured policy has been collected from the re-insurer. Similarly claim payable on re-insurance accepted is paid or provided for. Further see that commission on re-insurance ceded or accepted has been shown separately in the Revenue Account.
- (8) **Expenses of management:** Satisfy that expenses have been classified in accordance with the Code of Conduct. Verify that expenses have been properly incurred and booked under the appropriate head in terms of the Code of Conduct and expenses chargeable to one head have not been charged to another. This is important because under the Code of Conduct there are limits on various expenses. Ascertain that all outstanding expenses have been provided for. Also, allocation of common expenses between the various types of insurance business should be carefully examined to see that greater load has not been passed on to the good line relieving the others. The basis of allocation should be consistent. Whatever to the good line relieving the others. The basis of allocation should be consistent. Whatever expenses are not permissible as expense of management in terms of the Code of Conduct, should be screened out and excluded.
- (9) **Investments:** Should be physically verified at the close of the year. Certificate of bank should be obtained for investments lodged with it. It should be seen that restriction on investments imposed by the Insurance Act, 1938 have not been violated.
- (10) **Cash and bank balances:** Physical verification of the cash should be carried out at the close of the year. Bank confirmation should be obtained for balances with banks. Also,

bank balance reconciliation statement should be verified.

- (11) **Balance Recoverable:** It should be seen that all receivables from agents, other insurers and other persons are fully recoverable. If not, suitable provision should be there for the part considered doubtful of recovery. For this confirmation of balance should be obtained from the concerned parties. In addition, statement of account, where there is any, should also be examined,
 - (12) Profit should be determined after making proper provision for bad and doubtful debts, depreciation on assets, contribution to Provident Fund, superannuation fund etc., debts due to government and all other matters for which a provision is necessary.
 - (13) The accounts should be prepared in the forms prescribed under the Insurance Act, 1938.
6. (a) **Reappointment of Retiring Auditor:** Section 224(2) provides that subject to the provisions of sub-section (1-B) and Section 224-A at any annual general meeting, a retiring auditor, by whatsoever authority appointed, shall be re-appointed unless:
- (i) he is not qualified for re-appointment;
 - (ii) he has given to the company notice in writing of his unwillingness to be re-appointed;
 - (iii) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
 - (iv) where notice has been given of an intended resolution to appoint some persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with.

The provisions for reappointment of retiring auditor seem to have been enacted to ensure that the auditor enjoys a degree of independence since he cannot be replaced except in the specific circumstances listed above.

However, it should be noted that even for the reappointment of a retiring auditor, the passing of a resolution is essential. In the absence of a resolution, the retiring auditor is not automatically reappointed.

- (b) **Performance Audit:** Performance audit seeks to evaluate whether the resources of an enterprise have been utilised efficiently to achieve the objective by deploying them in an optimum manner. Performance Audit has come as a natural sequel to the performance budgeting in the government sector to ensure the performance in monetary as well as physical terms. The need for performance audit was felt as the financial audit including propriety audit could not portray in full details the pictures of performance of an entity. In financial audit, the overall performance in monetary terms of the various activities could be known but that would be inadequate to know the real performance as it may not provide the specific details of each function; also it would be seriously affected by the change in the value of money. As public sector undertakings are being achieved or not. In this context, it is necessary to prepare the performance budget. The performance budgeting facilitates suitable review of performance audit are to be developed. For management purposes, such performance review needs to be conducted internally for each responsibility level to help the managerial and supervisory functions at various levels in the organisation's hierarchy. However, since public sector undertakings involve lot of public money and are, therefore, responsible for their efficient functioning to other higher levels of authority, an appraisal of their performance by an outside agency becomes imperative. In such a situation, the need for performance audit to assess whether the activities of the organisation are resulting in the achievement of its objectives is apparent.

The performance appraisal of an activity can only be done in the light of the objectives which it is directed to achieve. Objectives spell out the results desired from an activity. In performance audit, emphasis is placed on the outputs to be achieved. These need to be defined carefully in relation to the needed inputs. Whereas inputs are easy to measure,

tremendous amount of effort is required to identify, quantify and measure the resulting output particularly in a social context.

The performance evaluation of private sector undertakings is not difficult as the clear cut indicator-profit-making being the primary objective is available. Therefore, where production is profit-oriented, it is easy to conduct performance audit, as it compares planned profits with those actually realised as related to the inputs used. This criterion, however, cannot be the sole test to be applied to public sector investments whose objectives are not mere profit maximisation, but maximisation of 'net welfare'. If objectives are not well defined and spelled out in clear and specific terms, it would be difficult to evolve a scientific and universally acceptable approach for auditing the performance. Also, objectives which are not quantifiable would leave enough area for conflicting interpretations between audit and the executing agencies. Performance regarding non-monetary objectives cannot be revealed through accounts. Thus, the knowledge of conventional audit not being sufficient for audit of performance, some of the technique needs to be evolved to meet adequately the new challenge.

- (c) **Liability of an auditor for misfeasance under the Companies Act:** Under Section 543, the Court has wide powers to assess damage against delinquent directors and other officers of the company (including an auditor) for misfeasance or breach of trust. It is simple procedure under the Act for bringing an action against persons associated with promotion or management of a company under winding up. An auditor is covered within the scope of the liability as an officer of the company, pursuant to the definition of officer given in Section 2 (3) of the Act. The charge for misfeasance, which simply means breach of trust or negligence in the performance of duties can be framed against the auditor, if it appears that he has misapplied, or retained, or become liable or accountable for, any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company. This Section specifies a plain remedy to recover damages where an auditor is guilty of misfeasance. Mere negligence or neglect of duty, unless there is a corresponding loss will not create any liability. If an auditor is found to be negligent and unskillful in the performance of his duties due to which company suffers losses, he is liable at least to the extent the company has lost and proceedings may be taken against him.

The application for misfeasance proceedings must be made within five years from the date of the order of winding up, or of the first appointment of liquidator or of the misapplication, retainer etc., as the case may be whichever is longer. Misfeasance proceedings can be started notwithstanding that the auditor is also criminally liable for the same offence.

- (d) **Independence of Auditor:** Independence is the keystone upon which the respect and dignity of a profession is based. Independence stands for the strength of individuals to adopt an unbiased view of the matters undaunted by any favour or frown. In all matters relating to the assignment, an independence in mental attitude is to be maintained. Only so long as the auditor maintains high standard of independence and impartiality, the audit reports will continue to be accepted and regarded by businesses, financial institutions, Government and investors. Professional integrity and independence are an essential characteristic of all the learned professions but are more so in the case of accounting profession.

The Note issued by the Committee of the ICAI on "Independence of Auditors" contemplates that it is not possible to define "Independence" precisely. According to it, "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. It stipulates that the independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered. Independence of the auditor has not only to exist in fact, but should also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly he himself is satisfied, about his client and secondly no

unbiased person would be forced to the conclusion that on an objective assessment of the circumstances, there is likely to be an abridgment of the auditor's independence. There is also a collective aspect of independence that is important to the accounting profession as a whole. The Chartered Accountant is not personally known to third parties who rely on professional opinion and accept his opinion principally on a larger faith on the entire accounting profession.

The Companies Act has enacted specific provisions to give concrete shape to this vital concept. The provisions disqualifying certain types of persons from undertaking audit of limited companies, provisions relating to ceiling on the number of audits that can be undertaken by chartered accountants, provisions requiring special resolution for appointing auditors in certain cases and other provisions relating to appointment, reappointment and removal of auditors are designed to invest this institution of audit with sufficient independence to carry out the audit in the larger interests of shareholders and other users. The vast powers of access given to the auditor to the books of accounts and other documents of the company are specifically designed to give independence to the auditors. The power to qualify his report is yet another weapon in the armoury of the auditor to protect his independence. The enactment of specific instances of misconduct in the Schedule of the Chartered Accountants Act is yet another attempt to keep the independence and professional competence of the accounting profession.

(e) Balance Sheet Audit: Balance Sheet Audit consists of the verification of all the balance sheet items together with the examination of expense and income accounts which are closely related to these items. The balance sheet audit as against the conventional vouch and post audit has developed along with the development of internal control system and phenomenal growth in the activities of business entities. Balance-sheet audit encompasses the following:

- (i) Examining the basic constitution and internal regulations of the entity.
- (ii) Establishing the existence and ownership of assets included in the balance-sheet.
- (iii) Satisfying that all assets owned on the balance-sheet date have been included.
- (iv) Verifying the inclusion of assets in the balance sheet in accordance with the generally accepted accounting principles.
- (v) Ascertaining inclusion of assets in the balance sheet in accordance with the generally accepted accounting principles.
- (vi) Examining all opening, closing and adjustment entries.
- (vii) Satisfying that distinction between capital and revenue has been properly maintained.
- (viii) Satisfying that the capital amount has been properly reflected.
- (ix) Analysing the charges and credits to revenue accounts and inclusion of the resultant balance sheet.
- (x) Reviewing that internal controls on all materials areas are satisfactory.

It may be seen from the above that the vouch and post audit involving detailed checking of each and every transaction, whether revenue or capital, is in today's conditions mostly unavailable as it would require tremendous time input as well as it is not discriminatory in character to make the audit more meaningful. As against this, in the balance-sheet audit the problem of volume of transactions is taken care of by overall checks, analyses and evaluation of internal controls. The balance sheet items representing essence of the financial picture are checked thoroughly.

- 8. (a)** Analytical Review is a substantive technique which can be used at the initial planning stage of the audit, during the course of the detailed audit work and at or near the completion of the audit when reviewing the financial statements.

The auditor would obtain a copy of the final financial statements and compare these with:

- (i) management accounts covering the same period;
- (ii) previous periods financial statements for the same company; if possible.
- (iii) other companies financial statements from within the same industry.

The auditor would identify any unexpected results or odd fluctuations apparent from these comparisons. These procedures will provide information useful to the auditor in two ways:

- (i) confirming conclusions formed during earlier stages of the audit.
- (ii) highlighting areas which may require closer attention and in respect of which more detailed audit evidence should be sought. The use of ratios is a common audit technique in analytical review procedures and highlight odd fluctuations over a number of periods or between related accounts, e.g. depreciation on fixed assets or creditors and purchases.

Analytical review techniques must be carefully used. However, it is very important that the analysis and interpretation is done by a member of the audit staff who is sufficiently experienced with respect both to the client company and the industry in which it operates, as any conclusion reached will only be meaningful within that context.

- (b)** The analytical review of financial statements can influence the audit work undertaken at each of the three main stages of the audit. Planning Stage:

At this stage, an analytical review applied to the initial management accounts would indicate any areas where figures are either higher or lower than might have been expected, possibly indicating an area of higher audit risk. The results at this stage may influence the selection of areas to be tested in some depth and may also influence sample sizes, either increasing the size for sample if an unexpected figure is noted or decreasing it if the result is in line with expectations.

Substantive testing stage: At this stage, the results of analytical review will often confirm results obtained by other substantive tests, possibly allowing the appropriate audit conclusion to be reached after reduced audit testing. However, contradictory conclusions would result if more testing is done.

Final review stage: At this stage, in reviewing the final financial statements including detailed P&L a/c, the analytical review should be part of the overall 'reasonableness' check, ensuring that any discrepancies have been resolved and explained satisfactorily.

- (c)** Three specific examples are:

- (i) Comparing information policy decisions made in directors' meetings (e.g. from minutes) with actual results in management accounts are in line with decisions made. If discrepancies are apparent, then explanations should be sought.
- (ii) Comparing gross margins both from month to month in each department as given in management accounts and in comparing similar departments in different stores. It might indicate that either sales or cost of sales were mis-stated, and this possibility would have to be investigated.
- (iii) Comparing stock levels and values in various stores and from period to period, using the information available in management accounts - e.g.

Stock levels in different stores should bear a relationship to sales made in the various stores (allowing for possible limitations in storage area). Year to year this could be reviewed by reference to stock turnover ratios; individual stock lines should be valued at the same cost figure for all stores if there is a central buying department.

- 9. (a)** The auditor would be unlikely to use audit sampling techniques in the following situations.

- (i) Where the population size is so small that statistical sampling will create unacceptable margins of error. If the population is not sufficiently large then statistical methods are invalid. Also where transactions or balances are small in number and material in

relation to the financial statements. For example all large unusual items should be verified.

- (ii) Where the population is not homogeneous and requires stratification. For example stock and work in progress may need stratifying because of the diverse nature of the population and the need to increase the precision of the sampling unit. Raw material stocks, work in progress and finished good stocks are unlikely to represent a homogeneous population.
 - (iii) Where the population has not been maintained in a manner suitable for audit sampling. For example sales invoices may have been filed in customer order and not numerically. Audit sampling techniques would not be cost effective in these circumstances.
- (b) (i)** Attribute sampling is a statistical method used to estimate the proportion of items in a population containing a particular characteristic. This proportion is called the occurrence rate and is the ratio of items containing the specific attribute to the total number of population items. Auditors are usually interested in the occurrence of exceptions in populations and refer to the occurrence rate as a deviation rate or an error rate. An exception in attribute sampling may be a test of an internal control deviation or a monetary error. For example the signature of the credit controller on a sales order is an attribute and the absence of a signature is a deviation/error. By design, attribute sampling enables the auditor to conclude that the population contains errors (with an allowance for statistical error) in the same proportion as in the sample. Auditors use attribute sampling to determine the appropriateness of the assessed level of control risk, although it can be used for substantive tests particularly when tests of controls and substantive tests are performed concurrently.
- (ii)** Monetary unit sampling is a method of sampling which attempts to place a value on the errors in a population. The auditor is interested not only in error rates but also in the monetary effects of those errors. The population is divided up into units of one rupee and not into transactions or balances. The size of the sample is determined by the confidence level required and by the auditors tolerable error. Each transaction to which a Rs1 unit is attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said to be 'tainted' by the percentage of the error in the transaction. Thus Rs500 recorded as Rs550 would be 'tainted' by 10%. This method of sampling enables the auditor to determine the value of the most likely error and the maximum possible error in the population.
- (c)** The factors which the auditor should consider in determining the sample size are as follows:
- (i) *The efficiency and effectiveness of the internal control systems to process transactions without error:* The auditor has to determine the expected error rate. The auditor's estimate of this depends, amongst other things, upon his evaluation of internal control.
 - (ii) *The level of assurance which the auditor requires:* The auditor has to determine the amount of the risk which he is prepared to accept. This would be determined by the auditor's assessment of the audit risk attached to a particular client. There is considerable information available to the auditor about the organisation, its management and the expectations of company performance, for example, and these factors would play a role in determining sample size.
 - (iii) *The results of previous audit work:* The auditor has to assess the expected error rate based upon the results of audit work in this and previous years. The higher the expected error rate, the greater the sample size, although if very high error rates are expected it may not be appropriate to use a sampling approach.
 - (iv) *Stratification:* This is the process of dividing a population into strata so that items in each sub-population are expected to have similar characteristics. Sample sizes can be made smaller because the auditor can spend more time on those strata deemed to be

high risk.

