

# Andhra Pradesh Municipal Audit Manual



Department of Municipal Administration &  
Urban Development  
Government of Andhra Pradesh



CENTRE FOR GOOD GOVERNANCE  
Knowledge • Technology • People

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GO Ms.No.233 MA dated 22-5-2002

GO Ms.No.619 MA dated 21-8-2007

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**Koneru Ranga Rao**  
Minister for Municipal Administration  
Government of Andhra Pradesh

### MESSAGE

In the year 2001, Government of India (Gol), based on the recommendations of the Eleventh Finance Commission, issued guidelines to the Comptroller and Auditor General of India (CAG), to prescribe formats of Budget and Accounts for Panchyat Raj Institutions and Urban Local Bodies (ULBs) amenable to computerization.

In September, 2003, the Gol suggested to the CAG to develop National Municipal Accounts Manual (NMAM). In December, 2004, the NMAM developed by CAG was made available to State Governments across the country for development of State-specific Budget and Accounts Manuals to be used by the ULBs. Like many other ULBs in the country, ULBs in Andhra Pradesh have been following cash based single entry system of accounting, while the NAMM suggest accrual based double entry system of accounting.

The State Government has decided to introduce reforms in budgeting and accounting in all ULBs and desired the Centre for Good Governance (CGG) to develop state-specific accounts and budget manuals keeping the NMAM guidelines in view.

Centre for Good Governance has developed Manuals for Accounts, Budget, Audit, and Asset Management; and Handbook on Municipal Financial Accountability. I am confident that these manuals would facilitate better management of finance and accounts activities in the Urban Local Bodies (ULBs) and help in improved and efficient delivery of civic services.

**Koneru Ranga Rao**





**K. Rosaiah**

Minister for Finance, Planning & Legislative Affairs  
Government of Andhra Pradesh &  
Chairman, Steering Committee  
Centre for Good Governance, Hyderabad

**MESSAGE**

Centre for Good Governance (CGG) was established by Government of Andhra Pradesh (GoAP) in October, 2001 to help it to achieve its goal of transforming governance. One of the focus areas of CGG is Financial Management – to improve planning, resource allocation, monitoring, management and accounting systems and access to information, so that accountability is clear, spending is transparent and public expenditure is more effectively controlled and more productively targeted.

Government of Andhra Pradesh in Municipal Administration and Urban Development department have issued orders (GO Ms. No.233 MA dated 22<sup>nd</sup> May, 2002) in 2002 that ULBs adopt with immediate effect accrual based accounting system within their jurisdiction.

Government of India made the National Municipal Accounts Manual (NMAM) available to State Governments during December, 2004 for development of state-specific accounts and budget manuals. The Government of Andhra Pradesh has decided to introduce reforms in budgeting and accounts in all ULBs and in January, 2006 entrusted the CGG the work relating to preparation of state specific accounting and budget manuals as per the guidelines in NMAM. CGG has immediately responded and developed the following manuals and handbook.

- Andhra Pradesh Municipal Accounts Manual;
- Andhra Pradesh Municipal Budget Manual;
- Andhra Pradesh Municipal Asset Management Manual;
- Andhra Pradesh Municipal Audit Manual;
- Andhra Pradesh Municipal Uniform Budget and Accounts Code; and
- Handbook on Municipal Financial Accountability.

The manuals were approved by Government recently in GO Ms. No.619 MA dated 21 August, 2007. I am glad that the manuals and handbook are being published and hope that they would be helpful to all ULBs to improve their performance and serve the people.

K. ROSAIAH



## **Preface**

Centre for Good Governance has developed Manuals for Accounts, Budgeting, Asset Management and Handbook on Financial Accountability under directions from MA&UD Department, GoAP. A Municipal Audit Manual has also been developed to assist functionaries appointed for the purpose of audit of municipalities.

Audited financial statements serve a very important role in ensuring the accountability of officials vested with the responsibility of managing the affairs of the entity. The legislative authority uses them to meet its fiduciary responsibility of overseeing the activities of the executive. Auditors conduct test checks in order to assess compliance with various internal control processes within the organization. Auditors also have the responsibility to ensure that a) all revenues which are due to the entity have been collected with due diligence and b) all expenditure has been incurred with due regard to economy, efficiency and effectiveness. They point out weaknesses, if any, and suggest measures to improve financial accountability.

As audit is based on a test check of transactions, it is not practicable for audit nor is it expected that it would discover every instance of fraud or misappropriation. It is primarily the responsibility of the management to install internal control measures that are adequate and ensure compliance with them.

This manual is neither intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgment of audit work required. Suggested formats and requested levels of detail contained herein may not cover all circumstances or conditions encountered in an audit. Wherever necessary the auditor may obtain necessary guidance from Director of State Audit, GoAP and Comptroller and Auditor General of India.

This Manual has been developed by a team consisting Sri PV Subrahmanyam, Consultant, Sri N. Manmadha Rao, Internal Auditor, Sri DV Rao, Consultant, and Sri M. Brahmaiah, Director (FMRG) of CGG. I would welcome any suggestions for improving the Manual.

**Dr. RAJIV SHARMA, IAS**  
Director General  
Centre for Good Governance

June 2007  
Hyderabad



**GOVERNMENT OF ANDHRA PRADESH  
ABSTRACT**

Municipal Administration & Urban Development Department – Decision taken in the Workshop on Governing for Results – Local Bodies and Self Help Group V on 16<sup>th</sup> and 17<sup>th</sup> May, 2002 held in MCR HRD Institute, Hyderabad – Implementation – Orders – Issued.

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MUNICIPAL ADMINISTRATION AND URBAN DEVELOPMENT DEPARTMENT

GO Ms. No.233 MA

DATED 22-5-2002

ORDER

The following decision was taken in the Workshop, Governing for Results - Local Bodies and Self Help Groups held on 16<sup>th</sup> and 17<sup>th</sup> May, 2002 in MCR HRD Institute to adopt accrual based accounting system.

“The Urban Local Bodies/Corporations adopt with immediate effect the accrual based accounting system within their jurisdiction”.

2. Government has considered the above suggestion and hereby accepts for immediate implementation.

(BY ORDER AND IN THE NAME OF GOVERNOR OF ANDHRA PRADESH)

**A.K.GOYAL**  
PRINCIPAL SECRETARY TO GOVERNMENT

To  
The Commissioner, Municipal Corporation of Hyderabad, Hyderabad  
The Director of Municipal Administration, Hyderabad  
The Engineer-in-Chief,(PH), Hyderabad  
The Director of Town Planning, Hyderabad  
SF

//FORWARDED BY ORDER//

SECTION OFFICER

**GOVERNMENT OF ANDHRA PRADESH**  
**ABSTRACT**

MA&UD Department - National Municipal Accounting Manual - A.P. State Municipal Accounting Manual - Implementation in all ULBs in the State - Orders Issued.

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MUNICIPAL ADMINISTRATION AND URBAN DEVELOPMENT (UBS) DEPARTMENT

**G.O. Ms. No. 619 MA**

**Date: 21-08-2007**

**Read:**

Guidelines issued by Government of India dated: 16-05-2005.

Q R D E R

- 1 In the reference cited above, Government of India have communicated the model National Municipal Accounting Manual and instructed the State Governments to prepare the State Municipal Accounting Manual according to their needs and implement the same in all the Urban Local Bodies,
2. Accordingly Government of A.P, have prepared the A.P. State Municipal Accounting Manuals (1. A.P. Municipal Accounting Manual, 2. A.P. Municipal Budget Manual, 3. A.P. Municipal Asset Management Manual and 4. A.P. Municipal Audit Manual) in collaboration with Centre for Good Governance, Hyderabad. C. & A. G, Hyderabad has concurred with implementation of the same in the State.
3. Government hereby direct all the Urban Local Bodies in the State to implement the A.P. Municipal Accounting Manuals. The required Hard and Soft copies of A.P. Municipal Accounting Manuals will be provided by Centre for Good Governance, Hyderabad.
4. Commissioner and Director of Municipal Administration is instructed to take further necessary action.
5. These orders are issued with the concurrence of Fin. U.O. No. 17728/268/AI/Exp. M & F/07, dated: 2-08-2007.

(BY ORDER AND IN THE NAME OF THE GOVERNOR OF ANDRHA PRADESH)

**PUSHPA SUBRAHMANYAM**  
**SECRETARY TO GOVERNMENT**

To

The Commissioner and Director of Municipal Administration, Hyderabad.  
All the HoDs ,UDAs and ULBs in the State through CDMA, Hyderabad.

## ABBREVIATIONS

AAS	Auditing and Assurance Standard
Admn.	Administration
AP	Andhra Pradesh
APM Act	Andhra Pradesh Municipalities Act, 1965
APMAM	Andhra Pradesh Municipal Accounts Manual
BC	Backward Class
CA	Chartered Accountant
CAG	Comptroller and Auditor General of India.
CBI	Central Bureau of Investigation
CCTV	Closed Circuit Television
CGG	Centre for Good Governance
CVC	Chief Vigilance Commissioner
DCB	Demand, Collection & Balance
Dept	Department
EDI	Electronic Data Interchange
EDP	Electronic Data Processing
ES	Establishment
Fin & Plg	Finance & Planning
FR	Fundamental Rule
FW	Finance Wing
GO	Government Order
GoAP	Government of Andhra Pradesh
GAAS	Generally Accepted Audit Standards
GEN	General
GoAP	Government of Andhra Pradesh
HMC Act	Hyderabad Municipal Corporation Act, 1955
IAPC	International Auditing Practices Committee
ICAI	Institute of Chartered Accountants of India
IFAC	International Federation of Accountants
INTOSAI	International Organisation of Supreme Audit Institutions
IT	Information Technology
LA	Loans & Advances
LAN	Local Area Network
MA&UD	Municipal Administration and Urban Development Department
MIS	Management Information System
Ms.	Miscellaneous
NMAM	National Municipal Accounts Manual
QAT	Quality Assurance Team
RBI	Reserve Bank of India
SAC	Systems Auditability and Control
SAI	Supreme Audit Institution of India
SAS	Statements on Auditing Standards
SC	Scheduled Caste
SDDM	System Design Development Methodology
ST	Scheduled Tribe
SWOT	Strengths, Weaknesses, Opportunities and Threats
TGS	Technical Guidance and Supervision
ULB	Urban Local Body
VFM	Value for Money
ZGS	Zilla Grandhalaya Samstha



- 1.1 Urban Local Bodies (ULBs) are being challenged to take on new roles and responsibilities across a range of local services within their areas. These roles and responsibilities are now drawn more broadly to include wide range of citizen services. As the focal point of Government of Andhra Pradesh (GoAP) for improving the delivery of services to the public, ULBs retain responsibility for ensuring that specific services are provided. The proposed reforms in ULBs can introduce innovation, increase capacity, cut costs by achieving economies of scale, help to manage risk and address local needs more effectively. All this can lead to paradigm shift in improved services for local people.
- 1.2 Local area agreements, which are expected to be in place at all top tier authorities provide support to authorities and their partners by facilitating partnership working, simplifying the funding structures and providing a degree of freedom from Government that allows ULBs to target resources on local priorities. There are certain drawbacks in partnership working. It also brings greater risks, associated with shared or unclear accountability, with achieving mutual understanding and common objectives, and with difficulties arising from the complexity of cross-organizational working. For example, it may be unclear to the public whom to complain when things go wrong. ULBs must still be held to account for the public money for which they are responsible. They must manage competing claims on resources, be able to balance the collective interest and individual need, and make best use of the public money available to them.
- 1.3 The complex structure of wide variety of institutions in public services has always made it difficult for the public to make clear judgments on local services and the organizations that are responsible for them. Citizens' experiences are not necessarily consistent with organizational responsibilities or geographic boundaries. For local people, reliable information is important about: what services are available; how to access them; and how good they are. The authorities responsible for local services need accurate and up-to-date information to manage them well and plan for the future. Government, auditors and inspectors need appropriate information to monitor progress and assess performance. At present, these needs are not well met. There is wide variation in the information that is available - how accurate it is and how it is collected. Confidence that local services are well-run and continue to improve with less inspection and external intervention will depend on higher-quality information.
- 1.4 For better value for money, better financial management and improved financial reporting, there is an urgent need to:
  - deliver high-quality, risk-based audit in synchronization with the trends in urban sector reforms. This includes the use of resources assessment with a specific judgment on how well ULBs achieve value for money.

- promote world-class financial management and reporting by local authorities and provide practical guidance to assist them in achieving those high standards.
  - undertake national studies designed to help local authorities take practical steps to achieve better value for money and contribute to improved efficiency.
  - drive improvement in the use of performance information, data quality, data analysis, information management and the public accessibility of relevant information.
  - develop a framework which ensures data quality and which produces performance information that can be relied on to underpin evidence-based decisions for both local management and external assurance.
- 1.5 The audits of the accounts of ULBs have generally been unsatisfactory to a large extent and it is an acknowledged fact that these audits have virtually ceased to have practical effect in ensuring the integrity of ULBs.
- 1.6 Hitherto, the Government of Andhra Pradesh has adopted a number of audit practices such as vigilance committees, pre-audit practices, and performance indicators but in isolation from one another and without the back-up of a broader state-level audit framework.
- 1.7 In view of the rapid changes being brought in urban sector reforms, a holistic and comprehensive approach to audit is required.
- 1.8 In this regard, an Independent Audit Authority for ULBs away from Government would greatly help ushering in reform process in the area of accounting and audit with the following objectives.
- The statutory authority and auditors shall be independent of ULBs
  - There shall be regular rotation of auditors
  - Audit advice shall be based on Audit and Accounting Standards/Practices to be formulated by the Accounting /Auditing Standards Board
  - Holistic approach in evaluation, qualitative and quantitative metrics of performance, shall be considered
  - Local ownership of audit findings; and the ULB shall be responsible for the outcomes of audits. Self appraisal may be encouraged
  - Audit shall be proportional to the risk associated with the services provided and the organisation concerned. In the case of very good performance indicators, only a limited review is required. The audit may concentrate on the assessment of propriety of the system rather than a mere check.
  - An independent Audit Authority would act as a deterrent factor.

