

Auditing Standards, Statements and Guidance Notes – An Overview

1.1 Introduction

The past decade has been one of unprecedented change in the global economy and capital markets. Key aspects of the current business environment include a globalized, highly competitive, expanding economy; explosive growth in the development and use of technology; dramatic increases in new economy service- and technology-based businesses with predominantly intangible assets; unparalleled expansion in the number of public entities; large increases in the number of individuals who directly or indirectly own equity securities; and unprecedented growth in the market value of those securities.

The expanded use of technology in both the operating and financial systems of companies also has significantly affected the audit environment, forcing audit firms to recruit, train and deploy a large number of information technology specialists to support their audit efforts. It also has caused firms to reconsider their audit methods and techniques in an effort to harness technology to improve audit efficiency and effectiveness.

In the changing environment, it is obvious that a professional accountant should adhere to standards and procedures laid down by the professional accountancy bodies of which he is a member while discharging his duties in a responsible manner. In this direction, the role of a professional accounting body is to lay down such standards and procedures with the aim of providing guidance to members. The Institute of Chartered Accountants of India (ICAI) has been formulating auditing and accounting standards for the guidance of its members on its own volition in the larger interests of the society. In this chapter, we provide an overview of auditing standards and guidance notes issued by the Institute from time to time. Though these standards and guidance notes have been dealt at appropriate places, the main purpose is to acquaint and inculcate appreciation on the part of students in a focused manner as to significance of the standards in their day to day auditing activities. Towards the end of the Chapter, the clarification issued by the Council of the Institute is also included, which would go a long way in understanding as well as significance to the mandatory status of "Statements" and "Standards".

1.2 Historical Retrospect

The Institute, since its inception, has been committed to research in the field of accountancy. As early as in 1955, the Council set up the Research Committee. The Council at that point of time felt the necessity to establish such a Committee to deal with the growing complexities of

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the problems faced by membership at large and with a view to ensuring the highest of traditions and technical competence in the discharge of the duties by chartered accountants.

As back as in 1964, the Council published the "Statement on Auditing Practices" as prepared by the Research Committee not only for the benefit of its members but also for others outside the profession, who might be interested in this subject. It was hoped that this Statement would provide valuable guidance in the performance of audits, particularly of companies. The Council of the Institute fully realised that techniques of accounting and auditing had undergone and were undergoing important changes. Since the members were expected to keep pace with recent developments, this Statement attempted to set out practices which were generally accepted in other countries and which the Council considered desirable in the light of prevailing circumstances in India. The issuance of the Statement on Auditing Practices might be considered as a path break as far as establishing sound auditing practices is concerned. The Statement was further revised in 1968 and 1977.

Prior to establishment of the Auditing Practices Committee (APC), the Research Committee issued the following Statements in Auditing:

- ◆ Statements on Qualifications in Auditor's Report
- ◆ Statement on the Manufacturing and Other Companies (Auditor's Report) Order, 1975/1988 (Issued under Section 227(4A) of the Companies Act, 1956)
- ◆ Statement on Responsibilities of Joint Auditors
- ◆ Statement on Payments to Auditors for Other Services

1.3 Auditing and Assurance Standards Board – Scope and Functions

The Following are the important points as regards scope and functions of Auditing and Assurance Standards Board –

1.3.1 Setting up of AASB: The International Federation of Accountants (IFAC) came into existence in 1977 and constituted International Auditing Practices Committee (IAPC) to formulate International Auditing Guidelines. These guidelines were later on converted into International Standards on Auditing (ISA). Considering the developments in the field of auditing at international level, the need for issuing Standards and Guidance Notes in tandem with international standards but conforming to national laws, customs, usages and business environments was felt. With this objective, our Institute constituted the Auditing Practices Committee (APC) on September 17, 1982, to spearhead the new framework of Statements on Standard Auditing Practices (SAPs) and Guidance Notes (GNs) *inter alia* to replace various chapters of the old omnibus Statement on Auditing Practices issued in 1964.

In July, 2002, the Auditing Practices Committee has been converted into an Auditing and Assurance Standards Board by the Council of the Institute, to be in line with the international trend. A significant step has been taken aimed at bringing in the desired transparency in the working of the Auditing and Assurance Standards Board, through participation of representatives of various segments of the society and interest groups, such as, regulators, industry and academics. The nomenclature of SAPs had been changed to Auditing and

Assurance Standards (AASs). As per the Preface to Standards on Quality Control Auditing Review, other Assurance and Related Services w.e.f. April 1, 2008, the nomenclature of AASs under the authority of the Council are collectively known as the Engagement Standards and Quality Control Standards which include the following:

- (a) Standards on Auditing (SAs), to be applied in the audit of historical financial information.
- (b) Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
- (c) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.
- (d) Standards on Related Services (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.
- (e) Standard on Quality Control which contains extensive requirements in relation to establishment and maintenance of a system of quality control in the audit firms as well as even for sole practitioners.

1.3.2 Scope and Functions of AASB: The main function of the AASB is to review the existing auditing practices in India and to develop Statements on Standards on Auditing (SAs) so that these may be issued by the Council of the Institute. While formulating the SAs, the AASB takes into consideration the ISAs issued by the IAPC, applicable laws, customs, usages and business environment in India. The SAs are issued under the authority of the Council of the Institute. The AASB also issues Guidance Notes on the issues arising from the SAs wherever necessary. The AASB has also been entrusted with the responsibility to review the SAs at periodical intervals.

1.3.3 Scope of SAs: The SAs apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion. The SAs may also have application, as appropriate, to other related functions of auditors. Any limitation on the applicability of a specific SA is made clear in the introductory paragraph of the SA.

1.3.4 Procedure for issuing SAs: Broadly, the following procedure is adopted for the formulation of SAs:

- ◆ The AASB determines the broad areas in which the SAs need to be formulated and the priority in regard to the selection thereof.
- ◆ In the preparation of SAs, the AASB is assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision is made for participation of a cross-section of members of the Institute.
- ◆ On the basis of the work of the Study Groups, an exposure draft of the proposed SA is prepared by the Committee and issued for comments by members of the Institute.
- ◆ After taking into consideration the comments received, the draft of the proposed SA is finalised by the AASB and submitted to the Council of the Institute.