- (d) Statistical sampling provides the auditor with a sound scientific basis for the generation of audit evidence. If the techniques are correctly employed, personal bias in the choice of sample size is reduced. The auditor is able to determine the reliability or precision of the sample and the risk inherent in relying upon the sample results. Thus greater reliance can be placed upon the audit evidence, with the result that the quality of the audit evidence is enhanced. Statistical sampling enables the auditor to generate audit evidence in a consistent manner over time and across different companies. This consistency of approach again improves the quality of the audit. The interpretation of the results of the test is more objective and is expressed in quantitative terms. As the sample result is objective, the audit evidence created is defensible in a court of law. This may not be the case if judgement sampling is used.

10. (a) (i) The characteristics of on-line computer systems may apply to a number of the types of on-line systems discussed in the previous section. The most significant characteristics relate to on-line data entry and validation, on-line access to the system by users, possible lack of visible transaction trail and potential programmer access to the system. The particular characteristics of a specific on-line system will depend on the design of that system.
- (ii) When are entered on-line, they are usually subject to immediate validation checks. Data failing this validation would not be accepted and a message may be displayed on the terminal screen, providing the user with the ability to correct the data and re-enter the valid data immediately. For example, if the user enters an invalid inventory part number, an error message will be displayed enabling the user to re-enter a valid part number.
- (iii) Users may have on-line access to the system that enables them to perform various functions, e.g. to enter transactions and to read, change or delete programmes and data files through the terminal devices. Unlimited access to all of these functions in a particular application is undesirable because it provides the user with the potential ability to make unauthorised changes to the data and programmes. The extent of this access will depend upon such things as the design of the particular application and the implementation of software designed to control access to the system.
- (iv) An on-line computer system may be designed in a way that does not provide supporting documents for all transactions entered into the system. However, the system may provide details of the transactions on request or through the use of transaction logs or other means. Illustrations of these types of systems include orders received by a telephone operator who enters them on-line without written purchase orders, and cash withdrawals through the use of automated teller machines.
- (v) Programmers may have on-line access to the system that enables them to develop new programmes and modify existing programmes. Unrestricted access provides the programmer with the potential to make unauthorised changes to programmes and obtain unauthorised access to other parts of the system. The extent of this access depends on the requirements of the system. For example, in some systems, programmers may have access only to programmes maintained in a separate programme development and maintenance library; whereas, in emergency situations which require changes to programmes that are maintained on-line, programmers may be authorised to change the operational programmes. In such cases, formal control procedures would be followed subsequent to the emergency situation to ensure appropriate authorisation and documentation of the changes.
- (b) (i) The following matters are of particular importance to the auditor in an on-line computer system;
- (a) authorisation, completeness and accuracy of on-line transactions;

- (b) integrity of records and processing, due to on-line access to the system by many users and programmers;
 - (c) changes in the performance of audit procedures including the use of CAAT's due to matters such as:
 - (i) the need for auditors with technical skills in on computer systems;
 - (ii) the effect of the on-line computer system on the timing of auditing procedures;
 - (iii) the lack of visible transaction trails;
 - (iv) procedures carried out during the audit planning stage;
 - (v) audit procedures performed concurrently with on-line processing; and
 - (vi) procedures performed after processing has taken place.
 - (ii) Procedures carried out during the planning stage may include:
 - (a) the participation on the audit team of individuals with technical proficiency in on-line computer systems and related controls;
 - (b) preliminary determination during the risk assessment process impact of the system on the audit procedures. A well designed and controlled on-line system will affect the auditor's assessment of control risk and influence the nature, timing and extent of audit procedures.
 - (iii) Audit procedures performed concurrently with on-line processing include compliance testing of the controls over the on-line applications. For example, this may be by means of entering test transactions through the on-line terminal services or by the use of audit software. These tests may be used by the auditor either to confirm his understanding of the system or to test controls such as passwords and other access controls. The auditor would be advised to review such tests with appropriate client personnel and to obtain approval prior to conducting the tests in order to avoid inadvertent corruption of client records.
 - (iv) Procedures performed after processing has taken place may include:
 - (a) compliance testing of controls over transactions logged by the on-line system for authorisation, completeness and accuracy;
 - (b) substantive tests of transactions and of processing results rather than tests of controls where the former may be more cost effective or where the system is not well designed or controlled;
 - (c) re-processing transactions as either a compliance or substantive procedure.
 - (v) The characteristics of on-line computer systems may make it more effective for the auditor to perform a pre-implementation review of new on-line accounting applications than to review the applications after installation. This pre-implementation review may provide the auditor with an opportunity to request additional functions, such as detailed transaction listings, or controls within the application design. It may also provide the auditor with sufficient time to develop and test audit procedures in advance of their use.
- 11. (a)** Section 292A of the Companies Act, 1956 relating to Audit Committee contains following provisions:
- (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" which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.
 - (2) Every Audit Committee constituted under sub-section (1) shall act in accordance with terms of reference to be specified in writing by the Board.

- (3) The members of the Audit Committee shall elect a chairman from amongst themselves.
 - (4) The members of the company shall 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 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 internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.
 - (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 recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board.
 - (9) If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore 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 with 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, or with fine which may extend to fifty thousand rupees, or with both."
- (b)** Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. It is the first step of any energy management programmes. The function of an energy auditor could be compared with that of a financial auditor. At the moment, while energy auditor is not yet a mandatory requirement on an all-India basis, the financial auditor is a pre-requisite for any organisation. Another key distinction is that the energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party.
- The starting point for energy analysis of a factory would be to assess its past performance. The energy manager should first establish the energy efficiency indicator of the factory. To obtain this, the simplest approach is to consider the overall factory as a "black box" and identify the different forms of energies going into the boundary and the products leaving it over a given time period. Thus the evolution in the consumption of these energy inputs and the production rate can be derived. From these, the variation in the specific energy consumption (energy consumed per unit production) with time and production rate can be established. These figures can be compared with the average values or those pertaining to the best practices for similar industries in order to assess the comparative performance of the plant. It is found that there is indeed any scope for reduction in the specific energy consumption, one has to perform preliminary and/or detailed energy audit for analysing the different utility areas where these energies are to be converted into the final forms required by the production processes. The different phases of energy auditing in an industry are given below. All three phases can be included in a single audit or they can be conducted separately, depending on the size of the factory or facility under investigation.
- (i) Analysis of historical energy consumption and cost data.
 - (ii) Preliminary energy audit, with the objectives to identify:
 - ◆ Major energy consuming equipment and processes

- ◆ Obvious inefficiencies and energy wastes
- ◆ Priority areas for further detailed investigation
- (iii) Detailed technical and economic analyses of energy efficiency measures, especially those involving large capital investment or long payback periods.
- (c) Environmental reporting is the term now commonly used to describe the disclosure by an entity of environmentally related data, verified (audited) or not, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities or environmental performance to those who have an interest in such information as an aid to enabling/enriching their relationship with the reporting entity) via either
 - (a) the annual report and accounts package;
 - (b) a stand-alone corporate environmental performance report (CER);
 - (c) a site-centered environmental statement; or
 - (d) some other medium (e.g. staff newsletter, video, CD ROM, internet site)

Different methodological approaches to environmental reporting have evolved, mainly because of local cultural/regulatory differences are as under:

Compliance based reporting: Reporting the level of compliance with external regulations and consent limits is a common feature of the environmental reports of heavily regulated utilities (water, electricity).

Impact based performance reporting: Most private sector companies that are not subject to specific consent requirements identify their key environment impacts and base their reporting around target setting and performance (over time) in achieving those targets.

The Eco-balance approach: Some companies (including many from Germany) construct a formal “eco-balance” (=resource inputs vs. product and non-product output) from which they then derive performance indicators.

The environmental burden approach (ICI0: ICI (the UK chemicals manufacturer) has developed an externally focused reporting approach which quantifies the company’s impact on 6 or 8 environmental quality measures.

Environmental audits are becoming increasingly common in certain industries. The term “environmental audit” has a wide variety of meanings. They can be performed by external or internal experts (sometimes including internal auditors), at the discretion of the entity’s management. In practice, persons from various disciplines can qualify to perform “environmental audits”. Often the work is performed by a multi-disciplinary team. Normally, “environmental audits” are performed at the request of management and are for internal use. They may address various subject matters, including site contamination, or compliance with environmental laws and regulations. However, an “environmental audit” is not necessarily an equivalent to an audit of an environmental performance report.

12. The written report is the medium by which the criticisms and recommendations of a management audit department are conveyed to the Board, to functional directors and to management in general. It follows, therefore, that audit reports crystallise the work of the management audit and merit the closest consideration of all audit staff engaged in their preparation. Reports must be written with very great care after full consideration of the subject matter and with full regard to the fact that it is imperative that the report conveys exactly the right impression on the reader.

Management audit reports will, inevitably, cover a wide variety of subjects, reflecting as they do the many and ever increasing ramifications of management audit departments. Broadly, however, reports may be divided into four main categories.

1. Reports prepared by the management audit staff after their visits to a unit.
2. Periodical reports prepared by the senior members of the management audit department which summarise the main audit findings and recommendations for the period under

consideration and which afford a concise review of the departments activities for that period.

3. Reports on the results of special investigations and enquiries.
4. An annual audit report.

While draft in the above mentioned types of reports the management auditor generally observes the following guidelines.

1. Organisation of the report: The following should be considered at the time of organising the report; format, title; objective; scope; findings; recommendation on auditee's view and summary.
2. Planning the audit report.
3. Supporting information.
4. Preparing Draft Report.
5. Writing and Issuing the Final Report.

Types of Management Audit Reports:

- (i) Oral Reports
- (ii) Interim Written Reports
- (iii) Regular Written Reports
- (iv) Summary Written Reports

13. One of the major considerations governing the selection and application of an accounting policy is 'materiality'. AS 1 requires that "financial statements should disclose all "material" items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements".

Paragraphs 3 to 7 of AAS 13, 'Audit Materiality', issued by the Institute of Chartered Accountants of India, which state as below:

"3. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item, judged in the particular circumstances of its misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

4. The objective of an audit of financial information prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable the auditor to express an opinion on such financial information. The assessment of what is material is a matter of professional judgement.

5. The concept of materiality recognises that some matters, either individually or in the aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices. The auditor considers materiality at both the overall financial information level and in relation to individual account balances and classes of transactions. Materiality may also be influenced by other considerations, such as the legal and regulatory requirements, non-compliance with which may have a significant bearing on the financial information, and considerations relating to individual account balances and relationships. This process may result in different levels of materiality depending on the matter being audited.

6. Although the auditor ordinarily establishes an acceptable materiality level to detect quantitatively material misstatements, both the amount (quantity) and nature (quality) of misstatements need to be considered. An example of a qualitative misstatement would be the inadequate or improper description of an accounting policy when it is likely that a user of the financial statements would be misled by the description.

7. The auditor needs to consider the possibility of misstatements of relatively small amounts

that, cumulatively, could have a material effect on the financial information. For example, an error in a month end (or other periodic) procedure could be an indication of a potential material misstatement if that error is repeated each month or each period, as the case may be.”

From the above, it is clear that though ‘accrual’ is one of the fundamental accounting assumptions, the materiality threshold is applicable to this accounting assumption also. If an information is immaterial on the consideration of materiality as mentioned in paragraphs 6 and 7 above, its accounting treatment would not have any effect on the decisions of the users of the financial statements. This view is also supported by the Preface to the Statements of Accounting Standards, issued by the Institute of Chartered Accountants of India, which states that “Accounting Standards are intended to apply only to items which are material” (paragraph 4.3). Accordingly, it needs to be ascertained under the facts and circumstances of the company concerned as to whether the amount of Rs. 25,000 would be material or not in respect of each item, or in the aggregate and that would provide the basis for its accounting treatment.

Accordingly, the appropriateness of the accounting policy of the company would depend upon the considerations of materiality determined on the basis of paragraphs 6 and 7 above. Accordingly, the accounting policy in question would be proper provided it does not cross the threshold of materiality.

14. (a) According to the AS-5 on “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies” issued by the Institute of Chartered Accountants of India a change in an accounting policy can be justified if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of an enterprise.
- (b) A change in an accounting estimate is different from a change in the accounting policy. The former is a routine matter in accounting which is substantially based on estimates. An estimate is made on the basis of facts and circumstances known at the time of making of the estimates. For example an estimate of bad debts is made on the basis of information in possession at the time of making the estimate. This may change on receipt of further information at subsequent date, e.g., insolvency of a debtor known afterwards. On the other hand a change in accounting policy is far less frequent and amounts to almost a permanent change in the basis of accounting in the concerned area. For example, the accounting policy for changing depreciation may be changed from straightline method to written down value method or the research costs may be charged off in the year itself, instead of being deferred as was the past policy. Usually a change in the accounting policy has a far reaching, material and long-term effect. The accounting picture may get substantially altered by the change in the policy, which normally is not the case with the change in accounting estimates.

However, sometimes a change in accounting estimate may have material effect on the income trend of the enterprise and in that circumstances here is a need to separately disclose the change and its effect on the accounts. For example, is a significantly large proportion of debtors prove bad in the subsequent year than was originally estimated, a need for separate disclosure will arise.