## SCOPE

- 1.9 Urban sector reforms pave the way for transformation of ULBs from indifferent service providers to responsive developers of urban infrastructure which would ultimately link them to local markets to achieve not only financial sustainability but also become responsible institutions at the cutting edge level in the delivery of services to people as a milestone in the transformation of governance structure.
- 1.10 Large scale development and urbanization process in the state of Andhra Pradesh has imposed a sense of urgency on the ULBs to play a critical and significant role in the development process. The reforms initiated in Andhra Pradesh will be meaningful at the micro level only if the ULBs provide an environment that facilitates catching up with overall reform process which would enable transformation of ULBs from indifferent service providers to responsive developers of urban infrastructure. Such an agenda prima facie calls for accounting/auditing reforms to pave the way for creation of financial structures to link ULBs to local markets. Under the urban sector reform programme, GoAP has given a mandate to Centre for Good Governance (CGG) to develop Manuals for initiation of Accounting, Budgeting, Auditing and Financial Accountability. This Audit Manual is intended to define policy, procedures, and guidelines for audit in ULBs in Andhra Pradesh.
- 1.11 This Manual has been developed to give the auditors an overview regarding methodology to conduct audits and prepare reports. It lays out a systematic approach designed to keep the audit focused, involve all team members throughout the process and facilitate report preparation. Auditors must have a clear understanding of what they are supposed to be doing and how to accomplish the task at hand. At the same time, auditors should be encouraged to develop innovative audit approaches and use their experience and background to identify new audit initiatives. Auditors should be familiar with the Audit Standards/Practices prescribed by the Comptroller & Auditor General of India (CAG), GoAP as well as the Institute of Chartered Accountants of India (ICAI). These provide the guidance that assures a professional product.
- 1.12 The approach to conducting audit described in this Manual is based on the following principles:
- Teamwork is more efficient and effective than a layered, hierarchical system of getting audits done
  - Setting clear and specific objectives for an audit before the field work starts and having the flexibility to refocus and refine the objectives during the audit
- 1.13 The primary focus of audit is on risk analysis and on determining whether operations are accurately reflected in the financial statements to conform to prudential norms of disclosure.
- 1.14 ***The verification procedures suggested are generic in nature and the auditor while adopting the procedure shall check the latest executive instructions from competent authority relevant to the audit task on hand in respect of delegation of powers, financial***

***ceilings, administrative approvals, jurisdiction of authority, guidelines for auditors and validity of Government Orders.***

**AUDIT OBJECTIVES**

1.15 An audit is an independent service function within the ULB to assist the Commissioner/ Standing Committee in the effective discharge of their responsibilities by furnishing them analysis, appraisals, recommendations and pertinent information concerning the activities for the period under review to facilitate effective control.

1.16 Audit includes

- Monitoring management controls
- Anticipating, identifying and assessing of risks to the organization assets and activities
- Investigation into actual and potential lapses of control and possible areas of risk
- Recommendations for improvement of controls, risk mitigation plans, and periodic progressive reviews for attainment of organization's objectives

1.17 **Audit aims** to determine that the operations are

- Authorized by the Competent Authority, namely State Government, Municipal Corporation / Municipal Council / Standing Committee / Commissioner
- Carried out by using resources in an economical and efficient manner; by programme planned to yield results which are consistent with established goals and objectives;
- Carried out duly identifying, measuring, classifying, and reporting financial and operating events in an accurate and timely manner in accordance with adequate and effective internal controls and authoritative pronouncements; and
- Duly safeguarding assets

1.18 **Government Auditor's objectives:**

- a. That there is provision of funds for the expenditure duly authorized by the competent authority
- b. That the expenditure is in accordance with a sanction properly accorded and is incurred by an officer competent to incur it
- c. That payment has as a fact been made and has been made to the proper person and that it has been so acknowledged and recorded that a second claim against Government on the same account is impossible
- d. That the charge is correctly classified, and that if a charge is debitable to the personal

account of the contractor, employee or other individual or is recoverable from him under any rule or order, it is recorded as such in the prescribed account

- e. That in the case of receipts, (i) sums due are regularly recovered and checked against demand, and (ii) sums received are duly brought to credit in the accounts
- f. That in the case of stores and stock, where a priced account is maintained, stores are priced with reasonable accuracy, and that the rates initially fixed are reviewed from time to time, correlated with market rates and revised where necessary
- g. That the articles are counted periodically and otherwise examined for verification of the accuracy of the quantity balances in the books and that the total of the valued account tallies with the outstanding amount in the general accounts and that the numerical balance of stock materials is reconcilable with the total of value balances in the accounts at the rates applicable to various classes of stores; and
- h. That expenditure conforms to the following general principles which have for long been recognized as standards of financial propriety namely-
  - That the expenditure is not prima facie more than the occasion demands, and that every Government Servant exercises the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
  - That no authority exercises its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
  - That public moneys are not utilized for the benefit of a particular person or section of the community unless—
    - The amount of expenditure involved is insignificant
    - A claim for the amount could be enforced in a court of law, or
    - The expenditure is in pursuance of a recognized policy or custom; and
  - That the amount of allowances such as traveling allowances granted to meet expenditure of a particular type is so regulated that the allowances are not on the whole sources of profit to the recipients.

### 1.19 Change in Auditor's styles of functioning

#### Traditional Vs. Modern

Key Factor	Traditional Style	Modern Participative Style
Role	Policeman	Advisory
Authority	Formal	Citizen demand
Origin of Authority	Government	Corporate Good Governance
Style	Coercion	Suggestion Consulting

## 2 Definitions

- 2.1 The definition(s) of the terms used in this Manual are those which are commonly understood and used. These have been taken, if available from published sources like General Guidelines by the Institute of Chartered Accountants of India (ICAI) and “An introduction to Indian Government Accounts and Audit” by the Comptroller and Auditor General of India (CAG), “Local Fund Audit Department Manual” published by Examiner of Local Fund Accounts (now, Director of State Audit) GoAP.
- 2.2 The definitions used in Hyderabad Municipal Corporation Act, 1955, Andhra Pradesh Municipalities Act, 1965 and Andhra Pradesh State Audit Act, 1989 have also been taken.

### 1. Audit

According to General Guidelines on Internal Auditing issued by the ICAI “auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) or enterprises for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis, formulates his judgment which is communicated through his audit report”.

According to AAS-1 on “Basic Principles Governing an Audit” issued by ICAI, “an independent examination of financial information of an organisation accounts by a professional party with a view to expressing an opinion thereon”.

“Audit” is an instrument of financial control. In its relation to commercial transactions, it acts as a safeguard on behalf of the proprietor against extravagance, carelessness, or fraud on the part of proprietor’s agents or servants in the realization or utilization of his money or any other assets, and it ensures on the proprietor’s behalf that the accounts are maintained truly representing the facts, and that the expenditure has been incurred with due regularity and propriety. The agency employed for this purpose is called “Auditor”

Audit includes pre-audit, concurrent audit, post-audit, cent-per-cent audit, resident audit, test audit, special audit and such other examination of accounts as the Government may from time to time specify.

In pursuance of Constitutional responsibility, the Supreme Audit Institution (SAI) viz: The Comptroller and Auditor General of India is empowered to decide the nature, scope, extent, quantum of audit including the form and contents of audit reports in respect of audit to be conducted by him or on his behalf.

### 2. Auditor

A person, agency or accountancy firm employed to check the accounts of a sole trader, company, or association. Auditors check whether accounts are complete and consistent, and assess whether they are in agreement with other records of purchases and incomes.

Municipal Auditor means the Director of State Audit appointed under section 3 of the A.P. State Audit Act, 1989 (to audit the accounts of municipal fund) and includes any other person on whom all or any of the powers of the Auditor under this Act are conferred.

CAG means the Comptroller and Auditor General of India appointed under Article 148 of the Constitution of India.

### 3. Auditing and Assurance Standards (AASs)

“**Auditing Standards**” prescribe the norms of principles and practices, which the auditors are expected to follow in the conduct of audit. They provide minimum guidance to the auditor that helps determine the extent of auditing steps and procedures that should be applied in the audit and constitutes the criteria or yardstick against which the quality of audit results are evaluated.

In 1977, the International Federation of Accountants (IFAC) was set up with a view to bringing harmony in the profession of accountancy on an international scale. The IFAC has set up International Auditing Practices Committee (IAPC) with a view to bring in uniformity of auditing practices throughout the world, and to issue international auditing guidelines for implementation by the member bodies. The ICAI is a member of the IFAC and is committed to work towards the implementation of the guidelines issued by IFAC. The Auditing Practices Committee of ICAI develops statements on Auditing and Assurance Standards (AASs) after due consideration of international auditing guidelines. ICAI has issued 32 AASs so far which are applicable to audit carried out by Chartered Accountants (CAs). List of AASs is given in the Annexure - 1.

CAG is the Supreme Audit Institution of India. (SAI)

The mandate of CAG includes audit of Panchayati Raj Institutions and Urban Local Bodies. The auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) have been suitably adopted with due consideration of the Constitution of India, relevant statutes and rules. The CAG is authorized to lay down for the guidance of Government departments, the general principles of Government accounting and the broad principles in regard to audit of receipts and expenditure.

General Auditing Standards, stipulated by CAG applicable to Government sector are listed at Annexure - 2.

### Audit Working Papers

According to AAS 3 on Documentation “The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles”. Documentation refers to the working papers prepared or obtained by the auditor and retained by him in connection with performance of his audit.

### 4. Audit-Trail

A historical record of all price quotations and transactions. Checks can be made to ensure that the buying and selling of goods / services has been carried out in an accurate manner.

**5. Cent-per-cent Audit** means a post audit of all the transactions of a particular account of a specified period

6. **Compliance Audit** means check on the compliance with relevant regulations and conditionalities stipulated in the relevant charter and it often encompasses multi dimensional requirements faced by the auditor depending upon the charter and mandate.
7. **Concurrent Audit** means a post audit of a day-to-day accounts of a specified period, with a general review of the accounts from time to time
8. **Contract Audit** relates to audit function where service delivery is done through a system of contract.
9. **Financial Audit** relates testing the reliability of accounting records that form the basis for annual financial statements.
10. **Fraud Investigation** is an extension for internal auditors' role and responsibility in plugging internal control failures.
11. **Group Basis Audit** means conduct of audit of a group of Local Authorities by a group of auditors.
12. **Information System Audit** means an audit of computerized Management Information System to ensure its integrity and security
13. **Local Authority** means a Municipal Corporation constituted under the law relating to Municipal Corporations and a Municipal Council constituted under the AP Municipalities Act, 1965.
14. **Management Audit** focuses on control issues in managerial processes arising from managing an activity.
15. **Operational Audit** pertains to operational areas to examine the concept of economy, efficiency, effectiveness to evaluate value for money implications for the activity under review.
16. **Performance Audit** is an independent assessment or examination of the extent to which an organisation operates efficiently and effectively, with due regard to economy.

“Performance audit is concerned with the audit of economy, efficiency and effectiveness and embraces:

- a. Audit of economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- b. Audit of efficiency of utilization of human, financial and other resources, including examination of information system, performance measures and monitoring arrangements and procedures followed by audited organisations for remedying identified deficiencies; and
- c. Audit of effectiveness of performance in relation to the achievement of the objectives of the audited organisation and audit of actual impact of activities compared with the intended impact.”

17. **Post Audit** means the detailed audit conducted after the transactions are completed
18. **Post-Completion-Audit**  
The monitoring and evaluation of the progress of a capital investment project through a comparison of the actual cash flows and other benefits with those forecasts at the time of authorisation.
19. **Pre-Audit** means the preliminary audit before receiving the money or arranging payments.
20. **Probity Audit** is the one which is based on audit being the unseen force that keeps an eye on everything that goes on in the organization to verify financial propriety.
21. **Resident Audit** means concurrent or pre-audit of expenditure and review of receipts.
22. **Social Audit** is a review to ensure that the organization is committed towards achieving wider social responsibilities.
23. **Special Audit** means an audit of accounts pertaining to a specified item or series of items requiring thorough examination
24. **System Audit** means an audit of the information and security system to ensure system adequacy, safety and security of assets. Under this approach, audit role assumes assessment/review of internal control systems and their effectiveness in achievement of managerial objectives. The emphasis is more on review rather than performing endless verification tests. It assumes significance in the current trend to go in for automated transaction processing.
25. **Test Audit** means review of financial transactions on a sampling basis.
26. **VFM or Value for Money Audit** fine-tunes auditors' role to examine economy, efficiency, and effectiveness in different areas to assist management in it's pursuit of reduction of waste and maximization of stakeholders' return.