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- ◆ The Council of the Institute considers the final draft of the proposed SA, and, if necessary, modifies the same in consultation with the AASB. The SA is then issued under the authority of the Council.

1.3.5 Compliance with the SAs: While discharging their attest function, it is the duty of the members of the Institute to ensure that the SAs are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the SAs, his report should draw attention to the material departures therefrom. Auditors are expected to follow SAs in the audits commencing on or after the date specified in the Standard.

1.3.6 Linkage between SAs and Disciplinary Proceedings: The SAs (as well as other statements on auditing) represent the generally accepted procedure(s) of audit. As such, a member who does not perform his audit in accordance with these statements and fails to disclose the material departures therefrom, becomes liable to the disciplinary proceedings of the Institute under clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 (as amended by the Chartered Accountants (Amendment) Act, 2006), which specifies that a member of the Institute engaged into practice shall be guilty of professional misconduct if he “fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances”.

1.4 Framework of Standards and Guidance Notes on Related Services

Framework of Standards on Auditing and Guidance Notes on Related Services issued recently distinguishes audits from related services. Related services comprise reviews, agreed-upon procedures and compilations. As illustrated in the diagram below, audits and reviews are designed to enable the auditor to provide high and moderate levels of assurance respectively, such terms being used to indicate their comparative ranking. Engagements to undertake agreed-upon procedures and compilations are not intended to enable the auditor to express assurance.

	Auditing	_____Related Services_____			
Nature of service	Audit	Review	Agreed-upon Procedures	Compilation	
Comparative level of assurance provided by the auditor	High, but not absolute assurance	Moderate assurance	No assurance	No assurance	
Report provided	Positive assurance on assertion(s)	Negative assurance on assertion(s)	Factual findings of procedures	Identification of information compiled	

Assurance in the above context refers to the auditor's satisfaction as to the reliability of an assertion being made by one party for use by another party. To provide such assurance, the auditor assesses the evidence collected as a result of procedures conducted and expresses a conclusion. The degree of satisfaction achieved and, therefore, the level of assurance which may be provided is determined by the procedures performed and their results. In an audit engagement, the auditor provides a high, but not absolute, level of assurance (i.e. reasonable level of assurance) that the information subject to audit is free of material misstatement expressed positively in the audit report. In a review engagement, the auditor provides a moderate level of assurance that the information subject to review is free of material misstatement. This is expressed in the form of negative assurance (also known as limited assurance). For agreed-upon procedures, auditor simply provides a report of the factual findings, no assurance is expressed. Instead, users of the report draw their own conclusions from the auditor's work. In a compilation engagement, although the users of the compiled information derive some benefit from the involvement of a member of the Institute, no assurance is expressed in the report. Objective of an audit is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework "give a true and fair view". Absolute assurance in auditing is not attainable as a result of such factors as the need for judgement, the use of test checks, the inherent limitations of any accounting and internal control systems and the fact that most of the evidence available to the auditor is persuasive, rather than conclusive, in nature. The objective of a review of financial statements is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an identified financial reporting framework. While a review involves the application of audit skills and techniques and the gathering of evidence, it does not ordinarily involve on assessment of accounting and internal control systems, tests of records and of responses to inquiries by obtaining corroborating evidence through inspection, observation, confirmation and computation, the auditor attempts to become aware of all significant matters, the procedures of a review make the achievement less likely than in an audit engagement, thus the level of assurance provided in a review report is correspondingly less than that given in an audit report. In an engagement to perform agreed-upon procedures and auditor is engaged to carry out those 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. 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. In a compilation engagement, a member of the Institute is engaged to use accounting expertise as opposed to auditing expertise to collect, classify, and summaries financial information. The procedures employed are not designed and do not enable the member to express any assurance on the financial information. However, users derive some benefit as a result of the member's involvement because the service has been performed with due professional skill and care. An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor's name in a professional connection. If the

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auditor is not associated in this manner, third parties can assume no responsibility of the auditor

1.5 Quality Control and Engagement Standards

The Council of the ICAI has issued following Quality Control and Engagement Standards

S. No.	No. of Standard	Title of the Standard	*Effective Date
1	SQC 1	Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements	April 1, 2009
2	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing	April 1, 2010
3	SA 210	Agreeing the Terms of Audit Engagements	April 1, 2010
4	SA 220	Quality Control for an Audit of Financial Statements	April 1, 2010
5	SA 230	Audit Documentation	April 1, 2009
6	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements	April 1, 2009
7	SA 250	Consideration of Laws and Regulations in an Audit of Financial Statements	April 1, 2009
8	SA 260	Communication with Those Charged with Governance	April 1, 2009
9	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	April 1, 2010
10	SA 299	Responsibility of Joint Auditors	April 1, 1996
11	SA 300	Planning an Audit of Financial Statements	April 1, 2008
12	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment	April 1, 2008
13	SA 320	Materiality in Planning and Performing an Audit	April 1, 2010
14	SA 330	The Auditor's Responses to Assessed Risks	April 1, 2008
15	SA 402	Audit Considerations Relating to an Entity Using a Service Organization	April 1, 2010
16	SA 450	Evaluation of Misstatements Identified during the Audits	April 1, 2010
17	SA 500	Audit Evidence	April 1, 2009
18	SA 501	Audit Evidence - Specific Considerations for Selected Items	April 1, 2010
19	SA 505	External Confirmations	April 1, 2010