- (c) The Accounting Standard (AS-4) on “Contingencies and Events Occurring after Balance Sheet Date” issued by the Institute of Chartered Accountants of India provides that a contingent loss should be provided for by a charge in the statement of profits and loss if:
 - (i) it is probable that at the date of the financial statement events subsequent thereto will confirm that an asset has been impaired or a liability has been incurred as at that date; and
 - (ii) a reasonable estimate of the amount of the resulting loss can be made.

It may be noted that the provision by way of charge in the accounts should be made if both

of the above conditions are satisfied. If either is not satisfied, then a disclosure of the contingent loss should be made, unless the possibility of a loss is remote.

Contingent gains should not be accounted for in financial statements.

- (d) The given question is covered by note (f) under the horizontal form of the balance sheet incorporated in Schedule VI (Part 1A) of the Companies Act. Under that note dividends declared by subsidiary companies after the date of the balance sheet should not be included unless they are in respect of period which closed on or before the date of the balance sheet. In the instant case, the subsidiary's relevant accounting year ended on November 30, 1998. The subsidiary had declared the dividend in April, 1999 when the audit of the company concerned was in progress. Since the subsidiary's accounting period fell before the end of the accounting period of the concerned company, the dividend declared in April, 1999 shall have to be accounted for in the accounts of the company for the year ended on March 31, 1999. Apart from the legal provision mentioned above the Accounting Standard on Contingencies and Events occurring after the balance sheet date issued by the Institute of Chartered Accountants of India, supports the above treatment.

- 15. Responsibility of the Auditor:** The Auditor's education and experience enable him to be knowledgeable about business matters in general but he is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation such as an actuary or engineer.

When the auditor uses work performed by experts he continues to be responsible for forming and expressing his opinion on the financial information.

Evaluating the work of an expert: The auditor should obtain reasonable assurance that work performed by experts is adequate. He should satisfy himself as to the expert's skill and competence.

The auditor should seek reasonable assurance that the expert's work constitutes appropriate audit evidence in support of the financial information, by considering:

- (i) the source data used;
- (ii) the assumptions and methods used and if appropriate, their consistency with the prior period; and
- (iii) the results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures.

The auditor should consider whether the expert has used source data which are appropriate in the circumstances. The procedures to be applied by the auditor should include:

- (i) making inquiries of the expert to determine how he has satisfied himself that the source data are sufficient, relevant and reliable; and
- (ii) conducting audit procedures on the data provided by the client to the expert to obtain reasonable assurance that the data are appropriate.

The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the expert. The auditor does not have the same expertise and therefore, cannot always challenge the expert's assumptions and methods. However, the auditor should obtain an understanding of those assumptions and methods to determine that they are reasonable based on the auditor's knowledge of the client's business and on the result of his audit procedures.

Normally, completion of the above procedures will provide the auditor with reasonable assurance that he has obtained appropriate audit evidence in support of the financial information. If the work of an expert does not support the related representations in the financial information, the auditor should attempt to resolve the inconsistency by discussions with the client and expert. Applying additional procedures, including possibly engaging another expert, may also assist the auditor in resolving the inconsistency.

If, after performing these procedures, the auditor concludes that the work of the expert is inconsistent with the information in the financial statements, or that the work of the expert does not constitute sufficient appropriate audit evidence, he should express a qualified opinion, a disclaimer of opinion or an adverse opinion, as appropriate. (Also refer to AAS-9 on "Using the Work of an expert")

16. (a) It is normally desirable for the auditor to attend at stock-taking of a limited company client to see whether the instructions issued by the management as regard stock taking and the related arrangements are being faithfully followed and to test check the work performed by the stock-taking staff. It is the duty of the auditor to examine the arrangements made for stock-taking to see whether, by following these, stock-taking can be properly accomplished. It is the further duty of the auditor to see that the arrangements made and the instructions issued are being actually implemented. Normally, to be satisfied about this, personal presence of the auditor is desirable. If the auditor cannot be present at stock-taking each year, he should be present once in a few years.

The ICAI has expressed the view that wherever practicable, the auditor should, by special arrangement with the client, be present for at least part of the time, when the physical verification is carried out.

- (b) Overall audit tests that may be appropriate for assessing the reliability of records of stock-in-trade and work-in-progress may be the following:
- (i) Reconciliation in quantities of opening stocks, purchases/production, sales and closing stocks.
 - (ii) Comparison of the quantities and amounts of stocks in the various categories with those included at the previous balance sheet date and with current sales and purchases.
 - (iii) Consideration of the gross profit ratio shown by the accounts and its comparison with the ratio shown in the previous year.
 - (iv) Consideration of the rate of turnover of stocks and its comparison with previous year.
 - (v) Consideration of the relationship of the quantities ready for sale and in course of production with the quantities shown in operating and sales budgets, if any.
 - (vi) Reconciliation of changes in stock quantities as between the beginning and end of the financial year with the records of purchases, production and sales.
 - (vii) Where applicable, examination of standard costing records and consideration of the variances shown thereby.
 - (viii) If input-output ratios can be worked out and relied upon, these may be used to establish the quantity of output or, if this figure is available, the quantity of raw and other materials used. These figures can then be the basis of establishing the degree of reliability of the stocks on hand.
 - (ix) On the basis of the length of the production process, the amount of work in progress that there ought to be can be estimated. This may then be compared with the amount shown in the records; if the two more or less agree, the actual work-in-progress can be treated as reliable.

17. (a) Depositing Undisputed Statutory Dues:

- (i) This clause requires the auditor to report upon the regularity of the company in depositing undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth-tax, service tax, custom duty, excise duty, cess and any other statutory dues to appropriate authorities. If the company is not regular in depositing the above mentioned undisputed statutory dues, the auditor is required to state the extent of arrears of statutory dues which have remained outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable.

- (ii) It may be noted that the use of the words “any other statutory dues” indicates that the clause covers all type of dues under various statutes which may be applicable to a company having regard to its nature of business. Apart from the statutory dues listed, the auditor is required to report on the regularity of the company in depositing “any other statutory dues” payable by the company to appropriate authorities under the statutes applicable to the company.
- (iii) The intention of the Government, in this clause is to ascertain how regular the company is in depositing statutory dues with the appropriate authorities. Since the emphasis of the clause is on the regularity, the scope of auditor’s inquiry is restricted to only those statutory dues, which the company is required to deposit regularly to an authority. The auditor is not required to ascertain whether the company is regular in depositing amounts, which may be levied by an appropriate authority from time to time upon occurrence or non-occurrence of certain events and therefore are not required to be paid regularly. Any sum, which is to be regularly paid to an appropriate authority under a statute (whether Central, State or Local or foreign) applicable to the company, should be considered as a “statutory due” for the purpose of this clause. In other words, obligation to pay a statutory due is created or arises out of a statute, rather than being based on an independent contractual or legal relationship. Thus, examples of “statutory dues” would include municipal taxes, taxes deducted at source, fees payable to the licensing authority in respect of business being carried on under license granted by an authority, say a cinema hall. Accordingly, any sum payable to an electricity company as electricity bill would not constitute a statutory due despite the fact that such a company has been established under a statute. This is so because the due has arisen on account of contract of supply of goods or services between the parties. However, care shall have to be taken that in case any dues are recoverable as arrears of land revenue by the concerned authority, the same shall be treated as a statutory due.
- (iv) With reference to regularity, it is also important to distinguish amongst the various items stated in the clause. The auditor should very clearly understand the nature of each statutory due payable by the company while examining the aspect of regularity before commenting on the same. For instance, the regularity is a normal feature in case of certain statutory dues such as, provident fund, employees’ state insurance, sales tax, etc., because the companies are required to deposit the money with appropriate authorities on a monthly or quarterly basis. But this is not the case in respect of, say, custom duty on import of goods or demands arising on account of assessment orders etc., which a company is required to pay as and when an event giving rise to the liability of the company occurs. Such dues should be construed to have been paid regularly if the company deposits them as and when they become due. However, the auditor would be required to comment upon the regularity of the company in depositing the installments, if any, granted by an authority in respect of a demand against the company.
- (v) Non-payment of advance income tax would constitute default in payment of statutory dues. It may, however, happen that the company might not have any taxable income on the due dates on which advance tax is required to be paid. If such a company has an income after the last date on which the advance tax was required to be paid and consequently the company incurs interest under the relevant provisions of the Income Tax Act, 1961, it should not be construed that the company is not regular in depositing advance tax.
- (vi) It may be noted that at present, no Rules relating to the amount of cess for rehabilitation or revival or protection of assets of sick industrial companies, payable by a company under section 441A of the Act have been notified by the Central Government. Thus, it would not be possible for the auditor to comment on the regularity or otherwise about the cess till the time relevant rules or regulations are

issued. However, till the time such Rules are prescribed, the auditor should also state in his report under this clause that the Government has not notified any Rules under section 441A of the Companies Act, 1956 and therefore the auditor is unable to comment on this particular issue.

- (vii) It may be noted that the auditor has to report on the regularity of deposit of statutory dues irrespective of the fact whether or not there are any arrears on the balance sheet date. This is because there may be situations where a company has deposited the relevant dues before the end of the year while it has been in default in the matter for a significant part of the year. In cases where there are no arrears on the balance sheet date but the company has been irregular during the year in depositing the statutory dues, the auditor should state this fact in his audit report.
- (viii) For the purpose of this clause, the auditor should consider a matter as “disputed” where there is a positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty, e.g., where it has gone into appeal. For this purpose, where an application for rectification of mistake (e.g., under section 154 of the Income Tax Act, 1961) has been made by the company, the amount should be regarded as disputed. Where the demand notice/intimation for the payment of a statutory due is for a certain amount and the dispute relates only to a part and not the whole of such amount, only such amount should be treated as disputed and the balance amount should be regarded as undisputed. It is not necessary for the auditor to examine the sustainability or otherwise of the claim of the company regarding disputed amounts. It is sufficient for his purpose if the evidence available shows that the amount is disputed by the company. It may also be noted that the Order has clarified that mere representation to the concerned Department does not constitute the dispute.
- (ix) Another question that arises is that when do the statutory dues become payable. There can be two views with regard to the question. On the one hand, it can be argued that the statutory dues referred to in this clause become payable on the last date by which payment can be made without attracting penalty and/or interest under the relevant law. On the other hand, it can also be argued that the amounts referred to in the clause become so payable as at the date of the expiry of the stay granted by the authorities or, where instalments have been granted for the payment of statutory dues referred to in the clause, the date on which the default occurs and the amount becomes payable to the authorities. As the purpose of this clause is to indicate the amounts which have become actually payable and are outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable, the latter view seems to conform more closely to the requirements of the Order.
- (x) It may be noted that penalty and/or interest levied under the respective laws would be covered within the term “amounts payable”.
- (xi) The report should be restricted to the actual arrears and should not include the amounts which have not fallen due for payment to appropriate authority and have been recognised as outstanding dues at the balance sheet date.
- (xii) It is possible that in a large company where there are a number of departments with separate payrolls and where payments are spread over a number of days, the collection of data regarding the provident fund/employees’ state insurance collections and the company’s contribution thereto may take some time. In order to ensure that deposit of the dues is made in time, the company may make lump-sum deposits of estimated amounts and adjust the excess or deficit against the following month’s deposit. If this method is consistently followed and the difference between the total dues and the lump-sum deposit is not significant, it need not be considered that dues have not been regularly deposited and no adverse comment is necessary.
- (xiii) The auditor should make plans to test whether the company is regular in depositing undisputed statutory dues. The auditor, in order to be able to comment on this clause,

should have a general understanding of the various statutes governing the company and the dues payable by the company under those statutes. The auditor should also enquire of the management of the company about the statutes under which the company is required to pay any statutory dues. The auditor should also discuss with the management, the policies or procedures adopted for identification and payment of statutory dues. The auditor may also obtain from the management or himself prepare a calendar of dates for submission of various statutory dues by the company for his reference.

- (xiv) The information necessary to comply with this requirement of the Order may be obtained from the company in the form of a statement. The statement should contain a list of various statutes under which the company is required to make payments regularly to appropriate authorities, the kind of payments under each statute, the due date for making the payment to the appropriate authority, the date on which the payment is made by the company, the arrears not due and the arrears over due for more than six months. The auditor should verify the statement provided by the management with the underlying documents and records. The auditor's general understanding of the various statutes governing the company and the dues payable by the company under those statutes would help the auditor in assessing the completeness of the statement. The auditor should recognise that there could be a situation that a statutory due might have become payable but has not been captured by the accounting and internal control systems established by the enterprise and, therefore, the auditor should perform procedures to mitigate risk arising from such a situation.
- (xv) The auditor should obtain a written representation with reference to the date of the balance sheet from the management:
 - (i) specifying the cases and the amounts considered disputed;
 - (ii) containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months from the date they became payable; and
 - (iii) containing a statement as to the completeness of the information provided by the management.
- (xvi) While the auditor has to report upon the regularity of the deposit, he is not required to specify in detail each instance where there has been a delay or the extent of the delay. It should be sufficient if he indicates whether generally the deposits have been regular or otherwise. The following are examples of the wordings, which may be used in relevant situations:
 - “undisputed statutory dues including provident fund, investor education and protection fund, or employees' state insurance, income-tax, sales-tax, wealth tax, service tax, custom duty, excise duty, cess have been regularly deposited by the company with the appropriate authorities in all cases during the year”.
 - “undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, custom duty, excise duty, cess have generally been regularly deposited with the appropriate authorities though there has been a slight delay in a few cases”.
 - “undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, custom duty, excise duty, cess have not generally been regularly deposited with the appropriate authorities though the delays in deposit have not been serious”.
 - “undisputed statutory dues including provident fund, investor education and

protection fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, custom duty, excise duty, cess have not been regularly deposited with the appropriate authorities and there have been serious delays in a large number of cases".