## 3 Audit Concepts

### CONCEPT OF MATERIALITY

- 3.1 The concept of materiality is fundamental to process of accounting. It covers all the stages from recording to classification and presentation. It is, therefore, an important and relevant consideration for an auditor who has constantly to judge whether a particular item or transaction is material or not. AAS-13 on Audit Materiality lays down standard on the concept of materiality and its relationship with audit risk.
- 3.2 AAS-13 requires that the auditor should consider materiality and its relationship with risk when conducting an audit. The auditor is required to assess materiality right from the stage of planning the audit till the final stage of reaching at his opinion. The auditor requires more reliable audit evidence in support of material items. He should also ensure that material items are properly and distinctly disclosed in the financial statements.
- 3.3 Accounting Standard-13 defines material items as “items the knowledge of which might influence the decisions of the user of the financial statements. Whether or not the knowledge of an item would influence the decisions of the users of the financial statements is dependent on the particular facts and circumstances of each case.
- 3.4 Materiality is a relative term and what may be material in one circumstance may not be material in another. Therefore, the decision to judge the materiality of the item whether in the aggregation of items or presentation / classification of items shall depend upon the judgment of the preparer of the account considering the circumstances of the particular case. For example, NMAM requires that any income or expenditure under a particular individual head, which is more than 1% of the total gross income of the ULB or Rs.1,00,000 whichever is higher, shall be shown separately in the Schedules annexed to the Income and Expenditure Statement. Similarly, any expense incurred under various Government Circular(s) has to be shown as a separate and distinct item under an appropriate account head in Income and Expenditure Account.
- 3.5 Materiality is an important and relevant consideration for the auditor because he has to evaluate whether an item is material in giving or distorting a true and fair view of financial statement.
- 3.6 To decide whether a particular item/transaction is material, the auditor has to view from the following angles:
  - a. The effect on an individual financial statement as well as the whole set of financial statements.
  - b. The percentage of the possible error:

For Profit and Loss account items, the percentage is usually calculated with reference to the profit before interest and tax. For Balance Sheet items, the percentage is usually calculated with reference to the total share capital and reserves or the total fixed assets. As a general rule, an error less than 5% would be regarded as immaterial.

c. Recurring or non-recurring error:

Recurring errors must be investigated no matter how small the percentage is. Recurring errors imply that there is a problem with the accounting system, which should be followed up.

d. Statutory requirement:

In general, if an error does not seriously affect the accounts users' decisions, this minor mistake is ignored. However, in the context of law, sometimes there is no room for the materiality concept. For example, if the Municipalities Act requires that a particular item must be disclosed in financial statements, it must be done even if the amount is as little as One Rupee.

e. Critical points:

Sometimes, a minor change would make a situation completely different. For example, a small error may make an organisation change from a profit position into a loss. A one mark difference can determine whether one passes or fails the examination! In this case, no matter how small the error is, it is material.

f. Conceptual error:

Some errors occur at conceptual level, but not at calculation/technical level. An error in the treatment of fixed assets would have a significant effect on the accounts. For example, if the purchase price of a fixed asset is written off to the Profit and Loss Account in its entirety in the year of purchase, rather than over the useful life of the asset, the profit for that year would be seriously affected.

g. Materiality should be judged in relation to the group:

The group to which the asset or the liability belongs is material. For example, for any item of current asset in relation to total current assets and any item of current liability in relation to total current liabilities.

h. Compare with corresponding figures of the last year:

For example, an item is of a low amount this year but it was of a much higher amount in the previous year - then it becomes material when compared to the corresponding figure of the previous year.

3.7 The above is not a comprehensive list. The most important point is rationality. A sound knowledge of accounting and a general knowledge of the environment in which the organisation is operating would help to make a good professional judgment of whether an item is material or not.

3.8 The materiality concept is important in accounting and auditing. Before investigating any item in the financial statements, ask one's self. A reference to CAG's publication on Auditing Standards and Auditing and Assurance Standards issued by the ICAI would be helpful in arriving at the final decision.

- 3.9 If there is no serious impact on the accounts and consequently on final audit report, no further investigation need be made.

### **CONCEPT OF AUDIT RISK**

- 3.10 Audit risk is the risk that an auditor may give an inappropriate opinion on financial information that is materially misstated. For example, an auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated.

- 3.11 Auditor must be aware of unavoidable risk that is significant with reference to materiality of transactions involved and adequacy of internal control systems to determine the extent to which degree of risk involved could be mitigated.

- 3.12 Low risk areas are those which require application of routine “nuts and bolts” audit procedures in the ordinary course of vouching, casting, checking, etc.

- 3.13 High risk areas pertain to:

- (i) Adequacy of provisions
- (ii) Full disclosure of liabilities including contingent liabilities
- (iii) Interpretation of various Government notifications, laws, Auditing and Assurance Standards
- (iv) Post Balance Sheet review of subsequent events
- (v) Analytical review of draft audit reports, financial statements, precedents
- (vi) Implication and Impact of legislation
- (vii) Detection of over-statement of assets or under-statement of liabilities
- (viii) Application of concept of materiality

- 3.14 Assessment of Inherent Audit Risk at the financial statement level would involve use of judgment in respect of few factors like:

- The integrity of management
- Experience of management
- Environmental/external pressures on management
- Need for expert’s involvement depending on the complexity of transactions
- Completion of unusual and complex transactions particularly at the year-end or near-year-end
- Transactions not subject to normal processing mode
- Susceptibility of assets to loss or misappropriation.

3.15 Components of audit risk which are interrelated are:

- a) Inherent risk (that material errors will always occur)
- b) Control risk (that internal audit / control will fail to detect)
- c) Detection risk (that errors will not be detected by the audit)

### **AUDIT SAMPLE**

3.16 Audit should select sample in such a way that it is representative by random selection, systematic selection, or haphazard selection after assessment of the characteristics of the data and (auditor's) previous experience.

### **SAMPLING RISK**

3.17 Sampling risk arises in both tests of control and substantive audit procedures. There is a possibility that auditor's conclusion based on a sample may be different from the conclusion had the entire data been subjected to audit. It may be over-reliance or under-reliance in respect of tests of control. In case of detailed audit procedure, it may be incorrect reliance or incorrect acceptance. These affect audit efficiency.

### **TOLERABLE ERROR**

3.18 Tolerable error is the maximum error in the sampling population that the auditor is willing to accept and still arrives at the conclusion that it has achieved audit objective.

### **EXPECTED ERROR**

3.19 If audit expects error to be present in the population, a larger sample than when no error is expected is to be examined in order to conclude that actual error is not greater than expected tolerable error

### **AUDIT WORKING PAPERS**

3.20 According to AAS - 3 on Documentation "The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles". Documentation refers to the working papers prepared or obtained by the auditor and retained by him in connection with the performance of audit.

3.21 Therefore working papers should provide for

- (i) means of controlling audit work
- (ii) evidence of audit work performed
- (iii) supporting data usually contained in supplements
- (iv) detailed data regarding activities of the auditee
- (v) constitutional documents like memorandum and articles, Government Orders, trust deeds, certificates given by statutory authorities etc
- (vi) abstract of minutes
- (vii) terms of reference and engagement contract

- 3.22 The working papers need to be maintained in a standardized format like check lists, specimen drafts, which would improve the quality and efficiency of the audit.
- 3.23 Custody and confidentiality is to be borne in mind after taking into account pertinent legal and professional requirements in this regard.
- 3.24 For further guidance, AASs of ICAI and various orders issued by GoAP/CAG may be referred.

**Factors that Influence role of Audit Functionary**



## Audit Organisation - Director of State Audit

4

- 4.1 The Head of Audit Department, the Director of State Audit, GoAP is responsible for upholding and continuously maintaining the conducive environment to his auditors to achieve their objectives and be a role model.
- 4.2 His responsibilities are to certifying the accounts of Panchayati Raj Institutions and Urban Local Bodies; and
- Establishing policies for the auditing activity and serving as liaison between the Department and the Local Bodies. As official Head of the Department, he will be the official spokesperson on all audit matters.
  - Developing and executing a comprehensive audit agenda for the evaluation of the management controls provided over all activities.
  - Examining the effectiveness of all levels of management in their stewardship of resources and their compliance with established policies and procedures.
  - Recommending improvement of management controls designed to safeguard resources and ensure compliance with Government laws and regulations.
  - Reviewing procedures and records for their adequacy to accomplish intended objectives, and appraising policies and plans relating to the activity or function under audit review.
  - Authorizing the publication of reports on the results of audit examinations, including recommendations for improvement.
  - Appraising the adequacy of the action taken by operating management to correct reported deficient conditions; accepting adequate corrective action; continuing reviews with appropriate management personnel on action considered inadequate until there has been a satisfactory resolution of the matter.
  - Conducting special examinations at the request of management, including the reviews of representations made by people or associations.
- 4.3 Powers and Functions:
- Inspect the accounts of ULBs
  - Condone the audit due to natural calamities
  - Initiate disciplinary action against authorities found negligent in discharge of enforcing or misuse of their powers
  - Call for all files including confidential files not produced to auditors and deal with them
  - Conduct group based audits as may be required
  - Clarify interpretation of rules

#### 4.4 Statutory Regulations Governing ULB Audit:

GoAP have formulated the Andhra Pradesh Audit Act, 1989 which is deemed to have come into force with effect from 7-1-1989 and also framed the statutory rules thereunder to enforce various provisions of the said Act.

#### 4.5 Audit Hierarchy

1. Director of State Audit
2. Deputy Director / Regional Deputy Director
3. District Audit Officer
4. Assistant Audit Officer

(G. O Ms No.137 Fin & Plg. (FW. Admn. II) Dept, Dated 21<sup>st</sup> Sep,2000)

#### 4.6 Comptroller and Auditor General (CAG)

The GoAP entrusted the Technical Guidance and Supervision over the audit of Urban Local Bodies to the CAG vide G.O. Ms. No. 613 Finance (Admn.II) Department, dated 24-8-2004. The CAG would conduct test check of the ULBs and the audit report will be laid on the table of the Legislative Assembly of the State.

Scope of the Technical Guidance and Supervision (TGS) by the Principal Accountant General (Audit -1), Andhra Pradesh.

- 1) The audit methodology and procedures for audit of Panchayati Raj Institutions and Urban Local Bodies by the Director of State Audit will be as per the audit guidelines / standards prescribed by the CAG and Various Acts and Rules of the Government
- 2) The nature, extent and scope of audit including form and contents of the report of Director of State Audit on the Panchyati Raj Institutions and Urban Local Bodies accounts will be as per the guidelines given by the Principal Accountant General and various Acts and Rules of the Government.
- 3) The Director of State Audit will prepare annual audit plan, under intimation to the Principal Accountant General, indicating the particulars of Panchayati Raj Institutions and Urban Local Bodies that would be audited during the year.
- 4) The Principal Accountant General would conduct test check of some of the Panchayati Raj Institutions and Urban Local Bodies units audited by the Director of State Audit, in order to provide technical guidance. The report of the test check conducted by the Principal Accountant General would be sent to the Director of State Audit for pursuance of action taken by the Panchayati Raj Institutions and Urban Local Bodies. The Director of State Audit will pursue the compliance of such paras in Principal Accountant General's inspection report in the same manner as if these are his own reports.

- 5) The Principal Accountant General will monitor the quality of the inspection reports issued by the Director of State Audit by calling for some of the reports for his scrutiny. The Director of State Audit will furnish returns in such form as may be prescribed by the Principal Accountant General for the purpose of monitoring.
- 6) Copies of issued Audit Reports in respect of 10% of Local Bodies should be forwarded by the Director of State Audit to the Principal Accountant General for advice on system improvements and the Principal Accountant General would make suggestions for improvement of existing manuals etc. to be followed by the State Audit Department.
- 7) Irrespective of the money value of the objections, any serious irregularities noticed such as system defects, serious violation of rules, frauds noticed by the Director of State Audit will be intimated to the Principal Accountant General.
- 8) The Director of State Audit will develop, in consultation with Principal Accountant General, a system of internal control in his organization.

4.7 Director of State Audit is the authority designated to audit the accounts relating to Local Authorities, which may be:

- Post-Audit:  
Means the detailed audit conducted after the transactions are completed.
- Pre-Audit:  
Means the preliminary audit before receiving the money or arranging payments.
- Special Audit:  
Means an audit of accounts pertaining to a specified item or series of items require thorough examination.

### **Submission, Approval and Issue of Audit Reports**

4.8 The Director of State Audit may

- Authorize any of his subordinates to prepare reports on the accounts audited and to send such report after approval to the concerned local authority
- Direct an Auditor to report to a designated Regional Deputy Director or Deputy Director
- Send a report to a reviewing authority and direct him to submit the report after such review within 15 days
- Direct an auditor to submit the report within 45 days from the date of completion of audit
- Withhold full pay and allowances including traveling and daily allowances to the auditors, if the review/submission of audit report is not made within the prescribed time
- Send the draft audit report with objections to the competent authority within 7 days with a request to return the report after rectifying the defects
- Communicate the audit report on approval by the competent authority to the concerned local authority with a special letter by registered post acknowledgement due containing all the objections.