20	SA 510	Initial Audit Engagements-Opening Balances	April 1, 2010
21	SA 520	Analytical Procedures	April 1, 2010
22	SA 530	Audit Sampling	April 1, 2009
23	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	April 1, 2009
24	SA 550	Related Parties	April 1, 2010
25	SA 560	Subsequent Events	April 1, 2009
26	SA 570	Going Concern	April 1, 2009
27	SA 580	Written Representations	April 1, 2009
28	SA 600	Using the Work of Another Auditor	April 1, 2002
29	SA 610	Using the Work of Internal Auditors	April 1, 2010
30	SA 620	Using the Work of an Auditor's Expert	April 1, 2010
31	SA 700**	Forming an Opinion and Reporting on Financial Statements	April 1, 2011
32	SA 705**	Modifications to the Opinion in the Independent Auditor's Report	April 1, 2011
33	SA 706**	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	April 1, 2011
34	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements	April 1, 2011
35	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements	April 1, 2010
36	SA 800	Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Framework	April 1, 2011
37	SA 805	Special Considerations-Audits of Single Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	April 1, 2011
38	SA 810	Engagements to Report on Summary Financial Statements	April 1, 2011
39	SRE 2400	Engagements to Review Financial Statements	April 1, 2010
40	SRE 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity	April 1, 2010
41	SAE 3400	The Examination of Prospective Financial Information	April 1, 2007

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42	SAE 3402	Assurance Reports on Controls At a Service Organisation	April 1, 2011
43	SRS 4400	Engagements to Perform Agreed Upon Procedures Regarding Financial Information	April 1, 2004
44	SRS 4410	Engagements to Compile Financial Information	April 1, 2004

* *Effective date means that the SA is effective for audits of the financial statements for periods beginning on or after the specified date*

** *"The Council, in partial modification of the decision taken by it at its 291st meeting held in December, 2009, decided that the effective date/applicability of the following Standards on Auditing a) SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements"; b) SA 705, "Modifications to the Opinion in the Independent Auditor's Report"; c) SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" be postponed by one year and consequently the said Standards shall now be effective/applicable for audits of financial statements for periods beginning on or after 1st April, 2012 (instead of audits of financial statements for periods beginning on or after 1st April, 2011 as was earlier decided and referred to above).*

(Students may note that the abovementioned Quality Control and Engagement Standards are reproduced in Volume II to the book)

1.6 Guidance Notes

Various technical committees of the Institute are involved in the task of issuing guidance notes on topics relating to accounting and auditing for guidance of the members. Some of the important topics in auditing on which guidance notes have been issued are discussed below:

1.6.1 Guidance Note on Independence of Auditors: Professional integrity and independence is an essential characteristic of any member of the accounting profession. A detailed note on this topic was first published by the Council in 1968. In the light of the experience gained over a period of years, this note was revised by the Council and published as a guidance note in 1975. The revised Guidance Note contains essentially a discussion on relevant section of the Companies Act, 1956, and the provisions of the Chartered Accountants Act, 1949 which aim at ensuring independence of auditors.

1.6.2 Guidance Note on Audit Reports and Certificates for Special Purposes: The increasing involvement of members in giving audit reports or certificates on special purpose statements or other information prepared by an enterprise necessitated the need for guidance to the auditor regarding various facets of such assignments including the form and contents of audit reports and certificates for special purposes. In view of this, the Institute brought out this Guidance Note on Audit Reports and Certificates for Special Purposes.

The following is an overview of the areas touched upon by the Guidance Note:

- ◆ Scope of special purpose reports and certificates
- ◆ Responsibility for preparation of special purpose statements
- ◆ Scope of the reporting auditor's functions
- ◆ Contents of such reports and certificates
- ◆ Reports and certificates on specific items of financial statements
- ◆ Communication of report or certificate
- ◆ Communication with previous auditor.

The Guidance Note also contains examples of such reports and certificates.

1.6.3 Guidance Note on Tax Audit under Section 44AB of the Income-Tax Act: This Guidance Note was first issued by the Taxation Committee in 1985 and was revised by the Direct Taxes Committee. Refer to Chapter 15 for a detailed discussion.

1.6.4 Guidance Note on Audit of Abridged Financial Statements: The Companies (Amendment) Act, 1988, brought about significant changes in Section 219 of the Companies Act, 1956. By virtue of these amendments, a company listed on a recognised stock exchange could send abridged balance sheet and abridged profit and loss account to its members, etc. subject to certain conditions. The form of these abridged financial statements had been prescribed by the Central Government. The Companies Act, 1956, did not specifically require audit of abridged financial statements. The audit of abridged financial statements assured the readers that the relevant information was properly disclosed in such statements and thus lend a greater degree of credibility to them. Considering this, the Institute issued this Guidance Note to provide guidance to the members on issues relating to such audit. The following is an overview of the areas covered by the Guidance Note:

- ◆ Legal requirements
- ◆ Form and content of abridged financial statements
- ◆ Form and content of abridged profit and loss account
- ◆ Other requirements regarding abridged financial statements
- ◆ Authentication of abridged financial statements
- ◆ Audit of abridged financial statements

The appendices to the Guidance Note contain Form 23AB on statement containing salient features of balance sheet and profit and loss account etc., specimen auditor's report on abridged financial statements – qualified and unqualified opinion.

1.6.5 Guidance Note on Audit of Inventories: The Guidance Note deals with procedures of the auditor in respect of audit of inventories. It outlines the peculiar features of inventories, which impact the audit procedures. The following is a gist of the important aspects of audit of inventories covered by the Guidance Note:

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- ◆ *Internal Control Evaluation*: segregation of incompatible functions, standard form for recording movement of inventory, cross checking of data generated by different departments.
- ◆ *Verification*: management's responsibility for physical verification, sufficient appropriate audit evidence for existence, ownership and valuation, procedures for verification by auditor.
- ◆ *Examination of Records*: type of records, extent of auditor's examination, auditor's procedures in case of absence or insufficiency of records.
- ◆ *Attendance at Stock Taking*: need for auditor's attendance at stock taking, methods and procedures for stock taking, factors to be considered and procedures to be adopted in assessing the adequacy of stock taking, movement of stocks during stock taking, cut off procedures.
- ◆ *Confirmation from Third Parties*: factors to be seen, confirmations from third parties.
- ◆ *Examination of Valuation and Disclosures*: basis for valuation of inventories and methods of applying the basis, compliance with Accounting Standard (AS) 2, "Valuation of Inventories", use of standard costing, examination of the disclosure in financial statements.
- ◆ *Analytical Review Procedures*: illustrative analytical procedures, comprising mainly of comparison of various elements.
- ◆ *Work in Progress*: assessing appropriateness of its valuation etc.
- ◆ Management Representations
- ◆ Documentation by the auditor

The Guidance Note also gives illustrated set of instructions to be issued by the client to its staff responsible for stock taking, illustrative letter of confirmation of inventories held by others, illustrative letter of confirmation of inventories held by the entity on behalf of others and an illustrative management representation letter for inventories.