- (xvii) If the auditor is of the opinion that the company is not regular in depositing undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, custom duty, excise duty, cess and any other statutory dues with the appropriate authorities, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, are required to be mentioned by the auditor in his audit report. In indicating the arrears, the period to which the arrears relate should also preferably be given and further, wherever possible, the fact of subsequent clearance or otherwise may also be indicated. The following is the format in which the auditor may report the extent of the arrears of outstanding statutory dues:

Statement of Arrears of Statutory Dues Outstanding for More than Six Months

<i>Name of the Statute</i>	<i>Nature of the Dues</i>	<i>Amount (Rs.)</i>	<i>Period to which the amount relates</i>	<i>Due Date</i>	<i>Date of Payment</i>
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(b) Disputed Amounts

- (i) This clause requires that in case of disputed statutory dues, the amounts involved should be stated along with the forum where the dispute is pending.
- (ii) The audit procedures applied by the auditor for commenting on the previous clause, including obtaining a statement from the management in regard to the matters specified in the clause, would help the auditor in determining the dues of sales tax/income tax/custom duty/wealth tax/service tax/excise duty/cess that have not been deposited on account of any dispute, the amounts involved and the forum where dispute is pending. The auditor should also obtain a management representation about the disputed dues, the amounts involved and the forum where the dispute is pending. The auditor should carry out necessary audit procedures to verify the information provided by the management.
- (iii) It is clarified here that mere representation to the concerned Department does not constitute dispute. According to the Order, it is necessary that there should be an appeal before the relevant appellate authority. It is, however, reiterated that where an application for rectification of mistake (e.g., under Section 154 of the Income tax Act, 1961) has been made by the company, the amount should be regarded as disputed.
- (iv) A show-cause or similar notice generally contains the requirements/queries of the assessing officer. Normally, issuance of a show cause notice by the concerned department should not be construed to be a demand payable by the company. However, in some cases, a show cause notice and demand may be combined in one document. Normally, in such cases, the demand would not be construed to have arisen till the time the assessee has disposed off the requirements of the show cause order. Hence, it would be necessary to evaluate each situation individually.
- (v) Tax demands that have been set aside are clearly not 'dues'. Similarly, if a demand has been referred for reassessment and the effect of such referral is the cancellation of the earlier demand, this too would not constitute an amount due. The wording of the order would be of significance; if the demand is not cancelled, it will remain disputed dues. As far as demands that have been stayed are concerned, these should be regarded as disputed dues. These should be disclosed along with a disclosure of the fact of stay. The fact that a stay has been granted does not mean that the authority granting the stay has held that the amount in question is not a valid demand against the company. The stay normally is a concession that the amount may not be deposited

immediately or that it may be deposited in installments. Sometimes a stay is granted if the assessee provides a bank guarantee. It may also be noted that there may be a situation that the appellate authority has decided a case in favour of the company but the Department may prefer to make an appeal to a higher authority. In such a case, there is considered to be no dispute until the time the Department makes an appeal to the relevant appellate authority. Further, in case where the amount under the dispute is pending for an appeal to be filed and the time limit for filing the appeal has lapsed, the disputed amount would become a statutory due and the reporting responsibilities of the auditor as are applicable to any other undisputed statutory due under clause 4(ix)(a) of the Order would become applicable. Further, in case where the amount under dispute has not been paid before filing the appeal and no appeal is filed within the time allowed and the time limit for filing the appeal has expired, the disputed amount would become a statutory due.

- (vi) It is possible that in respect of same nature of statutory dues, there may be more than one dispute pertaining to different periods for which, appeals might have been filed separately. For example, different years' income tax liabilities might have been disputed at different levels of appellate authorities. Hence, in such cases, the information required by the clause should be given separately in respect of each period. In the case of a large company having a number of manufacturing and marketing divisions, it would be quite normal that many cases relating to sales tax, income tax, excise, customs etc., are disputed and are pending at various stages. It cannot be the intention of the clause that each case is listed separately. It is, therefore, proper to summarise the cases stage-wise under each broad head, e.g., sales tax, income-tax, custom duty, excise duty, wealth tax, cess and give the particulars as indicated in paragraph (g) below.
- (vii) The information required by the clause may be reported in the following format:

Statement of Disputed Dues

<i>Name of the Statute</i>	<i>Nature of the Dues</i>	<i>Amount (Rs.)</i>	<i>Period to which the amount relates</i>	<i>Forum where dispute is pending</i>
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- (viii) Further, a plain reading of the clause suggests that the amounts to be reported under clause 4(ix)(b) of the Order are those which have not been deposited on account of any dispute, irrespective of the treatment of such disputed amounts in accounts. It is quite possible that an amount is disputed and has not been deposited but on consideration of the likely outcome of the dispute, a provision has been made in the accounts. Such an amount will need to be reported, notwithstanding that it has been provided for. Similarly, even if it had not been provided for, it would have to be reported as long as it is not deposited. It is also possible that an amount is disputed, has been deposited and on consideration of the likely outcome of the dispute, has been shown as a recoverable. Though such an amount is not contemplated for reporting under the clause, since it has been deposited, the fact of such deposit having been made under protest should be brought out by the auditor in his report under the clause.

Whether a disputed amount should be provided for in the accounts or not will need to be judged in the context of Accounting Standard (AS) 4, "Contingencies and Events Occurring After the Balance Sheet Date and/or Accounting Standard (AS) 29, "Provisions, Contingent Liabilities and Contingent Assets".

(c) Entry in Register u/s 301:

- (i) This part of the clause requires that the auditor should report whether the transactions that need to be entered into a register in pursuance of particulars of contracts or arrangements referred to in section 301 of the Act have been so entered. Section 301 of the Act requires that every company shall keep one or more registers in which shall

be entered separately, particulars of all contracts or arrangements to which sections 297 and 299 of the Act apply.

- (ii) It is suggested that the auditor should acquaint himself with all the requirements of sections 297, 299 and 301 of the Act.
- (iii) It should also be noted that according to section 299(6), section 301 is not applicable to situations where two companies having common directors enter into a transaction but none of the director, individually or together with the other directors, holds more than two percent of the paid up share capital of the company. Thus, the reporting under this clause pertains only to the loan transactions with the parties covered by section 301 of the Act and does not extend to such situations where loan transactions are entered into with another company where the directors are common but such directors do not hold more than two percent of the paid up share capital.
- (iv) It may, however, be noted that as per section 299(6) of the Act, the requirements of section 301 of the Act do not apply to a contract or arrangement entered into or to be entered into between two companies where any of the directors of one of the company or two or more of them together holds or hold not more than two percent of the paid-up share capital in the other company. For example, the mere fact that a director is a shareholder in a public limited company will not mean that he is interested unless, of course he, together with other directors, holds more than 2% or more of the share capital.
- (v) Normally, particulars are entered in the register maintained under section 301 of the Act based on notices received (Form 24AA) from the directors of the company under section 299 of the Act. As mentioned earlier, the directors are required to make a disclosure of interest either at a meeting of the Board of Directors or by way of a general notice under sub-section (3) of section 299 of the Act. Entries are also made in the register on the basis of the approval of the board of directors accorded in terms of section 297 of the Act. In case the company is required to obtain prior approval of the Central Government but has not so obtained, the auditor should state the fact in his report under the Order. A separate qualification may not be required in the main audit report provided the necessary provisions to meet the cost of non-compliance has been made and the fact of non-compliance (including the amounts involved) has been appropriately disclosed in the financial statements.
- (vi) The auditor should obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under section 301 of the Act. The auditor should verify the entries made in the register maintained under section 301 of the Act from the declarations made by the directors in Form 24AA i.e., general notice received from a director under sub-section (3) of section 299 and on the basis of the approval of the board of directors under section 297 of the Act which would be evident from the minutes of the meetings of the board of directors. The auditor should also obtain a written representation from the management concerning the completeness of the information so provided to the auditor. While the auditor can verify the completeness of the entries in the register maintained under section 301 from Form 24AA in respect of transactions or contracts covered by section 297, the auditor should perform additional procedures to verify the completeness of the entries in the register to which section 297 of the Act applies. The auditor should review the information provided by the management. The auditor should also perform the following procedures in respect of the completeness of this information:
 - (i) review his working papers for the prior years, if any, for names of known companies, firms or other parties the particulars of which are required to be entered in the register maintained under section 301 of the Act; and
 - (ii) review the entity's procedures for identification of companies, firms or other parties the particulars of which are required to be entered in the register

maintained under section 301 of the Act.

- (vii) The auditor should verify, on the basis of information provided by the management and on the basis of the results of the procedures performed by him, whether transactions that need to be entered into a register in pursuance of section 301 of the Act have been so entered or not. The auditor also evaluates whether the register under section 301 is updated and maintained properly. The auditor should also examine, wherever applicable, secretarial compliance certificate issued under section 383A of the Act in regard to the completeness of the register maintained under section 301 of the Act. The auditor may also rely upon such a certificate issued by a company secretary provided the auditor complies with the requirements of Auditing and Assurance Standard (AAS) 9, "Using the Work of an Expert".
- (viii) There may be situations where the company has not properly maintained the register required to be maintained by it under section 301 or has not updated the said register and the necessary declarations from the directors in Form 24AA are also not available on record. In such situations, the auditor should state the fact of non-maintenance/improper maintenance of the aforesaid register, while reporting under this clause. An example of such a reporting by the auditor could be:

"According to the information and explanation given to us, we are of the opinion that the company has not entered all the transactions required to be entered in the register maintained under section 301 of the Companies Act, 1956. The following are the particulars of two such transactions which needed to be entered into the register but were not so entered:

- (i) purchase of plant and machinery costing Rs.2,00,000 from a firm in which one of the directors, Mr. X, is a partner.
- (ii) sale of administrative block building of the company for Rs.1,00,000 to a relative of Mr. Y, one of the directors of the company."

(d) Reasonableness of Transactions entered in Register u/s 301:

- (i) This clause requires the auditor to comment upon the reasonableness of the prices of all the transactions which have been entered in pursuance of contracts or arrangements covered in the register(s) maintained under section 301 of the Act if such transactions in respect of any party and in any one financial year exceed the value of rupees five lakhs. The auditor is required to determine the reasonableness of prices having regard to the prevailing market prices at the relevant time. It is clarified here that the scope of the auditor's inquiry under this clause is restricted to such transactions to which sections 297 and 299 of the Act apply and thereby required to be entered in the register maintained under section 301 of the Act.
- (ii) The auditor should, while reporting on this clause of the Order, in the first instance, determine whether the aggregate value of all the transactions entered into with any of the companies/firms/parties covered in the register maintained under section 301 of the Act exceed the value of rupees five lakhs. If so, the auditor has to examine whether each of the transactions entered into with such a company/firm/party have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time.
- (iii) The auditor has to examine whether the prices paid for the transactions examined by him are reasonable, having regard to the prevailing market prices at the relevant time. The auditor is not expected to make a roving market inquiry to determine the market prices prevailing at the time the transactions were entered into. However, he may examine information such as price lists, quotations, and records relating to prices at which similar transactions have been entered into with other parties, etc., at the relevant time. The auditor has to satisfy himself, taking into account all the relevant

information as well as any explanations given by the management, whether the prices at which various transactions have been made are reasonable. In determining the reasonableness of the prices, the auditor should take into account all the factors surrounding the transactions such as the delivery period/schedule of implementation, the quality and the quantity of the product/service, the credit terms, the previous record of supplier/buyer/client, etc. For example, a company may decide to buy the goods (not necessarily at the lowest prices) from parties required to be listed in the register maintained under section 301 of the Act on account of the fact that the company finds such parties more reliable in terms of quality and/ or supply of goods. In a transaction of purchase, it is not necessary that purchases be made in all cases at the lowest rates. When the rates paid are higher than the prevailing market prices, the auditor has to use his judgement to determine whether the difference in rates is reasonable having regard to the other factors mentioned above. This may often be the case where the company wishes to have more than one source of supply or where there is limit to the manufacturing capacity of the supplier who quotes a lower price. Thus, the intention of the clause is to require the auditor to examine and comment on the reasonableness of the prices at which the transactions have been entered into.

- (iv) A difficulty in judging the reasonableness of prices may also arise in cases where transactions are entered with sole suppliers. In such cases, the auditor may examine the reasonableness of prices paid with reference to list prices of the supplier concerned, other trade terms of the supplier, etc.
- (v) The auditor while reporting under this clause in circumstances outlined in paragraph (c) and (d) above should clearly bring out the reasons as to why no adverse comment was considered necessary.

18. AS 10 states as below:

“23. Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.”

The expenditure on fixed assets subsequent to their installation may be categorised into (i) repairs, and (ii) improvements or betterments. Repairs, generally imply “the restoration of a capital asset to its full productive capacity after damage, accident, or prolonged use, without increase in the previously estimated service life or capacity”. It frequently involves replacement of parts. On the other hand, betterment is defined as “... an expenditure having the effect of extending the useful life of an existing fixed asset, increasing its normal rate of output, lowering its operating cost, or otherwise adding to the worth of benefits it can yield. The cost of adopting a fixed asset to a new use is not ordinarily capitalised unless at least one of these tests is met. A betterment is distinguished from an item of repair or maintenance in that the latter has the effect of keeping the asset in its customary state of operating efficiency without the expectation of added future benefits.

Normally, expenditure on repairs, including replacement cost necessary to maintain the previously estimated standard of performance, is expensed in the same period. Similarly, the cost of adopting a fixed asset to a new use or modernisation of such asset without actually improving the previously estimated standard of performance is also expensed.

The company should expense the normal expenditure on repairs of the machines, including the cost of replacement necessary to maintain the previously assessed standard of performance of the machines, in the year when such expenditure is incurred. The incremental expenditure, over and above the normal repairs, incurred on improvement and renovation of its plant and machinery to increase their efficiency in production should be capitalised provided such improvements will result into increase in the future benefits beyond the previously assessed standard of performance of such machines.

Appendices

Appendix I – AAS 31 - Engagements to Compile Financial Information

Appendix II – AAS 32 - Engagements to Perform Agreed-upon Procedures regarding Financial Information

Appendix III – Amendment of the Companies (Auditor's Report) Order, 2004

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Appendix X – General Clarification on AAS 9

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Appendix I

Auditing and Assurance Standard (AAS) 31 Engagements to Compile Financial Information

Introduction

1. The purpose of this Auditing and Assurance Standard (AAS) is to establish standards on professional responsibilities of an accountant¹ when an engagement to compile financial statements or other financial information is undertaken and the form and content of the report to be issued in connection with such a compilation so that the association of the name of the accountant with such financial statements or financial information is not misconstrued by a user of those statements or information as having been audited by him.