- Inform the auditor that failure to conduct audit and submit report will be construed as willful absence of duty and shall be dealt with in accordance with provisions of Fundamental Rule (FR) 18

#### 4.9 Follow up action on audit reports

- Upon receipt of audit report, the Municipal Commissioner shall submit a report within two months from the date of receipt rectifying all the defects pointed out in the report and within four months from the date of receipt of special letter to the officer who issued the audit report and special letter.
- The Director may condone compliance with any objection, if connected records are lost due to any natural calamity
- The Director, if he considers that any case which appears to support a presumption of criminal misappropriation of fraud deserves special or immediate investigation, may bring it to the notice of Government for such action as may be considered necessary.
- The Director is empowered to initiate surcharge proceedings and such powers shall also be exercised by the concerned Regional Deputy Directors/District Audit Officers

#### 4.10 Furnishing of Audit Reports

The Director shall submit annually to the Government a Consolidated Audit and Review Report on the accounts of the local authorities in the State in such form and manner as may be prescribed by the Government. The Annual Consolidated Audit and Review Report shall be laid on the table of Legislative Assembly of the State.

- 4.11 The audit reports shall be preserved by the auditors in charge of audit unless the destruction orders have been issued

5.1 An audit programme needs to be developed giving brief outline taking into account:

- Review of internal and accounting procedures
- Evaluation of deficiencies in the system of internal control
- Decide extent to which special procedures have to be applied like independent verification of fixed assets, balances of outstanding dues, receivables, closing inventories, etc.
- Experience gained from previous audits and observations made in the audit reports
- Instructions from competent authority
- External changes in the overall environment affecting the audit.

5.2 The Commissioner of every ULB shall prepare an Annual Account in the form prescribed under the relevant Act, Rules and orders of GoAP and send a copy to the auditor within the time limit specified in the relevant Act or Rules. Where no time limit is specified, it shall be 15th June succeeding the financial year. Any failure in this regard would attract negligence on his part and action will be initiated under the provisions of the Section 12 of the Audit Act. The defaulting ULB would be liable to suffer a cut or withholding of grants for non-submission of accounts for audit and/or failure to submit utilization certificates without valid reasons.

## 6 Audit Techniques

- 6.1 The auditing methods/techniques suggested in this Manual are intended primarily for guidance, and may not necessarily be applicable for every audit. The auditor should use discretion in deciding which technique should be used in particular audit. It is advisable for the auditors to use their creativity and initiative to develop additional techniques.

### INTRODUCTION

- 6.2 Getting accurate information quickly is important in any audit. Getting sufficient, appropriate evidence is crucial in the examination phase. Evidence may be challenged by the organisation at the reporting phase of the audit.
- 6.3 Audit team is required to provide objective information. This calls for rigour in approaches in gathering evidence. By “rigour” mean more tough. It is important for the auditor to identify the probable nature, sources and availability of audit evidence.

### OBJECTIVE

- 6.4 The main objective of auditing techniques is to improve the quality of evidence in audit reports.
- 6.5 An audit programme specifies the techniques to be employed in the specific case by relating the techniques to the respective areas of accounting. For example, the techniques of *posting, checking and casting* are related to the principal books of account as well as subsidiary books. *Vouching* will be in respect of all the transactions, whether appearing in the Cash Book or in any Journal. The *confirmation* technique is appropriate in relation to Personal Account balances, bank balances or securities lodged with others.

Some of the techniques/methods to obtain audit evidence are discussed below:

- 6.6 The auditor obtains evidence in performing compliance and substantive procedures by one or more of the following methods:
- (i) Inspection
  - (ii) Observation
  - (iii) Inquiry and confirmation
  - (iv) Computation
  - (v) Analytical Review
  - (vi) Flowcharting; and
  - (vii) Interviewing

### 1. INSPECTION

- 6.7 Inspection consists of examining records or documents. It provides evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal control over their processing.

Difference between Inspection and Vouching:

- 6.8 Inspection and vouching are two different activities of gathering/obtaining audit evidence. Both activities require the auditor to examine documentation in support of management's assertions, but inspection is primarily relevant to the examination of evidence relating to the effectiveness of internal control procedures i.e. **internal control assertions**, whereas vouching is relevant only to the examination of evidence relating to the completeness, validity or accuracy of account balances and underlying classes of transaction i.e. **financial statement assertions**.
- 6.9 Four major categories of documentary audit evidence, which provide different degrees of reliability to the auditor are:
- (i) documentary evidence created by third parties and held by the auditor;
  - (ii) documentary audit evidence created and held by third parties;
  - (iii) documentary audit evidence created by third parties and held by the organisation; and
  - (iv) documentary audit evidence created and held by the organisation.

**2. OBSERVATION**

- 6.10 Observation consists of looking at a process or procedure being performed by others, for example, the observation by the auditor of the counting of inventories by the organization's personnel or the performance of control procedures that leave no audit trail.

**Advantages:**

- It provides a greater understanding of the business through audit involvement with operational personnel.
- Information collected reflects actual behavior and current events and not past events

**Disadvantages:**

- Potentially time consuming and difficult to record data and observe large numbers of people or activities.
- Random observation may not provide an adequate evaluation of the process due to fluctuations in volume or activity.

**3. INQUIRY AND CONFIRMATION**

- 6.11 One of the principal methods of obtaining corroborative evidence available to auditors is by inquiry. Inquiry involves seeking information from knowledgeable persons inside or outside the organisation.
- 6.12 Confirmation is the name given to a specific form of inquiry that is particularly widely used. It involves obtaining written confirmation from a third party in relation to an account balance in which the third party has an interest. For example, the auditor normally requests confirmation of receivables by direct confirmation with debtors.

- 6.13 Because confirmations are an important source of audit evidence, it is essential that auditors fully understand their use.
- 6.14 Certain issues relate to the use of confirmations in obtaining audit evidence, and the confirmations are used in the verification of specific account balances.
- 6.15 A few general issues relating to confirmations are:
- (1) In what situations is the use of confirmations appropriate?
  - (2) What assertions are addressed by confirmations?
  - (3) How should a request for confirmation be made?
  - (4) What are possible conflicts?
  - (5) How should the evidence provided be interpreted?

## **I. SITUATIONS FOR USING CONFIRMATIONS**

- 6.16 Confirmations are best used where there is a knowledgeable party, independent of the organisation and where alternative reliable evidence is not readily available.
- 6.17 The most knowledgeable parties (i.e. debtors, creditors, banks, lenders, borrowers and custodians of the organization's assets such as stocks and securities) having relationship with the organization holding reciprocal information as to organisation balances. It is in their own interest for such parties to maintain reliable records of their relationship with the organisation. It is also in their interest to respond to an auditor's request for confirmation to ensure that any differences are identified and resolved.
- 6.18 As a general rule, organisations are more likely to have reliable internal control. This ensures that their own accounting information is accurate. Therefore, organisations are more likely to have a positive policy for responding to audit confirmations.
- 6.19 Generally speaking, parties from whom confirmation is sought are likely to be independent, ensuring that the evidence is reliable. However, there are two situations where the auditor may need to exercise caution:
- The first is, where the other party is 'related' as specified in the Accounting Standard -18 issued by the ICAI.
  - The second is where the other party might be economically dependent on the organisation and may be motivated to provide an inaccurate response for fear of losing business with the organisation. Examination candidates tend to overstate this risk in answering questions on confirmations. Such situations are probably extremely rare. The auditor should be aware of the possible risk from their general understanding of the business of the organisation. Again, the larger the third party, the less likely it is to be economically dependent and thus the more reliable the evidence from confirmation.

## II. ASSERTIONS

- 6.20 Where confirmations relate to reciprocal balances (such as debtors, creditors, banks, borrowers and lenders), they provide persuasive evidence as to rights and obligations. Confirmations also provide strong evidence of ownership where the other party is acting as custodian.
- 6.21 However, because of human nature, confirmations may not provide such persuasive evidence of accuracy where the organisation's balance is in error in the other party's favour, e.g. an understatement of debtors or an overstatement of creditors. Neither do confirmations provide reliable evidence of the valuation of assets. Where the other party is a debtor or borrower, further evidence is required of their ability to pay. Where the other party is custodian, confirmation of the existence of the asset does not provide evidence of its value.

## III. FORM OF REQUEST

- 6.22 As a general rule, the request must be presented in such a form that facilitates a response by the other party. This can be achieved by using a standard form with space for the response and enclosing a return addressed envelope.

## IV. CONFLICTS

Conflicts between facilitating a response and the reliability of response:

- 6.23 Sometimes, there is a conflict between facilitating a response and the reliability of that response. For example, it is possible that the other party might confirm the information without checking it. Hopefully, such instances are rare.
- 6.24 At times, there is general reluctance to confirm through misunderstanding the purpose of the request. Debtors may misinterpret the confirmation as a demand for payment. Other parties may fear that confirmation might be binding if they should subsequently discover an error in their own records. It is usually customary to draft the wording of the confirmation to allay such fears when dealing with parties not accustomed to receiving such requests. Nevertheless, some respondents disclaim responsibility should their response be in error. This is usually the case with bank confirmations. However, this does not necessarily compromise the reliability of the confirmation.

Conflict of uses of information gathered from confirmations

- 6.25 Another possible conflict is between the uses of confirmations that specify the information to be confirmed, or that request the other party to supply information. The latter approach eliminates the risk that the other party may not undertake a careful check of their records before responding, but increases the risk that the other party fails to respond.

Conflict of use of positive or negative confirmation:

- 6.26 The use of positive or negative confirmations is another possible conflict scenario. Both specify the information to be confirmed but a negative request only requires a response where the information is incorrect. The debate as to their respective benefits is indeterminate. Generally speaking, negative confirmations are used where there are large numbers of small balances and the risk of material misstatement is assessed as low. However, the confirmation must be

seen more as a test of control than as a substantive procedure. It assists in confirming the presumed low incidence of errors and provides qualitative information on the type of errors that exist. Where detection risk is high, or the materiality of the account balance is high, positive confirmation will be needed to provide substantive evidence.

Conflict of 'confirmation request' to whom to be made:

- 6.27 A further issue when requesting confirmation from a large third party is the seniority of the respondent to whom the request is made. Some organisations have a standard policy in responding to confirmation requests, such as routing them through internal audit. In other cases, a request may be ignored if it is addressed to senior management. However, a request addressed to the party responsible for maintaining the relevant records, is more likely to result in a response. A potential danger is that the response might conceal errors in the other party's records for which the respondent is responsible.

Authorisation of confirmation request by the management:

- 6.28 It is nearly always the case that management of the audited organisation must authorise each confirmation request. This exposes the risk that the process could be interfered with by the organisation because the confirmation is usually in the form of a request – from the organisation – for information to be supplied to their auditor. It is important that auditors control the process by ensuring that confirmations sent are in agreement with those selected for confirmation. It is also important that the envelopes bear the auditors' return address in the event of non-delivery.

## **V. INTERPRETATION OF EVIDENCE**

- 6.29 The factors discussed above must be considered when determining the reliability of confirmation evidence. Confirmation responses are at their most reliable when the auditor has reason to believe that the information has been checked by responsible officials against the other party's records that are subject to satisfactory internal control. Reliability must be questioned where the auditor has reason to suspect that the request might not have been given appropriate consideration or that the other party's records might not be wholly reliable.
- 6.30 Where no response is received to a positive request for confirmation (after suitable follow-up requests), alternative evidence must be obtained if the information to be confirmed is material to the financial statements or to maintain the integrity of sample evidence.

## **VI. DEBTORS' CONFIRMATIONS**

- 6.31 The use of confirmation evidence is usually very important in the audit of trade debtors because there are few other sources of external corroborative evidence. It is usually suitable when the majority of the credit customers are reasonable-sized businesses. Because existence is an important assertion being verified, it is important that the source from which the sample is selected is tested for completeness. This usually requires selecting the sample from a list of balances that has been tested against the sales ledger duly totaled and agreed with the General Ledger balance.
- 6.32 The list of debtors is usually subdivided into current due balances and overdue balances. Each presents separate audit risks. Overdue balances are more likely to contain errors and thus require a proportionately larger sample.

6.33 It is necessary to verify non-responses with alternative reliable evidence of the outstanding balance in order to maintain the integrity of the sample where positive confirmations are used. Such evidence includes delivery notes signed for by the customer, written customer sales orders and, if subsequently paid, a remittance advice accompanying the payment identifying the specific invoices being paid.

## **VII. CREDITORS' CONFIRMATIONS**

6.34 Creditors are much less frequently confirmed than debtors. The auditor already has external evidence in the form of supplier invoices and statements. Although held by the organisation and thus potentially at risk from being manipulated, they are likely to provide sufficient and appropriate evidence in the absence of any suspicious circumstances. In addition, the principal assertion verified by confirmation evidence would be that of completeness. The available population (creditor balances recorded by the organisation), is not a suitable starting point for selecting a sample for confirmation when verifying completeness. If time is available, auditors tend to prefer to use the complementary/reciprocal population of purchases (or payment transactions recorded after the period end) when verifying the completeness of recorded creditors.

## **VIII. BANK CONFIRMATIONS**

6.35 In many countries, the auditing profession has come to a mutual agreement with the banking industry on the method to be employed in seeking confirmations. A standardized form is commonly used with open questions for the bank to complete. The evidence should be reliable because banks usually maintain a high level of internal control over records of customer balances. However, because the task of completing the confirmation is often entrusted to a relatively junior personnel and is not subject to independent checks, auditors must be alert for the possibility of clerical errors when making use of the evidence obtained by confirmation.