The Clarification issued by the Institute on the auditor's duties where inventories are stated to be "As Valued and Certified by the Management" in the financial statements, issued in September, 1999, has also been given.

1.6.6 Guidance Note on Audit of Debtors, Loans and Advances: The Guidance Note deals with the audit procedures that might be adopted by the auditor in case of audit of debtors, loans and advances. A gist of the relevant areas covered by the Guidance Note is as follows:

- ◆ *Internal Control Evaluation in Respect of Debtors*: fixing of credit/ loan/ advance limits, procedure for recording, realising and correlating outstandings from parties, aging schedule, periodic balance confirmation, authority for material adjustments to parties' account, periodic reconciliation statements, form and adequacy of security, recognition and realisation of interest income.
- ◆ *Verification*: audit evidence regarding existence, completeness, valuation and disclosure.

- ◆ *Examination of Records*: audit procedures for examining records
- ◆ Indications of doubtful debts/ loans
- ◆ *Special considerations in case of loans and advances*: requirements of section 293, 295 and 370 of the Companies Act, 1956, reporting requirements under MAOCARO, 1988 and section 227 of the Companies Act, 1956.
- ◆ *Direct Confirmation Procedures*: methods of obtaining confirmations, types of confirmations, timing of confirmations.
- ◆ *Analytical Review Procedures*: comparison of some important elements of debtors/loans and advances.
- ◆ Disclosure
- ◆ Management Representations
- ◆ Documentation

The Guidance Note also contains an illustrative confirmation letters to be sent to debtors and management representation letter for debtors, loans and advances.

1.6.7 Guidance Note on Audit of Investments: This Guidance Note deals with the procedures that might be adopted by the auditor for auditing investments. The Guidance Note also throws light on the exceptional features of investments which have an impact on the audit procedures. The important aspects of audit of investments covered by the Guidance Note are highlighted as follows:

- ◆ *Internal Control Evaluation*: control over acquisition, accretion and disposal of investments, safeguarding of investments, controls in respect of title of investments, information controls.
- ◆ *Verification of Transactions*: authority to invest, legal requirements, supporting documents, terms of sale or purchase (ex or cum dividend/interest), rights issues, bonus issues.
- ◆ *Physical Verification*: responsibility of auditor, use of depository/ custodial services by the client, scripless trading, timing of physical examination, investments held by others, investments not held in the name of the client vis a vis legal requirements, procedure in finance/chit fund/nidhi companies etc., immovable properties held as investments.
- ◆ *Examination of Valuation or Disclosures*: valuation and disclosure of investments vis a vis, compliance with Accounting Standard (AS) 13 and statutory requirements, method of valuation.
- ◆ *Analytical Procedures*: comparison of various ratios.
- ◆ Management Representations
- ◆ Documentation by the auditor.

The Guidance Note, for the benefit of the members, also give a gist of legal requirements, including disclosure norms, relating to investments under certain prominent statutes,

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illustrative letter of confirmation for investments held by banks, and management representation letter for investments.

1.6.8 Guidance Note on Audit of Miscellaneous Expenditure (Revised): The Accounting Standards Board of the Institute of Chartered Accountants of India had in the recent past issued the Accounting Standard (AS) 26, Intangible Assets. The Accounting Standard lays down the accounting treatment, viz., recognition, measurement and disclosure requirements for certain intangible assets that are not dealt with specifically in any other Accounting Standard.

Though the Institute had in October 1995 issued the Guidance Note on Audit of Miscellaneous Expenditure Shown in Balance Sheet, the same has been revised pursuant to the issuance of the Accounting Standard 26 and the changed accounting principles in respect of intangible assets contained therein.

The 2003 Guidance Note contains detailed guidance for auditors in respect of audit of various items covered under "Miscellaneous Expenditure", for example, preliminary expenses, commission or brokerage on underwriting or subscription of shares etc., when AS 26 comes into force or is voluntarily applied by the entity in accounting for intangible assets. The issues touched upon by the Guidance Note include internal control evaluation, verification and disclosure of such expenditure pursuant to issuance of AS 26.

1.6.9 Guidance Note on Audit of Cash and Bank Balances: The Guidance Note deals with the audit procedures that might be adopted while auditing cash and bank balances. The following is a gist of the relevant areas covered by the Guidance Note:

- ◆ *Internal Control Evaluation:* segregation of incompatible functions, authorisation, recording of transactions, safe custody of cash, chequebooks etc., reconciliation statements, etc.
- ◆ *Verification of Cash Balances:* timing of carrying out verifications, procedure for verification, situations of unduly large cash balances, IOUs, procedures in case of discrepancies, frequency of verification.
- ◆ *Verification of Bank Balances:* procedures for verification, examination of bank reconciliation statements and unusually old outstandings therein, post dated cheques, obtaining confirmations from banks, inoperative bank accounts, fixed deposits, remittance in transit, treatment of stale cheques, valuation of foreign exchange transactions.
- ◆ *Examination of Valuation and Disclosure:* compliance with recognised accounting policies, practices, statutory requirements.

The Guidance Note also gives an illustrative letter of confirmation for bank balances.

1.6.10 Guidance Note on Audit of Liabilities: This Guidance Note contains recommended audit procedures in case of audit of liabilities. The following is an outline of the relevant areas discussed in the Guidance Note:

- ◆ *Internal Control Evaluation in Respect of Loans and Borrowings:* credit limits/borrowing powers and limits, authority, terms of borrowing, compliance with statutory requirements,

variation in terms, security against loans, documentation, reporting of non compliance, balance confirmations, foreign exchange loans.