2. This AAS is directed towards the compilation of financial information. However, it should be applied to the extent practicable, to engagements to compile non-financial information, provided the accountant has adequate knowledge of the subject matter in question. Engagements to provide limited assistance to a client in the preparation of financial statements (for example, selection of an appropriate accounting policy), do not constitute an engagement to compile financial statements. This AAS should be read in conjunction with the “Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.”

Objective of a Compilation Engagement

3. **The objective of a compilation engagement is for an accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information.** This ordinarily entails reducing detailed data to a manageable and understandable form without the requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the accountant to express any assurance on the financial information. However, users of the compiled financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.

4. A compilation engagement would ordinarily include the preparation of financial statements (which

¹ For the purpose of this Auditing and Assurance Standard and to distinguish between an audit and a compilation engagement, the term 'accountant' (rather than 'auditor') has been used throughout to refer to a member of the Institute in practice.

may or may not be a complete set of financial statements) but may also include the collection, classification and summarisation of other financial information, for example, preparation of quarterly financial results, restatement of financial statements in accordance with a financial reporting framework other than in accordance with which the financial statements to be restated are already prepared and presented.

General Principles of a Compilation Engagement

5. **The accountant should comply with the “Code of Ethics” issued by the Institute of Chartered Accountants of India.** The ethical principles governing the accountant’s professional responsibilities for this type of engagement are:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality;
- (e) Professional conduct; and
- (f) Technical standards.

Independence is not a requirement for a compilation engagement. **However, where the accountant is not independent, a statement to that effect should be made in the accountant’s report.**

6. **In all circumstances when an accountant’s name is associated with financial information compiled by him, the accountant should issue a report.**

Responsibility of Management

7. The management is responsible for taking reasonable steps to prevent and detect errors, fraud or other irregularities. This includes:

- (i) Ensuring that the financial information generated in the entity is correct, complete and reliable;
- (ii) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- (iii) Establishing controls designed to safeguard the assets of the entity and also to deter fraudulent or other dishonest conduct and to detect any fraud that occurs;
- (iv) Establishing controls to provide reasonable assurance that the entity complies with laws and regulations applicable to its activities, or for detecting any non-compliance with laws or regulations that occurs.

8. **A compilation engagement cannot be regarded as providing assurance on the adequacy of the client’s internal control systems or on the actual incidence of fraud or non-compliance with laws and regulations. A compilation engagement carried out by the accountant does not relieve the management of these responsibilities.**

9. The management is also responsible for preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any. **The accountant should, accordingly, obtain an acknowledgement from the management of its responsibility for the appropriate preparation and presentation of the financial statements or other information and of its approval of such information to be compiled. The accountant should also obtain an acknowledgement from management of its responsibility for the accuracy and completeness of the underlying accounting data and the complete disclosure of all material and relevant information to the accountant.**

Defining the Terms of the Engagement

10. An engagement letter will be of assistance in planning the compilation work. The scope of a compilation engagement would, normally, be defined by the instructions of the client, though in certain cases, for example, in case of compilation of financial statements of a company, the form and content of such financial statements might be laid down under a statute. **The accountant should, therefore,**

ensure that there is a clear understanding between the client and the accountant regarding the terms of the engagement by means of an engagement letter or such other suitable form of contract. Thus, it is in the interest of both the accountant and the entity that the accountant sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the accountant's acceptance of the engagement and helps avoid misunderstanding regarding matters such as the objective and scope of the engagement and the extent of the auditor's responsibilities.

11. The engagement letter would include matters such as the following:

- (a) Nature of the engagement including the fact that neither an audit nor a review will be carried out and that accordingly no assurance will be expressed.
- (b) Fact that the engagement cannot be relied upon to disclose fraud or defalcations that may exist but that the accountant will bring to the attention of the management any such matter which might come to his attention during the course of his engagement.
- (c) Nature of the information to be supplied by the client.
- (d) Fact that management is responsible for:
 - (i) the accuracy and completeness of the information supplied to the accountant, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.
 - (ii) preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.
 - (iii) safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.
 - (iv) ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.
 - (v) ensuring complete disclosure of all material and relevant information to the accountant.
- (e) Intended use and distribution of the information, once compiled.
- (f) Basis of accounting on which financial information is to be compiled and the fact that the basis, and any known departures therefrom, if any will be disclosed.
- (g) The fact that the management is responsible to the users for the information to be compiled by the accountant.
- (h) Unrestricted access to whatever records, documents and other information is requested in connection with the compilation engagement.
- (i) Basis on which fees would be computed and any billing arrangements.
- (j) Request for the client to confirm the terms of engagement by acknowledging the receipt of the engagement letter.

An example of an engagement letter for a compilation engagement appears in Appendix I.

Planning

12. **The accountant should plan the work so that an effective engagement will be performed.**

Documentation

13. **The accountant should document matters, which are important in providing evidence that the engagement was carried out in accordance with this Auditing and Assurance Standard and the terms of the engagement.**

Procedures

14. **The accountant should obtain a general knowledge of the business and operations of the entity and should be familiar with the accounting principles and practices of the industry in**

which the entity operates and with the form and content of the financial statements/ other financial information that is appropriate in the circumstances.

15. To compile financial information, the accountant requires a general understanding of the nature of the entity's business transactions, the form of its accounting records and the accounting basis on which the financial information is to be presented. The accountant ordinarily obtains knowledge of these matters through experience with the entity or inquiry of the entity's personnel.

16. Other than as noted in this Auditing and Assurance Standard, the accountant is not, ordinarily, required to:

- (a) make any inquiries of management to assess the reliability and completeness of the information provided;
- (b) assess internal controls;
- (c) verify any matters; or
- (d) verify any explanations.

In a compilation engagement, an accountant would normally have to rely on the management for most of the information needed to compile the financial statements or other financial information, including accounting estimates as well as the fact that the information given to the accountant is complete and reliable. **The accountant should request management representation letter covering significant information or explanations given orally on which he considers representations are required.**

17. If the accountant becomes aware that the information supplied by management is incorrect, incomplete, or otherwise unsatisfactory, the accountant should consider performing the procedures listed in Paragraph 16 and request management to provide additional information. If management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for the withdrawal.

18. The accountant should read the compiled information and consider whether it appears to be appropriate in form and free from obvious material misstatements. In this sense, material misstatements include:

- (a) mistakes in the application of the identified financial reporting framework.
- (b) non-disclosure of the financial reporting framework and any known departures therefrom.
- (c) non-disclosure of any other significant matters of which the accountant has become aware.

The identified financial reporting framework and any known departures therefrom should be disclosed within the financial information, though their effects need not be quantified.

Special Considerations

Clients Having an Identified Financial Reporting Framework

19. As far as practicable, in case of compilation of financial statements prepared within an identified financial reporting framework², the accountant should ensure that the financial statements or other financial information compiled comply with the requirements of the identified financial reporting framework. In case of any material departures from the requirements of the identified financial reporting framework, the fact should be stated in the Notes to the Accounts or other compiled financial information as well as in the accountant's

² Paragraph 3 of the Framework for Statements on Standard Auditing Practices and Guidance Notes on Related Services states as follows:

"Financial statements are ordinarily prepared and presented annually and are directed toward the common information needs of a wide range of users. Many of those users rely on the financial statements as their major source of information because they do not have the power to obtain additional information to meet their specific information needs. Thus, financial statements need to be prepared in accordance with one, or a combination of :

- (a) relevant statutory requirements, e.g., the Companies Act, 1956, for companies;
- (b) accounting standards issued by the Institute of Chartered Accountants of India; and
- (c) other recognised accounting principles and practices, e.g., those recommended in the Guidance Notes issued by the Institute of Chartered Accountants of India."

report on the compilation.

Clients Having No Identified Financial Reporting Framework

20. In case of clients for whom compliance with an identified financial reporting framework is not required or the Accounting Standards issued by the Institute of Chartered Accountants of India are not mandatory, the client may specify that the accounts should be compiled on, for example, based on the requirements of the Income Tax Act, 1961. **However, since, accounts are normally assumed to be compliant with the generally accepted accounting practices, including the Accounting Standards issued by the Institute of Chartered Accountants of India, the different basis of compilation should be set out in the Notes to the Accounts or other compiled financial information as well as the report issued by the accountant on compilation.**

Non-Compliance with the Accounting Standards

21. In the case of a company, the financial statements compiled must comply with the relevant provisions of the Companies Act, 1956, including the Accounting Standards and, accordingly, give a true and fair view. However, without carrying out the procedures necessary for an audit, the accountant cannot form any opinion on whether the accounts give a true and fair view, even though he has compiled these financial statements. The compilation is based on the information supplied to the accountant by the client and does not include any verification thereof. **However, if the accountant becomes aware of material non-compliance with any applicable Accounting Standard(s), the same should be brought to the attention of the management and, if the same is not rectified by the management, it should be included in the Notes to the Accounts and the compilation report of the accountant.**

Accounting Estimates Made by Clients

22. Often in compilation engagements, it is necessary for certain items in the accounts, for example, work in progress, to be based on estimates by the client. Such estimated items should be so described where material. **If, based on the information provided to the accountant, it appears that certain estimates are unreasonable, the accountant should draw these to the attention of the management for reconsideration.**

23. **If the accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other compiled financial information. If such amendments are not made and the financial statements are still considered to be misleading, the accountant should withdraw from the engagement.**

24. The financial statements or other financial information compiled should be approved by the client before the compilation report is signed by the accountant. The client should be asked to sign a statement on the face of the accounts retained by the accountant. The accountant should ensure that the users of the financial statements or other financial information so compiled are aware of the extent of his/her involvement with the accounts so that the users do not derive unwarranted assurance. Accordingly, the word 'audit' should not be used in describing the nature of services involving compilation of financial statements or other financial information, nor the fee for these services be described as "auditors' fee", or remuneration in the accounts, correspondence or any other document. The accountant should also take note that the financial statements or other financial information so compiled should not be prepared on the letter-heads or other stationery of the accountant, carrying his (or firm's) name and address since it is liable to be misinterpreted.

Reporting on a Compilation Engagement

25. It is essential that the accountant clearly brings out the nature of association with the financial statements and the nature of the work performed by him. The report on compilation engagements should, ordinarily, be in the following lay out:

- (a) **Title:** The title of the report should be "Accountant's Report on Compilation of Unaudited Financial Statements" (and not "Auditor's Report");

- (b) **Addressee:** The report should ordinarily be addressed to the appointing authority;
- (c) **Identification of the financial information** also noting that it is based on the information provided by the management;
- (d) **When relevant, a statement that the accountant is not independent of the entity;**
- (e) **A statement that the management is responsible for:**
 - (i) **completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant;**
 - (ii) **maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;**
 - (iii) **preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any;**
 - (iv) **establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities;**
 - (v) **establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance;**
- (f) **A statement that the engagement was performed in accordance with this Auditing and Assurance Standard;**
- (g) **A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information;**
- (h) **A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework;**
- (i) **Date of the report;**
- (j) **Place of signature; and**
- (k) **Accountant's signature:** The report on compilation of financial information should be signed by the auditor in his personal name. Where a firm is appointed for the engagement, the report should be signed in the personal name of the accountant and in the name of the firm. The partner/proprietor signing the report on compilation of financial information should also mention the membership number assigned by the Institute of Chartered Accountants of India

Appendix II to this Standard contains examples of compilation reports.

26. The financial statements or other financial information compiled by the accountant should contain a reference such as "Unaudited," "Compiled without Audit or Review" and also "Refer to Compilation Report" on each page of the financial information or on the front of the complete set of financial statements.

Effective Date

27. This Auditing and Assurance Standard is applicable to all compilation engagements beginning on or after April 1, 2004.

Compatibility with International Standard on Auditing (ISA) 930

The standards for compilation engagements established in this Auditing and Assurance Standard are generally consistent in all material respects with those set out in the International Standard on Auditing (ISA) 930, "Engagements to Compile Financial Information", except for the additional section titled, "Special Considerations", as given in paragraphs 19 to 22 of this Auditing and Assurance Standard.

The said section has been added to provide guidance to members in respect of certain typical issues which might be faced by the members in carrying out compilation engagements. For example, duties and responsibilities of the accountant in case of clients having an identified financial reporting framework, such as the Companies Act, 1956 and any material departures therefrom; clients having no identified financial reporting framework, say, where the financial statements are based on the

requirements of the Income Tax Act, 1961. The section also provides guidance in respect of situations where the accountant becomes aware of a material non-compliance with the applicable Accounting Standards; as also duties of the accountant relating to accounting estimates made by the client.

Moreover, the Auditing and Assurance Standard, in paragraph 24, unlike the International Standard on Auditing (ISA) 930, also requires that the financial statements should be approved by the client before compilation report is signed by the accountant. The AAS also requires the accountant to ensure that the users of the compiled financial statements are aware of the extent of his/ her involvement with the accounts so that the users do not derive any unwarranted assurance. The AAS, unlike the ISA, also prohibits the accountant from preparing the financial statements on his letter head or other stationery bearing his (or firm's) name or address.

In addition, the AAS, unlike the ISA, does not require the accountant to send a form of expected report to the client alongwith the engagement letter. Also, the AAS requires the accountant to mention the place of signature in his report as compared to the ISA which requires the accountants to give his address.

Appendix I

Example of an Engagement Letter for a Compilation Engagement

The following letter is for use as a guide in conjunction with the considerations outlined in paragraph 11 of this Auditing and Assurance Standard. This example is for the compilation of financial statements of a company and will need to be varied according to individual requirements and circumstances.

(Date)

To the Board of Directors (*or other appropriate representatives of senior management*):

You have, vide your letter dated _____ requested that we compile the balance sheet of _____ (*name of the company*) as at _____ (*date*) and the related profit and loss account and the (cash flow statement)³ for the year ended on that date. We are pleased to confirm our acceptance and understanding of the engagement by means of this letter. As no audit or review engagement procedures would be carried out, no opinion on the financial statements will be expressed. Further, our engagement cannot be relied upon to disclose whether frauds or defalcations, or illegal acts exist. However, we will inform you of any such matters which might come to our attention in the course of the engagement.