6.36 Another consideration when confirming bank balances is that they involve both debit and credit balances and contingencies. Therefore, evidence of both completeness and existence is sought. Although balances with each bank are usually individually material (in that all banks have confirmed – not just a sample), the auditors must take reasonable care that all banks which the organisation has had dealings with during the year are identified. Auditors should request confirmations from each bank, not just those with recorded balances outstanding at the period end

## **4. COMPUTATION**

6.37 Computation consists of checking the arithmetical accuracy or reasonableness of source documents and accounting records or of performing independent calculations.

6.38 The main advantage is it may provide the most efficient method to evaluate the outcome of a certain process.

6.39 The disadvantage is it may be complex and time consuming and may require assistance of outside experts, particularly where a valuation is being assessed - for example, the internal auditor's assessment of accuracy of iron ore stock-pile inventory recording processes.

## 5. ANALYTICAL REVIEW

6.40 Analytical review procedures may be defined as substantive tests of financial information made by a study of comparisons and relationship among data i.e. analytical review involves a comparison of detail balances or statistical data on a period-to-period basis in an effort to substantiate reasonableness without systematic examination of the transactions comprising the account balances.

6.41 Analytical procedures are used for the following purposes:

- To assist the auditor in planning the nature, timing and extent of other auditing procedures
- As a substantive test to obtain evidential matter about particular assertions related to balances or classes of transactions
- As an overall review of the financial information in the final review stage of the audit
- In some cases, analytical review procedure can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions

6.42 Analytical procedures include comparison of financial information with:

- Comparable information for a prior period or periods
- Anticipated results, such as budgets or forecasts; and
- Similar organisation information, such as comparison of the ratio of Establishment Expenses to Total Income with the averages of other organisations of comparable size

6.43 Analytical procedures also include study of relationship:

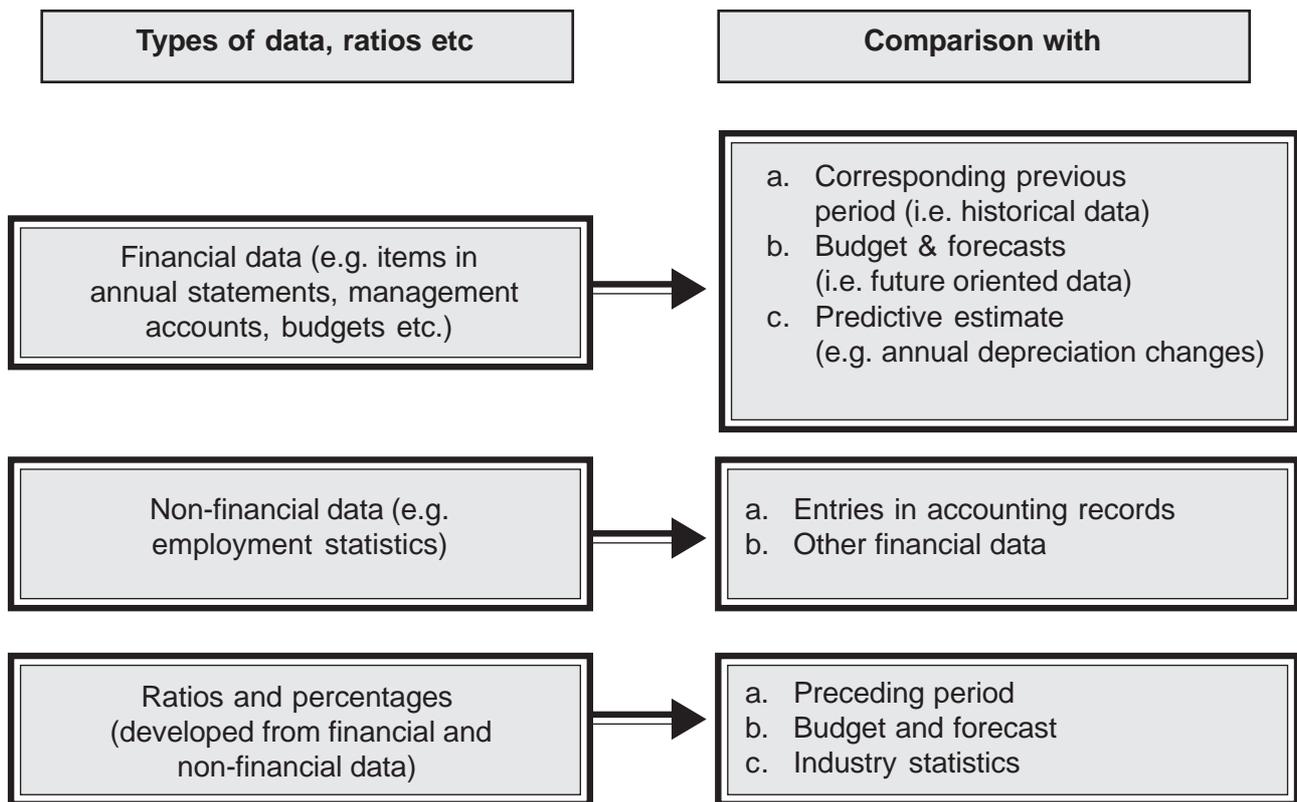
- Among elements of financial information that would be expected to confirm to a predictable pattern based on the organisation's experience
- Between financial information and relevant non-financial information

6.44 Essentially these procedures ensure that the various items making up the financial statements are consistent with:

- a. Each other (for example, the relationship between Tax Revenue and Total Income, or Current Assets and Current Liabilities)
- b. Known trends
- c. The auditors' knowledge of the ULBs

6.45 Analytic review is based on the assumption that comparability of period-to-period balances and ratios shows them to be free from significant error. A well performed analytic review not only benefits the examination by providing an understanding of the ULB's operations, but also highlights matters of interest and potential problem situations.

6.46 Various methods are used in performing the above procedures. The choice of procedure, methods and level of application is a matter of professional judgment. The following summarizes the above:



### Application of Analytical Procedures

6.47 Auditor **should** apply analytical procedures at planning and overall review stages of an audit. Analytical procedures at these stages are essential and required (i.e. **mandatory**) in the conduct of any audit. Analytical procedures may also be performed as substantive procedures (i.e. **optional**). The auditors' reliance on substantive tests reduces detection risk relating to specific financial assertions.

#### A. Analytical procedures at planning stage

6.48 Analytical procedures at this stage (sometimes called "preliminary analytical review") assist in:

- Increasing knowledge and understanding of the client's business through the accumulation of information on trends in key relationships
- Identifying areas of potential risk (e.g. relating to financial condition)
- Determining the nature, timing and extent of other audit procedures (i.e. audit strategy) by directing tests of areas of potentially material misstatement
- Planning to use both financial and non-financial information (i.e. number of employees, square feet of selling space and similar information)

#### B. Analytical procedure used as substantive tests

6.49 Analytical procedures at stages other than the planning and overall review are optional. The decision as to the procedure(s) to be used to achieve a particular audit objective is based on the auditor's judgment of the expected effectiveness and efficiency of the available procedure(s). The auditor will normally inquire the management as to the availability, and reliability of information

needed to apply analytical procedures and the results of such procedures performed by the organisation. The auditor prefers to use the analytical data prepared by the organisation, if he is satisfied that such data is properly prepared.

6.50 When the auditor intends to perform analytical procedures, he should consider the following:

- The objective of the analytical procedures, and the extent to which he may be able to rely on their results.
- The nature of the organisation
- The availability of information, i.e. financial or non-financial
- The reliability of information available
- The relevance of information available
- The comparability of information available
- The knowledge gained by the auditor during previous examinations
- The effectiveness of internal controls

### C. Extent of reliance on analytical procedures

6.51 The application of analytical procedures is based on the assertion of relationships among the data existing and continuing in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system. However reliance on the results of analytical procedures will depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when a material misstatement exists.

6.52 The following are the factors that determine the extent of *reliance* on substantive analytical procedures:

- **Risk of material misstatement**  
The risk that the analytical procedures fail to identify a material misstatement: This is inter-linked with the materiality of items involved. The less significant an account balance or class of transactions, the more reliance is on analytical procedures.
- **Other audit procedures**  
Other audit procedures directed to the same financial statement assertion. For example, a reduction in the extent of tests of detail will be justified where significant fluctuations and inconsistencies have been corroborated.
- **Accuracy of predictions**  
Income and Expenditure Accounts tend to be more predictable than Balance Sheet accounts because they are composed of large numbers of like transactions (whereas balances tend to be a net amount). Non-recurring accounting entries (e.g., asset revaluations) and discretionary expenses (e.g., research and development) do not lend themselves to effective analytical procedures.

- **Evaluation of internal control / risk assessments**  
If internal control over the processing of sales orders is weak (i.e., control risk is high) the auditor may have to place more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables.
- **The effectiveness of controls**  
The *effectiveness* of controls, if any, over the preparation of information used for analytical procedures.
- **Types of analytical procedures used**  
The more appropriate the analytical procedure, the more reliance can be placed thereon i.e. Trend Analysis, Ratio Analysis and Reasonableness tests.

#### D. Relevance of Ratio and Trend Analysis

6.53 **Analysis** means the examination and evaluation of the relevant information.

##### 1. Ratio Analysis

Ratio analysis is an important supplement to the audit process which has the merit of bringing to focus the abnormalities, deviations and unexpected variations.

A ratio measures the relative magnitude of two related factors and it does not have any significance of its own except to provide material for further analysis, interpretation and conclusion. It is a means to objectively assess or diagnose the financial health of an organisation.

The auditor can take broad view of data under audit by adopting ratio analysis. He can assess whether the data is reasonable, valid and consistent. Through the process of ratio analysis, any abnormal relationship between two related matters is most likely to be disclosed. The auditor shall have certain amount of knowledge of what should be the reasonable relationship. This may be acquired by the auditor from his knowledge and experience gained elsewhere or from the knowledge of the past relationships. Ratio analysis makes it possible for the auditor to locate problem areas (subject to scrutiny of confirming that the problem really exists).

At the planning stage, if the data are subjected to ratio analysis, the auditor would be in a position to plan his audit programme more purposefully. The auditor will be able to devote an appropriate amount of time and effort in areas where abnormalities have been detected.

The analysis of ratios and relationships has two phases:

- The determination and measurement of changes and inter-relationships in data
- The scrutiny, explanation and evaluation of the changes and their significance in the light of the circumstances.

Useful ratios include:

- financial ratios such as the receivables collection period (i.e. debtor days) and inventory (i.e. stock) turnover ratios; and

- ratios which relate to one account balance to another account balance (e.g. expense accounts as a percentage of sales revenue).

Because ratios identify stable relationships, they tend to be more relevant than absolute changes which could be influenced by many factors. Comparisons can be made with prior periods and against budgets and industry statistics. Ratios may be used more in planning and review than in obtaining substantive evidence.

## 2. Trend Analysis

Trend analysis compares current data with prior periods and is particularly useful for analysing income and expenditure (e.g., monthly turnover).

Methods include:

- 'Scatter-graphs' and other graphical techniques which rely on visual inspection;
- Time-series analysis which isolates trends from data by removing seasonal fluctuations; and
- Statistical regression (e.g., calculating the 'line of best fit') using a computer programme.

A good approach is to study the trends. Trend analysis is of course mainly resorted to in investigations. However, it may, be developed as a useful audit tool.

Trend of significant ratios can be studied by the auditor over a number of years either by plotting them on graph paper or by setting them chronologically.

The objective of comparison of absolute figures by reference to the corresponding figures of the previous year is to facilitate the comparison study of the items in the Balance Sheet and Income and Expenditure Account, so that the significance of the figures for the current year can be more readily appreciated and understood.

## E. Investigation of fluctuations and items

6.54 When analytical procedures identify unusual fluctuations and items i.e. relationships that are unexpected or inconsistent with evidence obtained from other sources, the auditor should investigate them. Unexpected trends or deviations should be discussed with relevant client's staff and explanations obtained.

6.55 Explanations must not be accepted at face value but corroborated either:

- using cumulative audit knowledge and experience obtained/gained during the course of the audit; and/or
- verifying other supporting evidence (i.e. applying other audit procedures based upon the results of inquiries)

6.56 Further investigation, by means of audit procedures designed to produce a satisfactory conclusions would be required if management is unable to provide an explanation or if the

explanation provided is considered not adequate.

## F. Analytical procedures used in the overall review stage

6.57 Analytical review at this stage is required in forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's knowledge of the organisation's business and relevant economic conditions. The review may also identify the need for further substantive procedures.

## 6. FLOWCHARTING

6.58 A flowchart is a method for documenting and understanding the flow of a system and for identifying its control points. This technique can be resorted to for evaluation of the internal control system. It is a pictorial description of how transactions flow through a system. They visually communicate the procedures, controls and the sequence in which they occur.

6.59 The advantages of using a flowchart to document a system are as follows:

- a. Flowcharts are easier and less time consuming to understand than a narrative
- b. Flowcharts make it easier to represent flow of transactions using standardized symbols
- c. It gives a bird's eye view of the system
- d. Flowcharts are easier to update

6.60 There are three rules of flowcharting as it relates to auditing:

- a. Prepare or update a flowchart for each audit, where practicable.
- b. Identify control points.
- c. Prepare a narrative on control points.