- ◆ *Internal Control Evaluation in Respect of Trade Creditors, Current Liabilities, Provisions, Trade Deposits:* in addition to those above, payment on duplicate invoices, schedule of creditors, adjustments to creditors, accounts to be authorised, cut off procedures.
- ◆ *Examination of Records of Loans and Borrowings:* validity and accuracy, agreement with the statements from creditors and loanees, loan agreements, change in the value of security, deferred payment credits.
- ◆ *Examination of Records of Trade Creditors and Other Current Liabilities:* cut off procedures, control accounts, documentary evidence, important aspects to be seen in the schedule of creditors etc., year end transactions, subsequent events.
- ◆ *Examination of Records of Provisions:* meaning of provision, objectives of audit of provisions, provision for taxes and duties, provision for gratuity, provision for bonus, provision for dividend, other provisions.
- ◆ *Examination of Records of Contingent Liabilities:* meaning, general procedures for verifying contingencies.
- ◆ *Direct Confirmation Procedures:* meaning, types – negative/ positive, suitability of each type, discrepancies in books of account vis a vis confirmations.
- ◆ *Examination of Disclosures*
- ◆ *Analytical Review Procedures:* comparison of various ratios
- ◆ *Special Considerations in Case of a Company:* compliance with the relevant sections of the Companies Act, 1956.
- ◆ *Management Representations*
- ◆ *Documentation*

The Guidance Note also contains illustrative letter of confirmation to be sent to creditors and management representation letter for liabilities and contingencies.

1.6.11 Guidance Note on Audit of Revenue: The Guidance Note contains recommended audit procedures in case of audit of liabilities. The following is an outline of the areas covered by the Guidance Note:

- ◆ *Assertions Regarding Revenue:* occurrence, completeness, measurement, presentation and disclosure.
- ◆ Internal Control Evaluation
- ◆ *Examination of Records:* compliance with AS 9, cut-off procedures, sales journal, dispatch documents, sales to intermediate parties, realisation in installments, export sales, revenue from services rendered.
- ◆ Examination of Presentation and Disclosure

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- ◆ *Analytical Procedures*: comparison of various relevant components of revenue.
- ◆ *Special Considerations in Case of a Company*: compliance with relevant statutory requirements.
- ◆ Documentation

1.6.12 Guidance Note on Audit of Expenses: This Guidance Note deals with the illustrative audit procedures that might be adopted by the auditors in auditing various items of expenses. The introductory part of the Guidance Note deals with the explanation of the term “expense” and the different approaches to identify the expense. It also deals with the peculiar features of “expenses” which impact the audit procedures as also the assertions to be examined in respect thereof.

The following is a gist of the relevant aspects of audit of expenses covered by the Guidance Note:

- ◆ Internal Control Evaluation
- ◆ Verification – Examining Records and Analytical Procedures
- ◆ Examination of Presentation and Disclosure
- ◆ Management Representation
- ◆ Documentation
- ◆ Special Considerations in the Case of a Company

The Guidance Note also contains illustrative audit procedures for the following items of expenses, viz., goods and raw materials consumed, purchases and purchase returns, wages and salaries, bonus, retirement benefits, other conversion costs, establishment and general administrative expenses, interest and financial charges, depreciation, research and development expenses, repairs and maintenance, contingencies, and taxes on income.

1.6.13 Guidance Note on Guidance Note on Section 227 3(e) and (f) of the Companies Act, 1956 (Revised): The above Guidance Note provides guidance to the members in reporting on clauses (e) and (f) of sub-section 3 of Section 227 of the Companies Act, 1956 which were inserted by the Companies (Amendment) Act, 2000. The institute issued the Guidance Note on the same in the year 2001. The Department of Company Affairs, in the year 2003, notified the Companies (Disqualifications of Directors under Section 274 (1) (g) of the Companies Act, 1956) Rules, 2003. Though the issuance of the said Rules did not per se change the scope of the statutory audit of the companies or the reporting responsibilities under section 227 (3) of the Companies Act, 1956, yet they did have an implication on sections 227 (3) (e) and (f) and 274(1)(g). Thus, to help the members understand the said Rules and their implications and properly fulfill their duties as auditors the Institute has revised the Guidance Note originally issued in the year 2001.

The introductory part of the Guidance Note contains the reporting requirements for the auditors under section 227(3) of the Companies Act, 1956. It also throws light on the guidance in respect of the same provided by the Statement on Qualifications in the Auditor’s Report, issued by the Institute.

The section dealing with clause (e) begins with the requirements of the newly inserted clause. It then goes on to interpret the phrase “adverse effect on the functioning of the company” since the Companies Act is silent on the meaning of the phrase. The Guidance Note then dwells upon the change, if any, in the scope of the audit and the auditor’s role pursuant to the insertion of the said clause. It also deals with the treatment of the negative or adverse remarks of the auditor in the report under CARO, 2003 *vis a vis* the requirements of clause (e).

The next part of the Guidance Note deals with the reporting requirements under clause (f) of sub-section (3) of section 227 of the companies Act, 1956. It guides the members as to the harmonious interpretation of clause (f) of section 227(3) with section 274(1)(g) of the Companies Act, 1956. The Revised Guidance Note also contains illustrative auditor’s report under various situations as well as the illustrative format of the auditor’s certificate envisaged by the Companies (Disqualifications of Directors under Section 274 (1) (g) of the Companies Act, 1956) Rules, 2003.

1.6.14 Guidance Note on Certificate on Corporate Governance (Revised): This Guidance Note provides guidance to members while certifying corporate governance pursuant to clause 49 of the Listing Agreement. The important aspects covered by the Guidance Note are as follows:

- ◆ Management’s Responsibility
- ◆ Auditor’s Responsibility
- ◆ General Principles
- ◆ Documentation
- ◆ Verification of Compliance of Conditions of Corporate Governance: board of directors, audit committee, remuneration of directors, board procedures, management, shareholders, report on corporate governance.
- ◆ Management Representations
- ◆ Auditor’s Certificate
- ◆ Role of Auditor in Audit Committee and Certification of Corporate Governance

The appendices to the Guidance Note contain the circular issued by the Secondary Market Department of SEBI on the extent of applicability of Clause 49 of the Listing Agreement to the listed entities which are body corporates but not companies, clause 49 of the Listing Agreement, and the format of the certificate to be issued by the auditor pursuant to clause 49.