As management, you are responsible for:

- (i) the accuracy and completeness of the information supplied to us, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.
- (ii) preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.
- (iii) safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.
- (iv) ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.

You will confirm that events and transactions are recorded in accordance with the applicable Accounting Standard(s), issued by the Institute of Chartered Accountants of India and other recognised accounting principles and practices and inform us of any departures therefrom.

As part of our normal procedures, we may request you to provide written confirmations of any information or explanations given to us orally during the course of our work.

We understand that the intended use and distribution of the information we have compiled is _____ (*specify*).

³ Only in cases where relevant.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information requested in connection with our engagement.

Our fees will be billed as the work progresses.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our compilation of your financial statements.

XYZ & Co.
Chartered Accountants

.....
Signature
(Name of the Member)
Designation⁴

Address:

Date:

For ABC & Co.

Acknowledged on behalf of _____ (name of the company)

Signature

Name and Designation

Date

Address

Appendix II

Examples of a Report of an Engagement to Compile Financial Statements

Illustration 1: Report on Compilation of Financial Statements

ACCOUNTANT'S REPORT ON COMPILATION OF UNAUDITED FINANCIAL STATEMENTS

To.....

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled, the unaudited balance sheet of (name of the entity) as at March 31, XXXX and the related profit and loss account and the cash flow statement⁵ for the period then ended.

The management of the _____ (name of the entity) is responsible for:

- (i) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.
- (ii) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- (iii) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.
- (iv) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.
- (v) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non compliance.

The compilation engagement was carried out by us in accordance with the Auditing and Assurance Standard (AAS) 31, "Engagements to Compile Financial Information", issued by the Institute of Chartered Accountants of India.

The balance sheet and the profit and loss account are in agreement with the books of account. We

⁴ Partner or proprietor, as the case may be.

⁵ Where applicable.

have not audited or reviewed these financial statements and accordingly express no opinion thereon.

For ABC & Co.
Chartered Accountants

.....
Signature
(Name of the accountant and membership number)
Designation⁶

Date:
Place:

Illustration 2: Compiled Financial Statements Where Such Financial Statements do not Comply with the Generally Accepted Accounting Practices in India.

ACCOUNTANT'S REPORT ON
COMPILATION OF UNAUDITED FINANCIAL STATEMENTS

To.....

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled the unaudited balance sheet of _____ (*name of the entity*) as of March 31, XXXX and the related profit and loss account and the cash flow statement⁷ for the period then ended.

The management of the _____ (*name of the entity*) is responsible for:

- (i) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.
- (ii) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- (iii) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.
- (iv) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.
- (v) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance.

The compilation engagement was carried out by us in accordance with the Auditing and Assurance Standard (AAS) 31, "Engagements to Compile Financial Information", issued by the Institute of Chartered Accountants of India.

Since the financial statements have been compiled for the Income Tax Department and have been drawn up on cash basis of accounting to reflect the necessary adjustments for computation of the income by the Department, these financial statements, accordingly, do not comply with the generally accepted accounting principles in India.

The balance sheet and the profit and loss account are in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

Date:
Place:

For ABC & Co.
Chartered Accountants

.....
Signature
(Name of the accountant and membership number)
Designation⁸

⁶ Partner or Proprietor.

⁷ Where applicable.

⁸ Partner or proprietor.

Appendix II

Auditing and Assurance Standard (AAS) 32

Engagements to Perform Agreed-upon Procedures regarding Financial Information

Introduction

1. The purpose of this Auditing and Assurance Standard (AAS) is to establish standards and provide guidance on the auditor's⁹ professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken and on the form and content of the report that the auditor issues in connection with such an engagement.
2. In an engagement to perform agreed-upon procedures, the auditor is engaged by the client to issue a report of factual findings, based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement. For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a financial statement, say, a balance sheet or even a complete set of financial statements.
3. This AAS is directed towards engagements regarding financial information. However, it may provide useful guidance for engagements to perform agreed-upon procedures regarding non-financial information, provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base his findings. This AAS is to be read in conjunction with the Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services. The principles laid down in the other AASs, issued by the Institute of Chartered Accountants of India, may be used by the auditor, to the extent practicable, in applying this AAS.

Objective of an Agreed-upon Procedures Engagement

4. **The objective of an agreed-upon procedures engagement is for the auditor to carry out procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings.**
5. As the auditor simply provides a report of the factual findings of agreed-upon procedures, no assurance is expressed by him in his report. Instead, users of the report assess for themselves the procedures and the findings reported by the auditor and draw their own conclusions from the work done by the auditor.
6. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results. However, it is possible in certain circumstances that the report of the engagement may not be restricted only to those parties that have agreed to the procedures to be performed, but made available to a wider range of entities or individuals, e.g., in case of government organisations.

General Principles of an Agreed-upon Procedures Engagement

7. **The auditor should comply with the *Code of Ethics*, issued by the Institute of Chartered Accountants of India.** Ethical principles governing the auditor's professional responsibilities for this type of engagement are:
 - (i) Integrity;
 - (ii) Objectivity;
 - (iii) Professional competence and due care;
 - (iv) Confidentiality;
 - (v) Professional conduct; and
 - (vi) Technical standards

⁹ The term "auditor" is used throughout this AAS when describing services involving performance of agreed-upon procedures.. Such reference is not intended to imply that a person performing related services need necessarily be the auditor of the entity's financial statements.

Independence is not a requirement for agreed-upon procedures engagement, however, the terms or objective of the engagement may require the auditor to comply with the independence requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India. **Where the auditor is not independent, a statement to that effect should be made in the report of factual findings.**

8. The auditor should conduct an agreed-upon procedure engagement in accordance with this AAS and the terms of the engagement.

Defining the Terms of the Engagement

9. The auditor should ensure with representatives of the entity and, ordinarily, other specified parties who will receive copies of the report of factual findings, that there is a clear understanding regarding the agreed procedures and the conditions of the engagement. Matters to be agreed include the following:

- (a) Nature of the engagement including the fact that the procedures performed will not constitute an audit or a review and that accordingly no assurance will be expressed.
- (b) Stated purpose for the engagement.
- (c) Identification of the financial information to which the agreed-upon procedures will be applied.
- (d) Nature, timing and extent of the specific procedures to be applied.
- (e) Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

10. In certain circumstances, for example, when the procedures have been agreed to between the regulator, industry representatives and representatives of the accounting profession, the auditor may not be able to discuss the procedures with all the parties who will receive the report. In such cases, the auditor may consider, for example, discussing the procedures to be applied with appropriate representatives of the parties involved, reviewing relevant correspondence from such parties.

11. It is in the interests of both the client and the auditor that the auditor sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the auditor's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the extent of the auditor's responsibilities and the form of reports to be issued.

12. Matters that would be included in the engagement letter include:

- (a) A listing of the procedures to be performed as agreed-upon between the parties.
- (b) A statement that the distribution of the report of factual findings would be restricted to the specified parties who have agreed to the procedures to be performed.
- (c) An example of an engagement letter appears in Appendix I to this AAS.

Planning

13. The auditor should plan the work so that an effective engagement will be performed.

Documentation

14. The auditor should document matters which are important in providing evidence to support the report of factual findings, and evidence that the engagement was carried out in accordance with this AAS and the terms of the engagement.

Procedures and Evidence

15. The auditor should carry out the procedures agreed-upon and use the evidence obtained as the basis for the report of factual findings.

16. The procedures applied in an engagement to perform agreed-upon procedures may include:

- (a) Inquiry and analysis.
- (b) Recomputation, comparison and other clerical accuracy checks.
- (c) Observation.
- (d) Inspection.

(e) Obtaining confirmations.

Appendix II to this AAS is an example report which contains an illustrative list of procedures which may be used as one part of a typical agreed-upon procedures engagement.

Reporting

17. The report on an agreed-upon procedures engagement needs to describe the purpose and the agreed-upon procedures of the engagement in sufficient detail to enable the reader to understand the nature and the extent of the work performed. The report should also clearly mention that no audit or review has been performed.

18. The report of factual findings should contain:

- (a) Title;**
- (b) Addressee (ordinarily, the appointing authority);**
- (c) Identification of specific financial or non-financial information to which the agreed-upon procedures have been applied;**
- (d) A statement that the procedures performed were those agreed-upon with the recipient;**
- (e) A statement that the engagement was performed in accordance with the Auditing and Assurance Standard applicable to agreed-upon procedures engagements;**
- (g) Identification of the purpose for which the agreed-upon procedures were performed;**
- (h) A listing of the specific procedures performed;**
- (i) A description of the auditor's factual findings including sufficient details of errors and exceptions found;**
- (j) A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed;**
- (k) A statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported;**
- (l) A statement that the report is restricted to those parties that have agreed to the procedures to be performed;**
- (m) A statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole;**
- (n) Date of the report;**
- (o) Place of signature ; and**
- (p) Auditor's signature**

The report should be signed by the accountant in his personal name. Where the firm is appointed, the report should be signed in the personal name of the accountant and in the name of the firm. The partner/proprietor signing the report on agreed-upon procedures should also mention the membership number assigned by the Institute of Chartered Accountants of India

Appendix II to this AAS contains an example of a report of factual findings issued in connection with an engagement to perform agreed-upon procedures regarding financial information.

Effective Date

19. This Auditing and Assurance Standard is applicable to all agreed upon procedures engagements beginning on or after April 1, 2004.

Compatibility with the International Standard on Auditing (ISA) 920

The standards established in this Auditing and Assurance Standards are generally consistent in all material respects with those set out in the International Standard on Auditing (ISA) 920, "Engagements to Perform Agreed-upon Procedures regarding Financial Information".

Appendix I**Example of an Engagement Letter for an Agreed-upon Procedures Engagement**

The following letter is for use as a guide in conjunction with paragraph 12 of this Auditing and Assurance Standard and is not intended to be a standard letter. The engagement letter will need to be varied according to individual requirements and circumstances.

Date

To the Board of Directors (or other appropriate representatives of the client who engaged the auditor).

This is in reference to your letter dated _____, appointing us to perform agreed-upon procedures in respect of _____ (*identify the items, e.g., sales, profit of a segment, accounts receivables, etc., of the entity*).

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services that we will provide.

Our engagement will be conducted in accordance with the Auditing and Assurance Standard on Engagements to Perform Agreed-upon Procedures regarding Financial Information, issued by the Institute of Chartered Accountants of India and we will indicate so in our report.

We have agreed to perform the following procedures and report to you the factual findings resulting from our work:

(Describe the nature, timing and extent of the procedures to be performed, including specific reference, where applicable, to the identity of documents and records to be read, individuals to be contacted and parties from whom confirmations will be obtained.)

The procedures that we will perform are solely to assist you in _____ (*state purpose*). Our report is not to be used for any other purpose and is solely for your information, and/ or for use by _____ (*in case the terms of reference so require*).

The procedures that we will perform will not constitute an audit or a review made in accordance with the generally accepted auditing standards in India and, consequently, no assurance will be expressed.

We look forward to your full cooperation and trust that you will make available to us whatever records, documentation and other information requested in connection with our engagement.

Our fees will be billed as work progresses.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the terms of the engagement including the specific procedures, which we have agreed will be performed.

For XYZ & Co
Chartered Accountants

.....
Signature
(Name of the Member)
Designation¹⁰
Date:
Address:

Acknowledged on behalf of
ABC Company by
(signed)

.....
Name and Title
Date
Address

¹⁰ Partner or proprietor, as the case may be.

Example of a Report of Factual Findings in Connection with Accounts Receivable

CONFIDENTIAL

Report Of Factual Findings In Connection With Agreed-upon Procedures Assignment Related To Accounts Receivable

To *(those who engaged the auditor)*

We have performed the procedures agreed with you and enumerated below with respect to the accounts receivable of ABC Company as at _____ *(date)*, set forth in the accompanying schedules *(not shown in this example)*. Our engagement was undertaken in accordance with the Auditing and Assurance Standard on Engagements to Perform Agreed-upon Procedures regarding Financial Information, issued by the Institute of Chartered Accountants of India. The procedures were performed solely to assist you in evaluating the validity of the accounts receivable and are summarized as follows:

1. We obtained and checked the addition of the trial balance of accounts receivable as at _____ *(date)*, prepared by ABC Company, and we compared the total to the balance in the related general ledger account.
2. We compared the attached list *(not shown in this example)* of major customers and the amounts outstanding at _____ *(date)* to the related names and amounts in the trial balance.
3. We obtained customers' statements or confirmations from customers to confirm balances outstanding at _____ *(date)*.
4. We compared such statements or confirmations to the amounts referred to in 2 above. For amounts which did not agree, we obtained reconciliations from ABC Company. For reconciliations obtained, we identified and listed outstanding invoices, debit notes and outstanding cheques, each of which was greater than Rs. XXX. We located and examined such invoices and debit notes subsequently raised and cheques subsequently received and we ascertained that they have been rightly listed as outstanding on the reconciliations.

We report our findings below:

- (a) With respect to item 1, we found the addition to be correct and the total amount to be in agreement.
- (b) With respect to item 2, we found the amounts compared to be in agreement.
- (c) With respect to item 3, we found there were suppliers' statements for all such customers.
- (d) With respect to item 4, we found the amounts agreed, or with respect to amounts which did not agree, we found the Company had prepared reconciliations and that the debit notes, invoices and outstanding cheques over Rs. XXX were appropriately listed as reconciling items with the following exceptions:

(Detail the exceptions)

Because the above procedures do not constitute either an audit or a review made in accordance with the generally accepted auditing standards in India, we do not express any assurance on the accounts receivable as at _____ *(date)*.

Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with the generally accepted auditing standards in India, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates

only to the accounts and items specified above and does not extend to any financial statements of ABC Company, taken as a whole.

Date:

For XYZ & Co

Place:

Chartered Accountants

.....