## 7. INTERVIEWING

6.61 Interview can also be described by other synonyms such as audience, conference, consultation, dialogue, meeting, talk, examine, interrogate, question etc. Interviewing is a process for gathering information which is a fundamental part of audit work.

6.62 Various types of interview are

- **Initial contact:** This sets entire tone and tenor of the audit programme. The auditee perceives the audit as a positive and constructive tool or avoidable inconvenience. The terms of reference for the audit are discussed and a clear mutual understanding is established.
- **Fact finding:** This is backbone of the audit work and a fine balance is required to be maintained between getting the facts and disturbing the auditee's work to avoid conflict. Negotiation skills, tact, and diplomatic approach are to be adopted.
- **General survey:** A general assessment of the overall domain environment to understand work culture and to define high areas of risk that may require interaction

with senior officials. An effort shall be made to sell the audit as a service.

- **Wrap up meeting:** This wrap up meeting involves explaining the audit findings to the senior officials in order to avoid surprises to them in the final audit report. It is a special negotiation process wherein the auditor is able to retain main audit paras but tones down certain other paras wherein the senior officers are able to bring in new perspective to initial audit findings. Personality factors may create sometimes a barrier to the effectiveness of audit closure process and finalization of report.
- **Staff appraisal:** This appraisal process is intended to appreciate staff attitudes, skills, and motivational needs.
- **Fraud:** Statutory implications shall be borne in mind as interviews in connection with investigations are covered under various Acts, such as Criminal Procedure Code, Evidence Act, Anti-Corruption Act and disclosure requirements stipulated in Rights to Information Act.

## INTRODUCTION

- 7.1 Audit procedure means, verification of a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made and also confirming that the amount mentioned in the bill has been posted to an appropriate account/register which would disclose the nature of the transaction on its inclusion in the final Statements of Account.

## SELECTION OF APPROPRIATE AUDIT PROCEDURE

- 7.2 Selection of the appropriate audit procedure is a matter of experience and judgment. For example, if no entry or record is available for the auditor for contingent liabilities in respect of pending suits, verification of the estimate of the liability would become difficult for lack of basis. In such cases, it would be more reasonable for the auditor to get the estimate confirmed by the other parties like solicitors. In addition, the auditor should examine the correspondence pertaining to the suit and should discuss the matter with the ULB officials. If the ULB is involved in similar suit in the past, by going through the records thereof and the auditor cull out relevant considerations for estimating the liability.

## EMPLOYING AUDIT TECHNIQUES

- 7.3 While collecting audit evidence through audit procedure, the auditor employs different techniques. In order to verify a particular item in financial statements, say, cash, the auditor may have to collect audit evidence from different sources. For example, in the case of “cash at bank”, reference may be made to bank column in cash book, or reference to bank reconciliation statement followed by examination of bank statement/bank pass book. Further, the auditor may like to obtain confirmation from the client’s asset. During all this process, the auditor would have to see that audit evidence obtained from different sources does not contradict each other. The cost of obtaining more and more audit evidence is justified by the benefit flowing from obtaining such evidence.

## CONCEPT OF “TESTS OF DETAILS OF TRANSACTIONS AND TESTS OF DETAILS OF BALANCES”

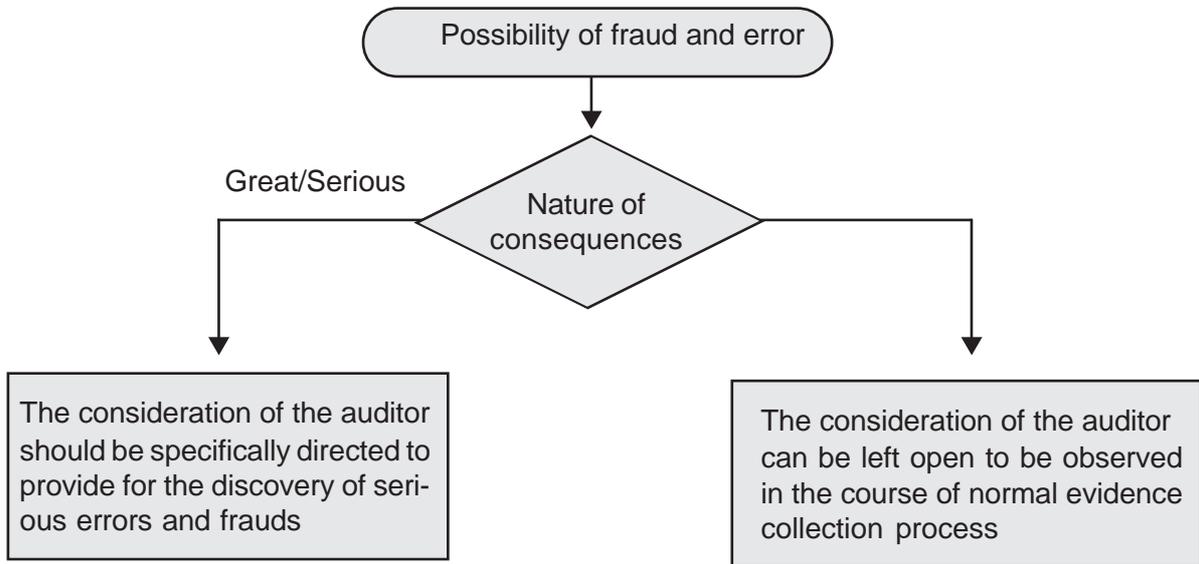
- 7.4 AAS describes audit procedures as being applied to classes of transactions and to account balances. The definition of substantive procedures distinguishes between tests of details of transactions and tests of details of balances. Often confusion may arise as to the distinction between the two and their significance in describing audit procedures.
- 7.5 Transaction classes are the individual economic exchanges of purchases, cash receipts and payments and wages. Each class is recorded in a special purpose journal such as the purchase journal. Each transaction is analysed into separate account balances to which it is to be posted. Thus, a credit purchase transaction is debited to purchases and credited to creditors. Ledger accounts represent the cumulative effect of postings from different transaction classes. Thus,

creditors are increased by purchase transactions and reduced by cash payment transactions. Auditing of purchases and cash payment transactions will result in verifying the account balance creditors.

7.6 However, the account balance creditors is also made up of amounts owed to individual parties and audit procedures can be applied directly to verifying balances owed to each creditor. Although it is possible to verify creditors solely by tests of details of transactions or solely by tests of details of balances, evidence from different sources is more persuasive than evidence obtained from a single source. Evidence as to balances is, therefore, usually obtained by examining details of both transactions and balances.

**POSSIBILITY OF FRAUD AND ERROR**

7.7 The auditor should prescribe audit procedures and techniques keeping in view the possibility of fraud and error while framing the audit programme. If the auditor undertakes a review and testing of internal controls and checks before or while drawing up the audit programme, he should focus his attention on the matters where the possibility of fraud and error is rather great



**AAS – 5 AUDIT EVIDENCE**

7.8 As per AAS – 1 “Basic Principles Governing an Audit” issued by ICAI, “*The auditor should obtain sufficient and appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.*”

7.9 As per the above, the auditor has to obtain audit evidence through two types of audit procedures i.e. one is compliance and another is substantive.

7.10 AAS – 5 Audit Evidence states that, in drawing up audit procedures, auditors should make sure they cover all the relevant financial statement assertions.

7.11 Compliance Procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance to be placed are ineffective.

Obtaining audit evidence from compliance procedures is intended to reasonably assure the auditor in respect of the following assertions:

Assertion	Audit objective
Existence	that the internal control exists
Effectiveness	that the internal control is operating effectively
Continuity	that the internal control has so operated throughout the period of intended reliance

7.12 *Substantive Procedures* are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. They are two types:

- tests of details of transaction and balances;
- analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

7.13 Obtaining audit evidence from substantive procedures is intended to reasonably assure the auditor in respect of the following assertions:

Assertion	Audit objective
Existence	that an asset or a liability exists at a given date
Rights and obligations	that an asset is a right of the organisation and liability is an obligation of the organisation at a given date
Occurrence	that a transaction or event taking place which pertains to the organisation during the relevant period
Completeness	that there are no unrecorded assets, liabilities or transactions
Valuation	that an asset or liability is recorded at an appropriate carrying value
Measurement	that a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period
Presentation and disclosure	an item is disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.

7.14 The extent and nature of substantive procedures to be performed will vary with respect to each of the above assertions.

7.15 Obtaining evidence relevant to one of the above assertions will not compensate for failure to do so with respect to another matter concerning the same item, e.g. existence of inventory and its valuation.

7.16 To understand assertions and the transaction classes relating to debtors, a list of audit objectives can be drawn.

**Audit objectives for debtors and related transaction classes**

Assertion category	Transaction class audit objectives	Account balance audit objectives
Existence or occurrence	Recorded sales transactions represent goods shipped during the period. Recorded cash receipt transactions represent cash received during the period.	Debtors represent amounts owed by customers at the balance sheet date.
Completeness	All sales and cash receipt transactions that occurred during the period have been recorded.	Debtors include all claims on customers at the balance sheet date.
Rights and obligations	The organisation has rights to the debtors and cash resulting from recorded sales and cash receipt transactions.	Debtors at the balance sheet date represent legal claims of the organisation on customers for payment.
Valuation or measurement	All sales and cash receipt transactions are correctly journalised, summarised and posted.	Debtors represent claims on customers at the balance sheet date and agree with the sum of the sales subsidiary ledger. The provision for bad debts represents a reasonable estimate of the difference between gross debtors and their net realisable value.
Disclosure	The details of sales and cash receipt transactions support their presentation in the financial statements including their classification and related disclosures.	Debtors are properly identified and classified in the balance sheet.

**CONCEPT OF SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE**

7.17 The words 'Sufficient' and 'Appropriate' are inter-related and apply to evidence obtained from both compliance and substantive procedures.

- Sufficient refers to "quantum of audit evidence obtained"
- Appropriate refers to "its relevance and reliability"

7.18 The auditor may often seek evidence from different sources or of different nature to support the assertions. The auditor should evaluate whether he has obtained sufficient and appropriate audit evidence before he draws his conclusions therefrom. The obtained evidence should enable the auditor to form an opinion on the financial information. In forming such an opinion, the auditor may obtain audit evidence on a selective basis by way of judgmental or statistical sampling procedures.

7.19 The following are the factors that influence the auditor's judgment as to what is sufficient and appropriate evidence:

1. The degree of risk of misstatement

This may be affected by the following factors:

- The nature of the item
  - The adequacy of internal control
  - The nature or size of the business carried on by the organisation
  - Situations which may exert unusual influence on management
  - The financial position of the organisation
2. The materiality of the item
  3. The experience gained during previous audits
  4. The results of auditing procedures
  5. The type of information available; and
  6. The trend indicated by accounting ratios and analysis

#### **AUDIT OF RECEIPTS AND PAYMENTS**

7.20 The act of examining bills is referred as audit of receipts and payments with an object of establishing the authenticity of the transactions recorded in the primary books/registers.

7.21 The essential points to be borne in mind while examining a bill are:

- a. That the date of the bill falls within the accounting period;
- b. That the bill is made out in the client's name
- c. That the bill is duly authorised
- d. That the bill is complete in all respects i.e. that the bill comprised all the relevant documents which could be expected to have been received or brought into existence.
- e. That the account in which the amount of the bill is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts

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

#### **REQUIREMENTS BEFORE COMMENCEMENT OF THE AUDIT OF RECEIPTS AND PAYMENTS**

7.23 Before the audit for a year is commenced, the auditor should:

- i. Peruse a copy of the latest Administration Report
- ii. Peruse the budget and the Government orders relating to them

- iii. gain a general knowledge of the financial position of the municipality and
- iv. go through:
  - a. the previous year's audit report,
  - b. Government orders sanctioning grants, contributions, etc,
  - c. proceedings of Council/Standing Committee; and
  - d. the annual objection statement of earlier years containing general defects in accounts and registers and attitude in the disposal of objections.

7.24 The auditor should equip himself with an update on the happenings in regard to budget and accounting process in ULBs and changes brought in by National Municipal Accounts Manual, State Municipal Accounts Manual, orders from Director of State Audit and/or Comptroller and Auditor General.

### **SCOPE OF AUDIT:**

7.25 In the system of pre-audit, both receipts and payments are checked before the transactions take place. There is not much scope to check the receipts in pre-audit. It is necessary to check that all the receipts are brought to account and remitted properly and correctly. This is not in vogue in many ULBs.

7.26 Currently, the accounts of the ULBs are audited annually. The audit consists of the check of receipts, payments and stores accounts and of the examination of the records connected therewith.

### **Audit of Receipts/Revenue**

7.27 The municipal revenue may be divided into the following three phases for purposes of check:

- (a) revenue having fixed demand i.e. taxes, fee etc., the demand for which is fixed and for which bills are issued, such as property tax, advertisement tax, tax on animals and vehicles, fees from trade licenses and encroachments etc.,
- (b) revenue leased out i.e. market leases, shop room leases, etc,
- (c) fluctuating items of revenue, where demand is not fixed.

7.28 **The auditors have to check whether Accounting Principles enunciated in the Andhra Pradesh Municipal Accounts Manual (APMAM) governing revenue recognition, provisioning, accounting, and treatment are properly and correctly adopted in accounting for revenue/expenditure under different activities.**

### **7.29 Synopsis of Changes under APMAM:**

- Under the accrual basis of accounting, financial effect of the transaction is recorded in the period in which they occur rather than in the period when the cash is actually received. Revenue Incomes accruing in the period are reflected in the accounts as compared to merely listing cash receipts and payments without reference to the period to which they relate and accrue.