1.6.15 Guidance Note on Computer Assisted Audit Techniques (CAATs): Recognising the developments in the field of technology and its impact on the accounting profession in India, Auditing and Assurance Standards Board had issued Standard on Auditing (SA) 315, “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment” and SA 330, “The Auditor’s Responses to Assessed Risks”. The Guidance Note deals extensively, with the concept of CAATs and related pertinent issues such what CAATs are, where they may be used, considerations in use of CAATs, how to use CAATs, testing of CAATs, controlling application of CAATs, documentation required when

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using CAATs, use of CAATs in small entities, etc. The Guidance Note also contains a comprehensive appendix containing examples of CAATs, their description and comparable advantages and disadvantages of each of these CAATs.

1.6.16 Guidance Note on Audit of Payment of Dividends: The Auditing and Assurance Standards Board of India have issued the Guidance Note on Audit of Payment of dividend in order to keep the members abreast in resolving the technical intricacies involved in auditing payment of dividend. The Guidance Note deals, in detail, about internal control evaluation and various verification procedures required to be done by the auditor. The Guidance Note takes in to account both, corporate as well as non-corporate entities. The Appendix to the Guidance Note contains extracts of various relevant Acts and Rules relating to payment of dividend, the objective being to make the publication a complete, self-contained document for use by the members and others.

1.6.17 Guidance Note on Audit of Capital and Reserves: The Auditing and Assurance Standards Board of India has issued Guidance Note on Audit of Capital and Reserves in order to keep the members abreast in resolving the technical intricacies involved in auditing of capital and reserves. The Guidance Note discusses the auditing aspect of capital and reserves separately. It deals in detail, with different principle related aspects dealing with the audit of capital and reserves including implications of key legal requirements. This Guidance Note not only gives special consideration to companies but partnerships and sole proprietary concerns as well. The Guidance Note also incorporates circulars issued by the Government and other regulatory authorities wherever applicable.

The Guidance Note on Audit of Capital and Reserves discusses significant aspects of their audit such as evaluation of internal controls and verification, the audit evidence, the auditing procedure to be followed in case of issue of shares for consideration other than cash and in case of issue of Sweat Equity shares etc. The Guidance Note also deals with various types of reserves and their accounting treatment while discussing auditing aspects. It also lays down the documentation requirements for the audit of capital and reserves.

1.6.18 Guidance Note on Provision for Proposed Dividend: This Guidance Note deals with the issue of responsibility of the auditors in respect of the provision for and disclosure of proposed dividends in the financial statements of companies. The Guidance Note also outlines the views of the Council of the Institute, inter alia, on the following matters:

- ◆ whether the “proposed dividend” is a liability before the general meeting to approve the financial statements;
- ◆ non provision of “proposed dividend” in the financial statements *vis-a-vis* true and fair view and the necessary disclosure in that case;
- ◆ auditor’s duties in respect of above non provision.

1.6.19 Guidance Note on Auditing of Liquidators: This Guidance Note deals with the audit under section 551 of the Companies Act, 1956, i.e., audit of accounts of liquidators. It contains the recommendations of the Institute on *inter alia*, the following aspects of such audit:

- ◆ Professional skills required.

- ◆ Audit procedures to be applied.
- ◆ Form and content of the audit report under section 551 of the Companies Act.

1.6.20 Guidance Note on Section 293A of the Companies Act and the Auditor: The Guidance Note was first issued by the Institute in 1976 when, under Section 293A of the Companies Act, 1956, companies were prohibited from making contributions to a political party or for any political purpose. Since elaborate amendments were incorporated in Section 293A by the Companies (Amendment) Act, 1985, which came into force from May 24, 1985, the Institute revised the existing Guidance Note in consonance with the amended provisions in 1986

The Guidance Note, among other things, also elaborates on the terms, political party, political purpose, directly or indirectly, person, average net profits, as used in the said section of the Companies Act, 1956. The Guidance Note also outlines the duties of the auditor in respect of section, besides trying to explain the intent and import of the said section.

1.6.21 Guidance Note on Audit of Consolidated Financial Statements: The basic objective of the Guidance Note is to provide detailed guidance to the members in understanding and resolving critical issues that might arise while auditing consolidated financial statements, for example, the objective of audit of consolidated financial statements, expectations from the auditors of consolidated financial statements vis a vis applicability of Engagement and Quality Control Standards (Formerly known as Auditing and Assurance Standards) to audit of consolidated financial statements, salient features of consolidated financial statements having an impact on audit thereof, types on consolidated adjustments, reporting responsibilities, situations where the auditor of parent's financial statements is also the auditor of the consolidated financial statements and situations where he is not. The Guidance Note contains illustrative formats of audit reports on consolidated financial statements.

The Guidance Note assumes added importance in view of the fact that while the Securities and Exchange Board of India had amended clause 32 of the Listing Agreement to require the listed companies to publish consolidated financial statements in addition to their separate financial statements, other companies are preparing consolidated financial statements on a voluntary basis as a mark of good reporting and governance practices.

Moreover, the Companies (Amendment) Bill, 2003 also envisages preparation of consolidated financial statements, thereby, giving it a statutory mandate.

1.7 Guidance note(s) on Related Services

The framework for auditing and related services makes it clear that there can be different layers of assurance depending upon the nature of services being performed by the chartered accountant. Related Services comprise of Review engagements, Agreed upon Procedures and Compilation Engagement. Reviews engagements involve providing moderate assurance (or negative assurance) but other two services, viz., and compilation and agreed upon procedures provide no assurance at all. The Institute has issued guidance notes covering these aspects of related services in a comprehensive manner.

1.8 Authority Attached to the Documents Issued by the Institute

The Institute has, from time to time, issued 'Statements' and 'Guidance Notes' on a number of matters. With the formation of the Accounting Standards Board and the Auditing and Assurance Standards Board, Accounting Standards and *Standards on Auditing* have also been issued. The level of authority attached to these documents and the degree of compliance required in respect thereof has been explained by the Institute through its various announcements issued from time to time.

1.8.1 Statements: The 'statements' have been issued with a view to securing compliance by members on matters which in the opinion of the council of the institute are critical for the proper discharge of their functions. 'statements' therefore are mandatory. Accordingly, while discharging their attest function, it is the duty of the members of the institute.