Signature

(Name of the Member and Membership number)

Designation¹¹

Appendix III

Published in the Gazette of India Extraordinary Part II, Section 3 – Sub-section(I)

Government Of India

Ministry of Company Affairs

Notification

New Delhi, the 25th November, 2004

G.S.R. 766(E): In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956 (1 of 1956) and after consultation with the Institute of Chartered Accountants of India [constituted under the Chartered Accountants Act, 1949 (38 of 1949)], the Central Government hereby makes the following amendments in Companies (Auditor's Report) Order, 2003, namely:-

1. (1) This Order may be called the Companies (Auditor's Report) (Amendment) Order, 2004.
- (2) It shall come into force on the date of its publication in the Official Gazette.
2. In the Companies (Auditor's Report) Order, 2003, -
 - (1) In paragraph 1, in sub-paragraph (2), for clause (iv), the following clause shall be substituted, namely:

“(iv) a private limited company with a paid up capital and reserves not more than rupees fifty lakh and which does not have loan outstanding exceeding rupees twenty five lakh from any bank or financial institution and does not have a turnover exceeding rupees five crore at any point of time during the financial year”.
 - (2) in paragraph 2, the clauses (c) to (i) shall be omitted;
 - (3) in paragraph 4,
 - (a) for clause (iii), the following clause shall be substituted, namely:

“(iii) (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and

(b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and

(c) whether receipt of the principal amount and interest are also regular; and

(d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and the amount involved in the transactions; and

(f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the

¹¹ Partner or proprietor as the case may be.

company; and

(g) whether payment of the principal amount and interest are also regular.”

(b) for clause (iv), the following clause shall be substituted, namely:

“(iv) is there an adequate internal control system 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 and services. Whether there is a continuing failure to correct major weaknesses in internal control system;”

(c) in clause (v), for sub-clauses (a) and (b), the following clauses shall be substituted, namely:-

“(a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and

(b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;”;

(d) in clause(vi),

(i) for the words, figures and letters “sections 58A and 58AA of the Act ”, the words, figures and letters “sections 58A, 58AA or any other relevant provisions of the Act” shall be substituted.

(ii) for the words “Company Law Board”, the words “Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal” shall be substituted;

(e) in clause (ix)

(i) in sub-clause (a), for the words “Wealth tax”, the words “Wealth tax, Service tax” shall be substituted;

(ii) for sub-clause (b), the following sub-clause shall be substituted; namely:-

“(b) in case dues of Income tax/ Sales tax /Wealth tax/ Service tax/ Custom duty/ Excise duty/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.”

(f) in clause (x), for the words “in the financial year immediately preceding such financial year also” the words “in the immediately preceding financial year” shall be substituted;

(g) in clause (xiii);

(i) in sub-clause (b), for the word “default” the word “doubtful” shall be substituted;

(ii) in sub-clause (d), the words “and would be conducive to recovery of the loan amount” shall be omitted;

(h) in clause (xiv), for the words “other securities”, the words “other investments” shall be substituted;

(i) in clause (xvii), the words “and vice-versa” shall be omitted.

(j) in clause (xix), for the words “securities have”, the words “security or charge has” shall be substituted.

File No: 2/28/2002-CL-V

Jitesh Khosla; Joint Secretary

Note: The Principal Order was issued vide notification number GSR 480(E) dated the 12th June, 2003.

New Delhi, the 25th November, 2004

G.S.R. 766(E): In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956 (1 of 1956) and after consultation with the Institute of Chartered Accountants of India [constituted under the Chartered Accountants Act, 1949 (38 of 1949)], the Central Government hereby makes the following amendments in Companies (Auditor's Report) Order, 2003, namely:-

1. (1) This Order may be called the Companies (Auditor's Report) (Amendment) Order, 2004.
- (2) It shall come into force on the date of its publication in the Official Gazette.
2. In the Companies (Auditor's Report) Order, 2003, -
 - (1) In paragraph 1, in sub-paragraph (2), for clause (iv), the following clause shall be substituted, namely:

“(iv) a private limited company with a paid up capital and reserves not more than rupees fifty lakh and which does not have loan outstanding exceeding rupees twenty five lakh from any bank or financial institution and does not have a turnover exceeding rupees five crore at any point of time during the financial year”.
 - (2) in paragraph 2, the clauses (c) to (i) shall be omitted;
 - (3) in paragraph 4,
 - (a) for clause (iii), the following clause shall be substituted, namely:

“(iii) (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and

(b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and

(c) whether receipt of the principal amount and interest are also regular; and

(d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and the amount involved in the transactions; and

(f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and

(g) whether payment of the principal amount and interest are also regular.”
 - (b) for clause (iv), the following clause shall be substituted, namely:

“(iv) is there an adequate internal control system 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 and services. Whether there is a continuing failure to correct major weaknesses in internal control system;”
 - (c) in clause (v), for sub-clauses (a) and (b), the following clauses shall be substituted, namely:-

“(a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and

(b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;”;
 - (d) in clause(vi),
 - (i) for the words, figures and letters “sections 58A and 58AA of the Act ”, the words, figures and letters “sections 58A, 58AA or any other relevant provisions of the Act” shall be substituted.

- (ii) for the words “Company Law Board”, the words “Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal” shall be substituted;
- (e) in clause (ix)
- (i) in sub-clause (a), for the words “Wealth tax”, the words “Wealth tax, Service tax” shall be substituted;
- (ii) for sub-clause (b), the following sub-clause shall be substituted; namely:-
 - “(b) in case dues of Income tax/ Sales tax /Wealth tax/ Service tax/ Custom duty/ Excise duty/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.”
- (f) in clause (x), for the words “in the financial year immediately preceding such financial year also” the words “in the immediately preceding financial year” shall be substituted;
- (g) in clause (xiii);
- (i) in sub-clause (b), for the word “default” the word “doubtful” shall be substituted;
- (ii) in sub-clause (d), the words “and would be conducive to recovery of the loan amount” shall be omitted;
- (h) in clause (xiv), for the words “other securities”, the words “other investments” shall be substituted;
- (i) in clause (xvii), the words “and vice-versa” shall be omitted.
- (j) in clause (xix), for the words “securities have”, the words “security or charge has” shall be substituted.

File No: 2/28/2002-CL-V

Jitesh Khosla; Joint Secretary

Note: The Principal Order was issued vide notification number GSR 480(E) dated the 12th June, 2003.

Appendix IV

Text of Companies (Auditor’s Report) Order, 2003

{after incorporating the amendments made by the Companies (Auditor’s Report) (Amendment) Order, 2004¹² dated 25th November, 2004}

Short title, application and commencement.

- (1) This order may be called the Companies (Auditor’s Report) Order, 2003.
- (2) It shall apply to every company including a foreign company as defined in section 591 of the Act, except the following:
 - (i) a Banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
 - (ii) an insurance company as defined in clause (21) of section 2 of the Act;
 - (iii) a company licensed to operate under section 25 of the Act; and
 - (iv) a private limited company with a paid up capital and reserves not more than rupees fifty lakh and which does not have loan outstanding exceeding rupees twenty five lakh from any bank or financial institution and does not have a turnover exceeding rupees five crore at any point of time during the financial year.
- (3) It shall come into force on the 1st day of July, 2003.

¹² DCA’s notification number GSR/766(E).

2. Definitions – In this Order, unless the context otherwise requires,-

- (a) “**Act**” means the Companies Act, 1956 (1 of 1956);
- (b) “**chit fund company**”, “nidhi company” or “mutual benefit company” means a company engaged in the business of managing, conducting or supervising as a foreman or agent of any transaction or arrangement by which it enters into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of instalments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to, members;

3. Auditor’s report to contain matters specified in paragraphs 4 and 5. – Every report made by the auditor under section 227 of Act, on the accounts of every company examined by him to which this Order applies for every financial year ending on any day on or after the commencement of this Order, shall contain the matters specified in paragraphs 4 and 5.

4. Matters to be included in the auditor’s report. – The auditor’s report on the account of a company to which this Order applies shall include a statement on the following matters, namely :-

- (i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) if a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern;
- (ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;
- (b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
- (c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;
- (iii) (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and
- (b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and;
- (c) whether receipt of the principal amount and interest are also regular; and
- (d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;
- (e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and the amount involved in the transactions; and
- (f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and
- (g) whether payment of the principal amount and interest are also regular.
- (iv) is there an adequate internal control system 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

and services. Whether there is a continuing failure to correct major weaknesses in internal control system

- (v) (a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and
 - (b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;

(This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year).
- (vi) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 58A, 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should 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?
- (vii) 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, whether the company has an internal audit system commensurate with its size and nature of its business;
- (viii) where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of section 209 of the Act, whether such accounts and records have been made and maintained;
- (ix) (a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at 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 by the auditor.
 - (b) in case dues of Income tax/ Sales tax /Wealth tax/ Service tax/ Custom duty/ Excise duty/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

(A mere representation to the Department shall not constitute a dispute).
- (x) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;
- (xi) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;
- (xii) whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out.
- (xiii) whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/ mutual benefit fund/societies;
 - (a) whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date the company has complied with the prudential norms on income recognition of balance sheet;
 - (b) whether and provisioning against sub-standard/doubtful/loss assets;
 - (c) whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrower;

- (d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;
- (xiv) if the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act;
- (xv) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;
- (xvi) whether term loans were applied for the purpose for which the loans were obtained;
- (xvii) whether the funds raised on short-term basis have been used for long term investment; If yes, the nature and amount is to be indicated;
- (xviii) whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company;
- (xix) whether security or charge has been created in respect of debentures issued?
- (xx) whether the management has disclosed on the end use of money raised by public issues and the same has been verified;
- (xxi) whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

5. Reasons to be stated for unfavourable or qualified answers. Where, in the auditor's report, the answer to any of the questions referred to in paragraph 4 is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Appendix V

Announcement : Website

The Council at its meeting held in January, 2001 approved the detailed guidelines for posting the particulars on Website by Chartered Accountants in practice and firm(s) of Chartered Accountants in practice. The guidelines are as under:

1. The Chartered Accountants and/or Chartered Accountants' Firms would be free to create their own Website subject to the overall guidelines laid down by the Council hereunder. The actual format of the Website is not being prescribed nor any standard format of the Website is being given to provide independence to the Members. There is no restriction on the colours which may be used in the Website.
2. Individual Members would also be permitted to have their Webpages in their trade name or individual name.
3. The Chartered Accountants and/or Chartered Accountants' Firms would ensure that their Websites are run on a "pull" model and not a "push" model of the technology to ensure that any person who wishes to locate the Chartered Accountants or Chartered Accountants' firms would only have access to the information and the information should be provided only on the basis of specific "pull" request.
4. The Chartered Accountants and/or Chartered Accountants' Firms should ensure that none of the information contained in the Website be circulated on their own or through E-mail or by any other mode or technique except on a specific "pull" request.
5. The Chartered Accountants would also not issue any circular or any other advertisement or any other material of any kind whatsoever by virtue of which they solicit people to visit their Website. The

Chartered Accountants would, however, be permitted to mention their Website address on their professional stationery.

6. The following information may be allowed to be displayed on the Firms'/Members' Websites:

- (i) Member/Trade/Firm name.
- (ii) Year of establishment.
- (iii) Member/Firm's Address (both Head Office and Branches)

Tel. No(s)

Fax No(s)

E-mail ID(s)

(iv) Nature of services rendered (to be displayable only on specific "pull" request)

(v) Partners

Partners Name	Year of Qualification	Other Qualification(s)	Tel. No. Res., Off., Mobile, Direct, E-mail Address	Area of Experience (to be displayable only on specific "pull" request)
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(vi) Details of Employees –

Professional	Others	Name	Designation	Area of experience (to be displayable only on specific "pull" request)
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(vii) Job vacancies for the Chartered Accountant/firm of Chartered Accountants (including articleship).

(viii) No. of articulated clerks. (to be displayable only on specific "pull" request).

(ix) Nature of assignments handled (to be displayable only on specific "pull" request) Names of clients and fee charged cannot be given.

7. Since Chartered Accountants in practice/firms of Chartered Accountants are not permitted to use logo with effect from 1st July, 1998, they cannot use log on Website also.

8. No photographs of any sort are permitted.

9. The members may include articles, professional information, professional updation and other matters of larger importance or of professional interest.

10. The bulletin boards can be provided.

11. The chat rooms can be provided which permit chatting amongst members of the ICAI and between Firms and its clients. The confidentiality protocol would have to be observed.

12. The members/firms can provide on line advice to their clients who specifically request for the advice whether free of charge or on payment.

13. The listing on suitable search engine should be permitted. However, the field of search should be restricted only to the field of "Chartered Accountants" or "CA" or "Indian CA", "Indian CPA", "Indian Chartered Accountant" or any permutation or combination related thereto. The Websites would be subjected to the guidelines contained herein and normally would not be vetted by the Institute of Chartered Accountants of India (ICAI). ICAI at its sole discretion may vet any of the Websites created by its members or individual Chartered Accountant or firms of Chartered Accountants and would have powers to direct deletion of certain portions and/or issue specific directions. In addition, necessary action can be taken in accordance with the Chartered Accountants Act, 1949 and the Regulations framed thereunder, in case there is any violation of the above guidelines.

14. The details in the Website should be so designed that it does not amount to soliciting client or professional work or advertisement of professional attainments or services. In case any content or technical feature of Website is against the professional Code of Conduct and Ethics as well as the restrictions contained in the schedules to the Chartered Accountants Act, 1949 or against the guidelines or directions issued by the ICAI from time to time, appropriate action will be initiated by the ICAI in terms of its disciplinary mechanism either *suo motu* or on complaint as provided under the Chartered Accountants Act, 1949.

15. The Website should ensure adequate secrecy of the matters of the clients handled through Website.

16. A number of Chartered Accountants Societies or other bodies are creating data-bases of Chartered Accountants or Chartered Accountants' Firms and are offering listing to Chartered Accountants. Such listing would be permitted with or without payment. In case a Chartered Accountant or Chartered Accountants' Firm is a member of a professional body or association or Chamber of Commerce and they offer listing to the members or firm, the same would be permitted.

17. The Institute of Chartered Accountants of India will regularly inform the aforesaid guidelines to the members and the Chartered Accountants' Firms to ensure the strict compliance of the guidelines. The guidelines may be revised from time to time.