- If the revenue is not measurable, determinable and reasonably realizable, such revenue is not recognized.
- Incomes which are not ascertainable in advance are recognized on collection basis. In respect of collection of revenue based incomes such as assigned revenues and user charges, income will be recognized as and when it is received.

7.30 The above concepts of accrual basis of accounting could be followed for most of the income sources. However, at the outset, where demand under any income head cannot be ascertained owing to absence of assessed data base for income due, such incomes may be accounted for on collection basis.

7.31 The audit process of check to be applied in each case is summarised below:

- i. Verification of the outstanding items of revenue.
- ii. Verification of the writes-off and remissions.
- iii. Check of collections.
- iv. Verification of the Demand, Collection and Balance.
- v. Check of revenues leased out.
- vi. Check of revenues managed departmentally
- vii. Check or fluctuating items of revenue.
- viii. Audit of paid vouchers,
- ix. Review of advances and deposits.
- x. Check of expenditure against budget allotment.
- xi. Review of the general financial position.
- xii. Examination of several accounts and registers.
- xiii. Annual accounts and the statements to be attached to the Annual Account.
- xiv. Verification of the Cash Book balance with that shown in the pass book as at credit of the municipality in the Treasury or Bank.

### **BOOKS OF ACCOUNT AND REGISTERS TO BE MAINTAINED**

7.32 Primary Books of Account to be maintained at the ULB as per APMAM:

- a. Cash Book
- b. Journal Book
- c. Ledger

### **REVENUE RECEIPTS REGISTERS**

7.33 The following registers are to be maintained in connection with revenue receipts depending upon their applicability or requirement.

SI No.	Name of the Register
1	Property Tax Demand Register
2	Vacant Land Tax Demand Register
3	Agricultural Land Tax Demand Register
4	Collection Register of Tax on Carriages and Animals
5	Advertisement Tax Demand Register
6	Mutation Register of Property Tax
7	Property Tax Arrear Demand Register
8	Vacant Land Tax Arrear Demand Register
9	Agricultural Land Tax Arrear Demand Register
10	Advertisement Tax Arrear Demand Register
11	Register of Transfer of Titles
12	Register of Vacancy Remission
13	Register of Writes-off and Temporary Remissions
14	Register of Revision Petitions
15	Register of Appeals
16	Register of Bills Issued
17	Register of Warrants
18	Register of Distraigned Properties
19	Register of Prosecutions
20	Register of Suits
21	House Service Connections Register
22	Meter Register
23	Water Charges Demand Register
24	Meter Reading Card
25	Meter Ledger
26	Water Charges Arrear Demand Register
27	Register of Miscellaneous Bills
28	Miscellaneous Demand Register

29	Register of revenue yielding properties and other miscellaneous sources of revenue
30	Register of tickets in respect of departmental collections
31	D & O Trades Demand Register
32	D & O Trades Arrear Demand Register
33	Register of Encroachment Fees
34	Encroachment Fee Arrear Demand Register
35	Register of Miscellaneous Receipts
36	Register of Miscellaneous Licences
37	Register Applications for Construction, Reconstruction, Extension etc
38	Register of Construction, Reconstruction or Extension of Buildings as assessed to Property Tax
39	Register of Miscellaneous Sales
40	Register of Travellers Bungalow
41	Register of Cheques
42	Register of Money Order

**REGISTERS TO BE MAINTAINED AS PER APMAM**

SI No.	Name of the Register	Number (APMAM)
1	Receipt	GEN-8
2	Receipt Register	GEN-9
3	Statement on Status of Cheques Received	GEN-10
4	Collection Register	GEN-11
5	Summary of Daily Collection	GEN-12
6	Register of Bills for Payment	GEN-13
7	Payment Order	GEN-14
8	Cheques Issue Register	GEN-15
9	Register of Advance	GEN-16
10	Register of Permanent Advance	GEN-17
11	Deposit Register	GEN-18
12	Summary Statement of Deposits Adjusted	GEN-19
13	Demand Register	GEN-20
14	Notice/Bill for Municipal Dues	GEN-21
15	Summary Statement of Bills Raised	GEN-22
16	Register of Notice Fee, Warrant Fee, Other Fees	GEN-23
17	Summary Statement of Notice Fee, Warrant Fee, Other Fees	GEN-24

**AUDIT PROCEDURE - CHECK LIST**

7.34 ***The suggested check list is illustrative and not exhaustive. The verification procedures suggested are generic in nature and the auditor while adopting the procedure shall check the latest executive instructions from competent authority relevant to the audit task on hand to examine delegation of powers, financial ceilings, administrative approvals, jurisdiction of authority, guidelines for auditors, validity of Government orders and their applicability as on the date of audit.***

1. General
2. Property tax and other taxes
3. Various fees
4. Octroi
5. Cess
6. Water Supply charges

7. Assigned Revenues
8. Rentals, Fees & Other Incomes
9. Public Works
10. Stores
11. Employee Related Transactions
12. Health and Sanitation
13. Other Revenue Expenditures
14. Grants
15. Borrowings
16. Special Funds
17. Investments
18. Fixed Assets
19. Lease and Hire Purchase
20. Loans and Advances

## **GENERAL**

Check whether arrangement with Banks is done by sanction from competent authority with reference to

1. Appointment of authorized collection agency for direct collection at all authorized branches of designated bank.
2. Operation of collection counters at ULB offices
3. Fixed time arrangement of collection of deposits from authorized collection centres
4. Issue of daily debit/credit advices
5. Issue of account statements on periodic basis
6. Tele-banking facilities
7. Payroll remittance arrangements
8. Payroll deductions and remittance thereof

## **Check whether**

1. Closing cash balance as per cash book is verified daily with physical cash balance at all collection offices duly signed by the authorized person.
2. Physical verification of cash is done in the presence of designated officer
3. Physical cash available at the closing hours of the last working day in the financial year is verified and certified
4. Cash chest is with two keys, one key with the cashier of collection office and the other with designated officer for verification of cash balance

5. Proper/adequate insurance cover has been taken for cash in the chest
6. Officers designated for operation of bank account shall coordinate with banks to check status of cheques/drafts deposited with them and sending daily statement
7. Bank reconciliation is being done on a monthly basis duly authenticated by designated officer
8. Original copy of cancelled receipt is attached with duplicate copy with "CANCELLED" marked on it.
9. Payment Order contains reference to Register of Bills, Measurement Book, Stock Ledger/ Fixed Assets Register for cross verification purpose, and audit trail, when payments are approved with purpose duly justified
10. Collection Register is tallied with Register of Cheques and daily cash collection summary
11. Month-end procedures as stipulated by APMAM is done
12. Liability for stale cheques account review is done and necessary reversal entries are passed
13. Bills paid are properly stamped after approval to check the same bills are not processed again for payment
14. Bank charges are recorded only as per original bank advices
15. Vouchers, sub-vouchers, and payee receipts are stamped properly
16. Payments made without proper authority
17. Excess payments
18. Objectionable charges
19. Illegal payments and want of competent sanction for charges
20. Amounts collected but not brought to account
21. Wasteful expenditure
22. Advances wrongly made
23. Defects in:
  - Measurement certificates
  - Disbursement certificates
  - Other certificates
  - Counter signatures
  - Pass orders
  - Pay orders

24. Any ward member has any interest in any subsisting contract made with ULB
25. All statements issued by Accounts Section are duly signed only by the Head of Accounts Section.
26. All payments made by the Accounts Section are recorded in the Cash Book (Form GEN-1) on a daily basis.
27. Payments exceeding Rs.100 or such other sum as may be prescribed by Rules are made only by "Account Payee Crossed" cheque.
28. All claims against the ULB, which are barred by time under any provisions of law relating to limitation, are refused and no claim on account of such time barred items is paid without the sanction of the authorities as prescribed in the applicable Act / Rules.
29. In case of payments made by drafts that are issued by banks through a written instruction other than a cheque, i.e., an authorisation letter, etc., the copy of the authorising document shall be attached to the Payment Order (Form GEN-14). The entry for payments made in this manner shall be recorded on receiving the drafts from the bank. A copy of the draft shall also be attached to the Payment Order.
30. At period end, the officers/sections to whom the permanent advance is provided have prepared a Payment Order for the replenishment of the expenditure incurred upto the period end and submitted it to the Accounts Section within 5 days from the end of the period.
31. In respect of cheques, which are cancelled or lost, Cheque Issue Register (Form GEN-15) is updated against the specific cheque numbers. The cheques cancelled should show the approval of the authorised signatories on the cheque and in the Cheque Issue Register.
32. The following reconciliation procedure is done at such periodic intervals as may be considered appropriate by the auditor depending upon Gross Turnover of the ULB
  - Bank reconciliation
  - Inter-unit reconciliation
  - Deposit reconciliation
  - Receivable and collection reconciliation
  - Advances reconciliation
  - Payables reconciliation
  - Reconciliation of balances with Government
  - Loans Received reconciliation
  - Reconciliation of Function wise Income or Expense Subsidiary Ledgers with Main Ledger.

**PROPERTY AND OTHER TAXES****Check whether**

1. Bills / Demands are raised on half yearly basis
2. Taxes are accrued in the month in which it is due and demands raised and also journal entries are passed
3. Reconciliation of demand at the beginning of the accounting year in respect of year-wise property tax and other tax receivables with year-wise total of balances recorded in the demand register
4. Quarterly reconciliation of amount collected and year-wise amount outstanding between Accounts Section and Tax Section with reference to balances maintained in the ledger accounts in the Accounts Section and demand register in the Tax Section
5. Status of collection of instruments deposited at the property tax bank account with designated banks on a daily basis
6. Daily collection report from authorized collection centres like e-seva, designated banks, and franchisees are received and reconciled between Tax Section, Accounts Section and bankers.
7. Cross reference of Tax Collection Register and summary of daily collection for review
8. Write offs and Remission are properly authorized as per specific procedure laid down in the Act
9. Certification by Head of Accounts Section for all reconciliation statements
10. Assessment books are maintained as required under the Act, containing rental value for each assessment
11. Assessment is authenticated by the Commissioner
12. Assessment Register is prepared at least once in five years
13. Intimation of newly constructed or occupied buildings is received
14. Assessment lists are prepared in prescribed form
15. Annual rental values are given properly as per Rules
16. Alterations in Demand Register are properly carried from assessment lists
17. In case of new or changes in assessments, tax is taken as accrued in the month in which the demand notice is served. Interest and penalties, if any, in demand and property (title) transfer charges are recognized only upon actual receipt
18. Revenue in respect of Notice fee/Distrait fee, Warrant fee, and other fees charged shall be recognized, when the bills for the same are raised

19. Collections to be made on behalf of State Government i.e. Education Tax, and Library Cess and included in the Property tax demand are reckoned together with Property tax demand and credited to a Control Account called "State Government Levies in Taxes-Control Account."
20. Revenue in respect of rebate/collection charges from State Government for collection made on their behalf is recognised at the rates prescribed by the State Government at the time of creating the liability to the State Government;
21. Wherever the system of self-assessment of taxes is prevalent, income is accrued when it becomes due as per the provisions of the Municipal Acts. Further, changes arising out of self-assessment are treated as 'Change in Demand' and are properly accounted for.
22. It is a normal practice for the ULB to include the arrears of the tax dues while issuing a fresh demand. Entries in respect of the arrears would have already been recorded in the earlier years. Income is recognized only in respect of the current year property tax demand.

### **Revenues Leased Out**

23. Approval for lease from competent authority and compliance of stipulated terms and conditions
24. Solvency of the bidder before the sale
25. Security / earnest money deposit paid
26. Valid documentation like lease deed, contract detailing specifications like duration of lease, fixation and manner of payment of rent, penal provisions, liability for payment of ground rent, etc.
27. Reasons for acceptance of other than highest bid.
28. Report submitted to the Council/Standing Committee in respect of non collection of dues and action taken for termination of lease
29. Legal action initiated for lease amounts remaining uncollected for three years or such time prescribed before they become time barred by limitation.

### **Revenue Managed Departmentally**

30. Receipt book procedure for issue, printing, control, numbering of tickets and authentication by responsible officer
31. Collection registers maintained and control over realization and reconciliation with account books
32. Security obtained from collecting agency

### **Fluctuating Items of Revenue**

33. Amount due has been realized without delay and counter-foil receipts are issued and properly credited.

34. Cash Book, Pass Book, Chitta, Remittance Challans, Cheque Books, Petty Cash Book etc shall be verified.
35. Statutory compliance with Municipal Acts and Rules.

## OCTROI

**Octroi is not applicable in Andhra Pradesh.** Hence it is a matter for guidance only.

### Check whether

1. Reconciliation of the amount collected daily with the statement of collections and summary of daily collections
2. Quarterly Reconciliation of balance in Octroi Deposit Ledger account with Register of Deposits in octroi section
3. For octroi outstanding in respect of account current holders, accounts shall be reconciled with the amount of octroi remained unrealized on a monthly basis
4. Reconciliation of statement of account from importers given account current facility on a monthly basis with balance in account current
5. No due certificate before refund of Octroi or any deposit
6. Weekly Reconciliation of transit deposit collected and refunded by octroi nakas
7. Appropriate MIS reports to facilitate proper internal control.