- (a) to examine whether 'Statements' relating to accounting matters are complied with in the presentation of financial statements covered by their audit. In the event of any deviation from such 'Statements', it is their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and
- (b) to ensure that the 'Statements' relating to auditing matters, are followed in the audit of financial information covered by their audit reports. If, for any reason, a member, has not been able to perform an audit in accordance with such 'Statements' his report should draw attention to the material departures there from.

A list of 'Statements' issued by the Institute which are in force is given below:

- (i) Statement on Auditing practices.
- (ii) Statement on Payments to Auditors for Other Services,
- (iii) Statement on the Companies (Auditor's Report) Order, 2003 (Issued under Section 227(4A) of the Companies Act, 1956).
- (iv) Statement on Qualifications in Auditor's Report.
- (v) Statement on the Amendments to Schedule VI to the Companies Act.

1.8.2 Guidance Notes: 'guidance notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

1.8.3 Accounting Standards and Standards on Auditing: The 'accounting standards' and '*Standards on Auditing*' establish standards which have to be complied with to ensure that financial statements are prepared in accordance with generally accepted accounting

standards and that auditors carry out their audit in accordance with the generally accepted auditing practices. They become mandatory on the dates specified in the respective document or notified by the council.

There can be situations in which certain matters are covered both by a 'Statement' and by an 'Accounting Standard'/'Standards on Auditing'. In such a situation, the 'Statement' prevails till the time the relevant 'Accounting Standard'/'Standards on Auditing' becomes mandatory. Once an 'Accounting Standard'/'Standards on Auditing' becomes mandatory, the concerned 'Statement' or the relevant part thereof automatically stands withdrawn.

Standards on Auditing (SAs) establish standards, which have to be complied with to ensure that auditors carry out their duties in accordance with the generally accepted auditing practices. They become operative (i.e., mandatory) in respect of audit of all enterprises on the dates specified in the respective SAs or notified by the Council. The duties of the members of the Institute in relation to operative SAs are similar to those in respect of 'Statements' relating to auditing matters, as described in paragraph 2 (b) above.

1.8.4 Accounting Standards: Accounting Standards are formulated by the Accounting Standards Board and issued by the Council of the Institute. The Accounting Standards are issued for use in the presentation of 'general purpose financial statements' which are issued to the public by such 'commercial, industrial or business enterprises' as may be specified by the Institute from time to time and subject to the attest function of its members. They become mandatory on the dates specified in the respective Accounting Standards or notified by the Council in this behalf.

- (a) The term 'General Purpose Financial Statements' includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large.
- (b) The reference to 'commercial, industrial or business enterprises' is in the context of the nature of activities carried on by an enterprise rather than with reference to its objects. The Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise, irrespective of whether it is profit oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). The exclusion of an entity from the applicability of the Accounting Standards is permissible only if no part of the activity of entity is commercial, industrial or business in nature. In other words, even if a very small proportion of the activities of an entity is considered to be commercial, industrial or business in nature, then it can not claim exemption from the application of Accounting Standards. In such a case the Accounting Standards will apply to all its activities including those which are not commercial, industrial or business in nature.

The Companies Act, 1956, as well as many other statutes require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes 'true and fair' view has not been defined either in the Companies Act, 1956, or in any other statute. The Accounting Standards (as well as other

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pronouncements of the Institute on accounting matters) seek to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view.

The 'Preface to the Statements of Accounting Standards' issued by the Institute in 2004 states (paragraphs 6.1 and 6.3):

"6.1 While discharging their attest function, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their reports so that the users of such statements may be aware of financial deviations."

"6.3 Financial Statements can not be described as complying with the Accounting Standards unless they comply with all the requirements of each applicable standard."

Once an Accounting Standard becomes mandatory, the duties of an auditor with respect to such standard are the same as those specified at paragraph 2(a) above.

*Accounting Standards 4 and 5 were made mandatory in respect of accounting periods commencing on or after 1.1.1987 for all commercial industrial or business enterprises. Accounting Standards 1, 7, 8, 9 and 10 were initially made mandatory in respect of accounting periods commencing on or after 1.4.1991 for companies governed by the Companies Act, 1956 as well as for other commercial, industrial or business enterprises except the following:

(a) Sole proprietary concerns/individuals (b) Partnership firms (c) Societies registered under the Societies Registration Act (d) Trusts (e) Hindu undivided families (f) Associations of persons.

Accounting Standards 1, 7, 8, 9 and 10 were made mandatory in respect of general purpose financial statements of enterprises listed at (a) to (f) above, for accounting periods commencing on or after 1.4.1993 where such statements were statutorily required to be audited under any law. In this regard, the Council of the Institute has clarified that the mandatory accounting standards also apply in respect of financial statements audited under Section 44AB of the Income tax Act, 1961. Accordingly, members should examine compliance with the mandatory accounting standards when conducting such audit. AS-6 was made mandatory in respect of accounts for periods commencing on or after 1.4.1995. The remaining Accounting Standards i.e. AS 11, 12, 13, 14 and 15 have been made mandatory with effect from the dates specified in the standards themselves.

While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards.

AS I - Disclosure of Accounting Policies - In the case of a company, members should qualify their audit reports in case :

* The Council has classified the enterprises for the purpose of applicability of Accounting Standards into three Categories, viz. Level I, Level II and Level III. This scheme comes into effect in respect of accounting periods commencing on or after 1-4-2004

- (a) accounting policies required to be disclosed under Schedule VI or any other provisions of the Companies Act, 1956, have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated in paragraph 16 above but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

If accounting policies have not been disclosed at one place or if certain significant accounting policies have not been disclosed, by a company on the ground that their disclosure is not required under the Companies Act, 1956, the member should disclose the fact in his audit report without necessarily making it a subject matter of audit qualification. Such a disclosure would not constitute a reservation, qualification or adverse remark except where the auditor has specifically made it a subject matter of audit qualification. Accordingly in the case of a company, the Board of Directors need not provide information or explanation with regard to such a disclosure (except where the same constitutes a qualification) in their report under sub-section (3) of Section 217 of the Companies Act, 1956.