18. No Advertisement in the nature of banner or any other nature will be permitted on the Website.

19. The Website should be befitting the profession of Chartered Accountants and should not contain any information or material which is unbecoming of a chartered accountant.

20. The Website may provide a link to the Website of ICAI, its Regional Councils and Branches and also to the Websites of Government/Government Departments/Regulatory Authorities. Except that neither link to nor information about any other Website is permitted.

21. The address of the Website can be different from the name of the firm. But it should not amount to soliciting clients or professional work or advertisement of professional attainments or services. The Website address should be as near as possible to the individual name/trade name, firm name of the Chartered Accountant in practice or firm of Chartered Accountants in practice. The Committee on Ethical Standards and Unjustified Removal of Auditors (CESURA) of ICAI will decide in case there is any difficulty.

22. The address of the Website should be intimated to the ICAI within 30 days.

23. The Website should mention the date upto which it is updated and the information should not be at material variance from the information as per the ICAI's records.

A number of non-Chartered Accountants' firms, corporates including banks, finance companies and newspapers have set up their own Websites providing advisory services on taxation and other areas where Chartered Accountants are rendering professional service. Some of such Websites may request Chartered Accountants or Chartered Accountants' firms to provide consultation and advice through their Websites. This would be permitted subject to the condition that on the Website, contact address of the Chartered Accountant concerned is not provided nor such Website will contain any material which advertises professional achievements or status of such Chartered Accountant except making a statement that they are Chartered Accountants. The name of Chartered Accountants' firm with suffix "Chartered Accountants" would not be permitted.

Appendix VI

For Attention of Members in Part-time Practice

The Council at its 242nd meeting held in May, 2004 passed the following resolution as a part of and in continuation of the existing resolution under Regulation 190A which appears as Appendix No.9 to the C.A. Regulations, 1988 (2002 edition).

"Further resolved that the general and specific permission granted by the Council is subject to the condition that:

- (i) any member engaged in any other business or occupation, in terms of general or specific permission granted shall not be entitled to perform any attest function. However, a member engaging in any of the following area(s), in terms of the specific or general permission so granted, shall be entitled to perform attest function:
 - (a) Authorship of books and articles.
 - (b) Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.
 - (c) Attending classes and appearing for any examination.
 - (d) Holding of public elective offices such as M.P., M.L.A. and M.L.C.
 - (e) Honorary office leadership of charitable-educational or other non-commercial organisations.
 - (f) Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
 - (g) Part-time tutorship under the coaching organisation of the Institute.
 - (h) Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.
 - (i) Editorship of professional journals.
 - (j) Acting as Surveyor and Loss Assessor under the Insurance Act, 1938.
 - (k) Acting as Recovery consultant in the Banking Sector.
 - (l) Any coaching assignment organised by the Institute, its Regional Councils and Branches of Regional Councils.
 - (m) Engagement as Lecturer in an University, affiliated college, educational institution, coaching organization, private tutorship, provided the direct teaching hours devoted to such activities taken together do not exceed 25 hours a week.
- (ii) A member who is not entitled to perform attest function shall not be entitled to train articled clerks.

Appendix VII

Clarification on Acting as Recovery Consultant in Banking Sector

The members of the profession have sought the Institute's view as to whether the Chartered Accountants in Practice acting as Recovery Consultant for recovery of Non-Performing Assets (NPA) of Banks under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFA&ESI) can charge fee on percentage basis as is permitted under Regulation 192 of the Chartered Accountants Regulations, 1988 for 'receiver' or 'liquidator'.

The Institute has examined the matter in detail and is of the view that Recovery Consultant cannot be equated with 'receiver' or 'liquidator' provided under Regulation 192 of the Chartered Accountants Regulations, 1988 and as such, the charging of fee by Recovery Consultant in Banking Sector on percentage basis is not permissible.

Appendix VIII

Revised clarification regarding Inclusion of "Insurance Financial Advisory Services under the Insurance Regulatory & Development Authority Act, 1999, including Insurance Brokerage" in the definition of "Management Consultancy & Other Services"

The attention of the members is drawn to the Announcement published in the January 2005 issue of the Journal at page 935 as well as hosted in the website regarding inclusion of "Insurance Financial Advisory Services under the Insurance Regulatory & Development Authority Act, 1999, including Insurance Brokerage" in the definition of "Management Consultancy and Other Services" as appearing at pages 8-10 of Code of Ethics, January 2001 edition.

The attention of the members is also drawn to the Announcement issued in the May 2005 issue of the Journal at page 1527 wherein it was clarified that as per the decision of the Council, a member is permitted to render Insurance Financial Advisory Services as prescribed under "The Insurance Regulatory and Development Authority (Insurance Brokers) Regulations, 2002" only in Corporate form. Further, it was also added that the members were required to comply with the conditions prescribed by the Insurance Regulatory & Development Authority and the conditions to be prescribed by The Institute of Chartered Accountants of India.

It was also mentioned in the clarification that the members are not permitted to do any work relating to insurance agency as prescribed under "Insurance Regulatory and Development Authority (Licencing of Insurance Agents) Regulations, 2000" and "Insurance Regulatory and Development Authority (Licencing of Corporate Agents) Regulations, 2002", either individually or in partnership/proprietorship form or in corporate form and the existing position regarding allowing members generally to hold life insurance agency licence for limited purpose of getting renewal commission, still hold good as provided in the Appendix (9) to the Chartered Accountants Regulations, 1988 (2002 edition).

Later on, it has been brought to the knowledge of the Institute that some Insurance Companies are inviting Chartered Accountants to become Insurance Advisor/Insurance Broker on the pretext of the decision taken by the Council at its 245th meeting held in August-September, 2004 wherein it was decided to include "Insurance Financial Advisory Services under the IRDA Act, 1999 including Insurance Brokerage" within the definition of Management Consultancy and Other Services (MCS).

In view of the above, it is again clarified that as on date the members in practice are not permitted to render "Insurance Financial Advisory Services under the IRDA Act, 1999 including Insurance Brokerage" as the conditions to be complied with by the members to be eligible to render the aforesaid services are yet to be prescribed by the Institute of Chartered Accountants of India. The existing position regarding allowing members in practice generally to hold life insurance agency licence for limited purpose of getting renewal commission, still hold good as provided in the Appendix (9) to the Chartered Accountants Regulations, 1988 (2002 edition).

Appendix IX

Announcement on (1) Listing with Bodies Creating Data-Base for Independent Directors of Chartered Accountants and (2) Acting as E-Intermediary.

Some members have brought to our notice that some website is creating data-base for independent directors and is inviting chartered accountants to enroll with it. The data-base collected by it will be provided to the listed companies in order to reach the chartered accountants for taking them on their Board as Independent Directors. It is also brought to our notice that certain Chartered Accountants have been approached to act as e-Intermediary. The members have sought clarification whether they can enroll with the website creating such data-base and whether they can act as e-Intermediary.

The aforesaid issues have been examined. The Code of Ethics, 2005 edition, at page 81 provides as under:

"(16) A number of Chartered Accountants Societies or other bodies are creating data-bases of Chartered Accountants or Chartered Accountants' Firms and are offering listing to Chartered Accountants. Such listing would be permitted with or without payment. In case a Chartered Accountant or Chartered Accountants' Firm is a member of a professional body or association or Chamber of Commerce and they offer listing to the members or firm, the same would be permitted."

Accordingly, it is clarified that listing with the website collecting data-base for independent directors is permissible with or without payment.

It is also clarified that since acting as e-Return Intermediary comes within the purview of the definition of "Management Consultancy and Other Services" appearing at pages 8-10 of Code of Ethics, 2005 edition, it is permissible.

Appendix X

General Clarification : GC)-AASB/1/2002 on AAS 9

Auditing and Assurance Standard (AAS) 9, Using the Work of an Expert

{The following is the General Clarification (GC)-AASB/1/2002 issued by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India on Auditing and Assurance Standard (AAS) 9, "Using the Work of an Expert."}

1. Paragraph 12 of AAS 9 provide as under:

"12. The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the expert. The auditor does not have the same expertise and, therefore, cannot always challenge the expert's assumptions and methods. However, the auditor should obtain an understanding of those assumptions and methods to determine that they are reasonable based on the auditor's knowledge of the client's business and on the results of his audit procedures."

2. The auditor while verifying the accrued liability for retirement benefits or for Group Gratuity Schemes has to use the work of an another expert, i.e., actuary or the insurer itself. In such a case, the issue to be considered is whether it is sufficient for the auditor to rely on the certificate given by insurer or actuary without establishing the reasonableness of the assumptions made by the actuary or the insurer based on the auditor's knowledge of the client's business. It is clarified that the auditor should, while using the certificate issued by the actuary or the insurer, obtain an understanding of the methods used by the actuary or the insurer in determining the liability and should also judge the appropriateness and reasonableness of assumptions, for example, with regard to the following:

- (i) Rate of Return
- (ii) Number of Employees
- (iii) Retirement Age
- (iv) Salaries
- (v) Promotion Policies
- (vi) Age of Employees

Appendix XI

General Clarification : (GC)-AASB/3/2004 on AAS 16

Auditing and Assurance Standard (AAS) 16, Going Concern

{The following is the General Clarification (GC)/AASB/3/2004 issued by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India on Auditing and Assurance Standard (AAS) 16, 'Going Concern'.}

1. The Companies (Amendment) Act, 2000 has mandated that every private company existing on 13th December 2000 with a paid-up capital of less than one lakh rupees, shall, within a period of two years from such commencement enhance its paid up capital to one lakh rupees. Similarly, every public company existing on 13th December 2000 with a paid-up capital of less than five lakh rupees, shall, within a period of two years from such commencement enhance its paid up capital to five lakh rupees. Where a private company or a public company fails to enhance the paid-up capital to the statutory minimum, as mentioned above, such company shall be deemed a defunct company within the meaning of section 560 of the Companies Act, 1956 and its name shall be struck off from the register by the Registrar.

2. Paragraphs 5 and 6 of Auditing and Assurance Standard (AAS) 16, Going Concern provide as follows:

"5. The auditor should consider the risk that the going concern assumption may no longer be appropriate.

6. Indications of risk that continuance as a going concern may be questionable could come

from the financial statements or from other sources.”

3. Further, AAS 16 also mentions that non-compliance with capital or other statutory requirements could be an example of an indication of risk that the going concern assumption may no longer be appropriate.
4. If a company fails to enhance its paid-up capital up to the statutory minimum, such company shall be deemed a defunct company within the meaning of section 560 of the Companies Act, 1956 and therefore, its name shall be struck off from the register by the Registrar of Companies. However, such an entity may decide not to carry on business or may decide to carry on the business in some other form of organisation, e.g., partnership, etc. This situation gives rise to the risk that the going concern assumption may no longer be appropriate.
5. The auditor, in such a situation, performs the audit procedures as required by the Auditing and Assurance Standard (AAS) 16, Going Concern. Unless, the entity under audit demonstrates otherwise, the auditor should consider the going concern assumption as inappropriate and report in accordance with paragraph 18 of AAS 16.

Appendix XII

General Clarification : GC)-AASB/2/2004 on AAS 26

Auditing and Assurance Standard (AAS) 26, Terms of Audit Engagement

{The following is the General Clarification (GC)/AASB/2/2004 issued by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India on Auditing and Assurance Standard (AAS) 26, “Terms of Audit Engagement.”}

1. The Auditing and Assurance Standard (AAS) 26, Terms of Audit Engagement was issued with a view to establish standards on:
 - (a) agreeing the terms of the engagement with the client; and
 - (b) the auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.
2. A question that arises is whether it is necessary that the engagement letter issued by the auditor should be acknowledged by addressee and returned to the auditor to indicate that the client's understanding of the terms of the engagement is in accordance with the engagement letter issued by the auditor and to establish that the auditor has complied with the requirements of the Standard in so far as they are related to sending the audit engagement letter.
3. Paragraphs 2 through 4 of AAS 26 provide as follows:
 - “2. The auditor and the client should agree on the terms of the engagement. The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.
 3. This AAS is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The Standard is also applicable to related services. When other services such as tax, accounting, or management consultancy and other services are to be provided, separate letters may be appropriate.
 4. Though the objective and scope of an audit and the auditor's obligations are, normally, laid down in the applicable statute or regulations and the pronouncements of the Institute of Chartered Accountants of India, the audit engagement letters would be informative for the clients.”
4. From the above it is clear that the basic purpose of issuing an engagement letter is that the auditor and the client should agree on the terms of the engagement. The auditor and the client are normally considered to be agreeing on the terms of the engagement if the objective and scope of an audit and the auditor's obligations are laid down in the statute or regulations governing the engagement. Examples of such engagements include audit under section 227 of the Companies Act, 1956, audit of public sector banks, etc. In such cases, it is not necessary that the engagement letter sent by the auditor in accordance with paragraph 5 of AAS 26 is acknowledged by the addressee and returned to the auditor to establish that the client's understanding of the terms of the engagement is in accordance with the engagement letter issued by the auditor. It shall be sufficient compliance with the

requirements related to sending the audit engagement letter, if an engagement letter is appropriately delivered to the client and the auditor retains the evidence for such delivery. In such cases, the audit engagement letters would be informative for the clients.

5. If, however, the client seeks any further explanations or clarification in regard to any terms, conditions or other contents of the engagement letter issued, it might indicate that there exists a difference in understanding of the terms of audit engagement either on the part of the client or on the part of the auditor. The auditor, in such cases, should take necessary steps to resolve the issues, for example by appropriately replying to the issues raised by the client. It is also desirable that the auditor documents the evidence indicating that the issues are settled and the client and auditor agree on the terms of the engagement.

6. There may be certain engagements where the objective and scope of the engagement and the auditor's obligations are not laid down in the applicable statute or regulations. In such situations, the auditor should request the client that a copy of the engagement letter be acknowledged by the addressee and returned to the auditor to establish:

- (a) that the client's understanding of the arrangements for the engagement is in accordance with the engagement letter issued by the auditor; and
- (b) that the auditor has complied with the requirements of the standard in so far as they are related to sending the audit engagement letter.