In the case of enterprises not governed by the Companies Act, 1956, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements. Similarly, the member should examine if the fundamental accounting assumptions have been followed in preparing the financial statements or not. In appropriate cases, he should consider whether, keeping in view the requirements of the applicable laws, a qualification in his report is necessary. In the event of non-compliance, by enterprises not governed by the Companies Act, 1956, with the disclosure requirements of AS1 in situations where the relevant statute does not require such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification.

Other Mandatory Accounting Standards - While making a qualification, the auditor should follow the requirements of the 'Statement on Qualifications in Auditor's Report' issued by the Institute. Subject to this, non-compliance with any of the requirements of a mandatory Accounting Standard other than AS 1 by any enterprise should be a subject matter of qualification except that, to the extent that the disclosure requirements in the relevant standard are in addition to the requirements of the Companies Act, 1956, or any other applicable statute, the member should disclose the fact of non-compliance with such disclosure requirements in his audit report without necessarily making it a subject matter of audit qualifications.

Financial Statements Prepared on a Basis other than Accrual - With regard to the fundamental accounting assumption of accrual, the Council of the Institute has made a specific announcement

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that in respect of individuals/bodies covered by para AS 1 - *Disclosure of Accounting Policies* above, the auditor should examine whether the financial statements have been prepared on accrual basis. In cases where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand, where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual', the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the accounting standards which are applicable in the context of basis of accounting followed by the enterprise have been complied with or not and consider making suitable disclosures/qualifications in his audit report accordingly.

Manner of Making Qualification Disclosure in the Audit Report - In making a qualification/disclosure in the audit report in respect of non-compliance with a Statement, SA, Accounting Standard or Guidance Note, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification/disclosure in respect of items which, in his judgement, are not material.

While making a qualification, the auditor should follow the requirements of the 'Statement on Qualifications in Auditor's Report' issued by the Institute.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

Examples of Qualifications/Disclosures in the Audit Report - Given below are some examples which illustrate the manner of making qualification/disclosure in the audit report. It may be clarified that these examples are aimed only at illustrating the manner of making qualifications/disclosures and are not intended in any way to be exhaustive.

Examples of Qualifications

- (a) Where proper disclosures regarding changes in accounting policies have not been made by a company.

"The profit and loss account and balance sheet comply with the accounting standards referred to sub-section (3C) of Section 211 of the Companies Act, 1956, except Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as the company has not disclosed in its accounts the fact of change, from this year, in the method of providing depreciation on plant and machinery from straight-line method to written-down value method, as also the effect of this change. As a result of this change, the net profit for the year, the net block as well as the reserves and surplus are lower by ₹ Each as compared to the position which would have prevailed had this change not been made.

Subject to the above, we report that".

- (b) Where a manufacturing company has accounted for interest income on receipt basis and not on time proportion basis.

"The profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956, except Accounting Standard (AS) 9, 'Revenue Recognitions', as the company has followed the policy of accounting for interest income on receipt basis rather than on time proportion basis. As a result, the net profit for the year and the current assets are understated by ₹..... each as compared to the position which would have prevailed if the company had accounted for interest income on time proportion basis.

Subject to the above, we report that"

- (c) Where an enterprise has capitalised financing costs related to certain fixed assets for periods after such assets were ready to be put to use.

"The profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956, except Accounting Standard (AS) 16, 'Borrowing Costs', as interest payable on borrowings related to the acquisition of fixed assets has been capitalised for the periods after which the assets were put to use. Consequently, the net profit for the year, the net block of fixed assets and the reserves and surplus have been overstated by Rs..... each as compared to the position which would have prevailed if the company had complied with the requirements of AS 16.

Subject to the above, we report that"

Examples of Disclosures

- (a) Where a company has not disclosed all significant accounting policies and has also not disclosed the accounting policies at one place.

"The profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956, except Accounting Standard (As) 1, 'Disclosure of Accounting Policies', as the company has disclosed those accounting policies the disclosure of which is required by the Companies Act, 1956. Other significant accounting policies, relating to treatment of research and development costs have not been disclosed nor have all the policies been disclosed at one place.

We report that"

- (b) Where a partnership firm does not make adequate disclosures regarding the revaluation of its fixed assets.

"During the year, the enterprise revalued its land and buildings. The revalued amounts of land and buildings are adequately disclosed in the balance sheet. However, the method adopted to compute the revalued amounts has not been disclosed, which is contrary to Accounting Standard (AS) 10, 'Accounting for Fixed Assets' issued by the Institute of Chartered Accountants of India.

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We report that"

- (c) Where a sole proprietary concern enterprise follows cash basis of accounting.

"It is the policy of the enterprise to prepare its financial statements on the cash receipts and disbursements basis. On this basis revenue and the related assets are recognised when received rather than when earned, and expenses are recognised when paid rather than when the obligation is incurred.

In our opinion, the financial statements give a true and fair view of the assets and liabilities arising from cash transactions of at and of the revenue collected and expenses paid during the year then ended on the cash receipts and disbursements basis as described in Note X."

Applicability of Accounting Standards to charitable and/or religious organisations - The Accounting Standards Board has received a query as to whether the accounting standards formulated by it are applicable to organisations whose objects are charitable or religious. The Board has considered this query and its views in the matter are set forth in the following paragraphs.

The Preface to the Statements of Accounting Standards states:

"The Institute will issue Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members".

The reference to commercial, industrial or business enterprises in the aforesaid paragraph is in the context of the nature of activities carried on by an enterprise rather than with reference to its objects. It is quite possible that an enterprise has charitable objects but it carries on, either wholly or in part, activities of a commercial, industrial or business nature in furtherance of its objects. The Board believes that Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise, irrespective of whether it is profit oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of a commercial, industrial or business nature. (e.g. an activity of collecting donations and giving them to flood affected people).

It is also clarified that exclusion of an entity from the applicability of the Accounting Standards would be permissible only if no part of the activity of such entity was commercial, industrial or business in nature. For the removal of doubts, it is clarified that even if a very small proportion of the activities of an entity were considered to be commercial, industrial or business in nature, then it could not claim exemption from the application of Accounting Standards. The Accounting standards would apply to all its activities including those which were not commercial, industrial or business in nature.