## CESS

Cess is the tax levied along with any other tax or in lieu of tax and is considered income of the ULB. The amount collected under cess should be utilized only for the purpose for which it is collected. Library cess is collected by the ULB on behalf of Zilla Grandhalaya Samstha (ZGS).

### Check list for cess related transactions:

1. Year-wise cess receivable shall be reconciled with year wise total of arrears recorded between Tax Section and Accounts Section
2. Quarterly reconciliation of amount collected and amount outstanding between ledgers in the Accounts Section and registers maintained in Tax Section
3. The Head of Accounts Section shall ensure daily coordination with banks to monitor collection/status of cheques deposited in respect of Cess Bank Account.
4. Cess Collection Register shall provide cross reference to Summary of Daily collection.

### Cess collections on behalf of ZGS

Library Cess is collected by the ULB on behalf of ZGS

1. **Cess is** collected as a surcharge on the property tax and credited to Control Account "State Government levies in taxes–Control Account"

2. The rate of levy is with approval of GoAP and any increase is done with sanction of GoAP
3. Library cess is levied on property tax but excluding education tax
4. Library cess will be automatically reduced when property tax is reduced (e.g. on appeals) and excess shall be refunded without the sanction of ZGS and adjustment shall be made accordingly
5. Library Cess collected is remitted to the credit of ZGS under intimation to Secretary, ZGS
6. Education tax is levied as surcharge on property tax under Elementary Education Act.
7. Exemptions applicable to property tax are also applicable to education tax and library cess

## **WATER SUPPLY**

### **Check whether:**

1. The demand at the beginning of accounting year in regard to year- wise water supply income receivable from previous year balance sheet shall be reconciled with year wise total of arrears in the Demand Register
2. Quarterly reconciliation of amount collected and year-wise amount outstanding between ledger accounts in Accounts Section and Demand Registers in Water Supply Section.
3. Quarterly reconciliation of deposits outstanding between ledger accounts in Accounts Section and Deposit Register in Water Supply Section
4. Water supply income collection register and summary of daily collection shall contain cross reference.

## **ASSIGNED REVENUES**

### **Check whether:**

1. Ratio of share is properly applied for as per the recommendations of Finance Commission and devolution of funds
2. Accounting treatment is explained in APMAM and accounting is done upon actual collection and accrual is applied based upon sanction orders duly quantifying the amounts
3. Provision is done for outstanding revenues upon review of recoverable status and approval of competent authority

## **RENTALS, FEES & OTHER INCOMES**

### **Check whether**

1. Accounting basis is properly determined based on the nature of revenue either on accrual basis or on cash receipts
2. Revenue is measurable and determinable

3. Contract revenue in respect of advertisement rights is accounted on cash or accrual basis
4. Other income is recognized pertaining to the period in which it becomes due e.g. when the bills are raised
5. Provision is made as per Provisioning norms for outstanding demand beyond 2 years
6. Provision no longer necessary is written back
7. Provision made additionally during the year is properly shown as expenditure
8. Refunds are adjusted against income and in case of refunds pertaining to previous years; it is treated as prior period item.
9. Written off receivables of rental, fee and other income is shown as prior period income
10. Opening balance reconciliation between Accounts and respective Sections.
11. Quarterly reconciliation of amounts collected and arrears outstanding between Accounts Ledgers and Demand Registers at respective Sections.

## **PUBLIC WORKS**

### **Check whether**

1. Distinction is maintained between works of capital nature and revenue nature
2. Quarterly reconciliation is done between Deposit Register at Engineering Section and that at Accounts Section
3. Upon completion of the Original Work, reconciliation is done between amount shown as expended in Engineering Section and the Capital Works—in-Progress Control Ledger Account at Accounts Section
4. Total expenditure incurred as stated in the statement of status on capital works in progress tallies with cumulative total of capital works in progress ledger accounts
5. Various taxes are deducted at source as required and deposited with respective Government agencies as per statutory stipulations
6. Reconciliation of total expenditure as per function-wise expense subsidiary ledger with repairs and maintenance ledger accounts
7. Compliance with budget availability at the time of approval
8. Before final payment, ensure that liquidated damages, penalties, and all other dues are recovered from contractor
9. All the bills or invoices are journalized before release of payments
10. Review of work sheet maintained to ascertain capitalization requirements
11. Technical sanction, agreement, execution, inspection and examination of tender files pertaining to contractor selection and estimates is properly done

**STORES****Check whether:**

1. Availability of budget at the time of accrual of expenditure
2. Before payment is released, all the purchase bills are journalized
3. Physical Stock Verification is done between physical stores and stock ledger in Accounts Section
4. Availability of necessary budget before procurement
5. Stores in charge is checking necessary budget provision for respective Sections before issue
6. All dues are recovered before final payment to the supplier
7. Necessary adjustment is made for the goods not actually received

**EMPLOYEE RELATED TRANSACTIONS****Check whether:**

1. Separate pay bills are prepared by each Section
2. Section wise consolidation of pay bills and consolidated pay bill summary is checked with previous month
3. Monthly reconciliation is done between Accounts Ledgers and Register of Loans to employees with period end passing of entries for interest accrued on loans
4. Monthly deductions are properly and timely remitted to appropriate statutory and other authorities.
5. Total establishment expenditure incurred as per Function-wise Subsidiary Ledger is reconciled with balance in Establishment Expense Ledger account and subsidiary ledger
6. Provident Fund and Pension Fund Contributions are properly deducted and remitted to the concerned authorities.
7. Interest receivables on the provident fund investment is less than the statutory liability for payment to the employees as per balances in their provident fund reserve account; and if so, check whether the difference is properly provided for and the amount is transferred to Provident Fund Bank Account.
8. Payment of pension and retirement benefits is made from Pension Fund/other Benefit Funds.
9. All the pension payments are made from Pension Fund Bank Account only. Deficit if any shall be met by transfer from Main Bank Account to Pension Fund Bank Account.
10. The following registers and documents are maintained in proper order:

Sl. No.	Particulars	Format No	Check Point
1.	Cash / Bank Payment Voucher	Form GEN - 5	Particulars of payment made and authorization for payment
2.	Register of Bills for Payment	Form GEN - 13	On satisfactory verification, the bills/claims shall be entered into the Register
3.	Payment Order	Form GEN - 14	Authorisation for making payment against Bills / Claims
4.	Cheque Issue Register	Form GEN - 15	Details of payments released through cheques shall be maintained in the Register
5.	Register of Advances	Form GEN-16	Name of the person and particulars of advance shall be maintained in the register
6.	Statement of Outstanding Liability for Expenses	Form GEN - 28	Details of the accrued expenditure from the bills received at the end of the accounting period shall be entered in the statement.
7.	Function – Wise Expenditure subsidiary ledger	Form GEN - 34	For recording function wise establishment expenditure
8.	Consolidated Pay Bill summary roll of the establishment for the month	Form ES - 1	Salary Expense and corresponding liability shall be recognized.
9.	Register of Employee Loans /Advances	Form ES - 2	Loans and Advances given to employees shall be recorded.
10.	Register of Interest on Loans to Employees	Form ES-3	Interest charge on loans and advances given to employees recorded.
11.	Un-paid Salary Register	Form ES - 4	Payment of salary not taken by the employees is maintained in the register
12.	Pension Payment Order	Form ES - 5	Details of pension payment shall be recorded
13.	Pension Register	Form ES - 6	Details of pension liability for each pensioner shall be maintained in the register

## OTHER REVENUE EXPENDITURE

### Check whether:

1. Budget availability for the expenditure incurred at the time of accruing of expenditure
2. All the bills/invoices are journalised before release of expenditure
3. Proper authorization of Payment Order as per delegation of powers
4. Payment Order is duly supported by all the required supporting documents
5. Expenditure is properly classified with reference to nature of expenditure and period /date of the bill
6. Proper reference to the Sections and Registers for the bills is provided in the Payment Order; and Payment Orders are returned where such reference is not provided.
7. All dues from suppliers /contractors/any other creditors are deducted before payments are made.
8. Monthly reconciliation of total expenditure incurred in function-wise expense subsidiary ledger is done with that of several administrative expense ledger accounts in the Accounts Section
9. All the reconciliation statements are certified by the Head of Accounts Section.

## GRANTS

### Check whether:

1. grant is intended for creation of assets e.g. laying of roads, water supply improvements, construction of sports centres, burial grounds, etc. or grant is intended for other than those for creation of assets
2. general grants, which is of a revenue nature, are recognised as income on actual receipt basis
3. any expenditure grant is received prior to the expenditure incurred, if so, check whether the grant so received is properly accounted as liability till the expenditure is incurred
4. any grant is receivable towards expenditure incurred, if so, check whether the grant amount is credited to Income and Expenditure Account during the year in which the expenditure is charged
5. any grant is received to meet the capital expenditure, if so, check whether:
  - a. the grant is treated as a liability till such time that the fixed asset is constructed or acquired
  - b. on construction or acquisition, to the extent of liability corresponding to the value of the asset so constructed/acquired is reduced

- c. the amount so reduced is treated as a capital receipt and transferred from the respective Specific Grant Account to the Capital Contribution
6. grant is received in the form of fixed asset, if so, check whether:
  - a. the asset is recognized at cost of acquisition, in the case of asset received at concessional rate
  - b. the asset is recognized at nominal value (Rupee One), in the case of asset received free of cost
7. any grant amount is adjusted for dues (e.g. repayment of earlier loan or otherwise) from the ULB at the time of sanction of grant
8. specific grant is received in advance and check whether the ULB has submitted an "Utilisation Certificate" in the manner prescribed in the Grant Sanction Order
9. Government grants are recognized in the books as per the Accounting Standard-12 "Accounting for Government Grants" issued by ICAI
10. any grant is received as compensation for expenses or losses incurred in a previous accounting period for providing immediate financial support and if so, check whether the grant is recognized and disclosed in the Income and Expenditure Account of the period in which it is receivable
11. an amount equivalent to the amount of capital expenditure incurred and capitalized is transferred from the Specific Grant Account to the Capital Contribution Account, when the asset under the specific grant is completed and the asset is capitalized
12. bills received in respect of revenue expenditure incurred as well as works executed or acquisition / purchase of fixed assets before the last date of the accounting period, are processed and forwarded to the Accounts Section for accounting and payment within 15 days from the end of the accounting period.
13. any investments are made from Specific Grants received in advance and if so, check whether the invested amount is entered in a Grant Investment Register
14. any grant is received as a nodal agency under certain schemes and if so, check whether the expenditure is met directly by ULB or paid to the beneficiaries group upon producing the utilization statement
15. grant was utilized for the purpose for which it was received
16. plan funds received from Central/ State Government are shown as grant funds in the financial statements and not mixed up with Earmarked Funds
17. Reconciliation of expenditure incurred on the project during the period in respect of each grant between Accounts Ledger and Grant Register in the Engineering/Project Section.

**BORROWINGS (LOANS RECEIVED)****Check whether:**

1. Proper provisioning is done in respect of interest accrued and due and charged to current year's Income and Expenditure Statement
2. Physical verification of Sinking Fund Investment documents with Sinking Fund Investment Account
3. Funds borrowed are properly utilized
4. Present value of Sinking Fund Investment reflects value of fund as per Government sanction and funds are transferred from Municipal Fund to the Sinking Fund Account in case of mismatch
5. interest expenditure on loan is recognised on accrual basis
6. interest on borrowings directly attributable to acquisition or construction of qualifying fixed assets upto the date of commissioning of the assets are capitalised as per Accounting Standard – 16 "Borrowing Costs"
7. there is any interest accrued but not due, if so, check whether:
  - a. a provision is made for the interest accrued between the date of last payment of interest and the date of financial statements;
  - b. the interest is charged to the current period's Income and Expenditure Statement
  - c. a reversal entry is passed at the beginning of the new accounting period for the provision entry [i.e. above (a) point] made in the previous accounting period
8. Transfers to Escrow Account from income collected shall comply with stipulated conditions for borrowings
9. expenses incurred for issuing of debentures or bonds (issue expenses) is recognised as deferred and amortised in equal instalments over a period of 5 years or the tenure of the loan, whichever is earlier
10. any borrowed amount is adjusted for dues (dues on old loan and interest) from the ULB at the time of sanction
11. terms of sanction for raising loan or issuing debenture provided any provision to establish a Sinking Fund, if so, check whether an amount stipulated in the terms of sanction is transferred to the Sinking Fund from the Municipal Fund at the end of the year
12. interest earned and profit/loss on disposal of investments made in respect of Sinking Fund is properly updated in the Register of Sinking Fund
13. present value of Sinking Fund investments is less than the value of the Fund stipulated in the terms of sanction, if so, check whether the difference is transferred from the Municipal Fund
14. observations made by the lender during inspection/audit are complied with and adverse findings are reported to competent authority

**SPECIAL FUNDS****Check whether:**

1. fund creation is recorded in Special Fund Register before transfer of money with proper reference in the Journal Voucher
2. fund is utilized for the purpose for which it is created
3. reduction in Special Fund is matched with expenditure from the Fund
4. ledger balance of Special Fund Account is reconciled with Special Fund Register and Special Fund Bank Account
5. reconcile the expenditure incurred towards SC/ST/Women & Child welfare activities and unspent balance is transferred to SC/ST/Women & Child Welfare Fund Bank Account
6. Special Funds collected along with other collections, if so, check whether:
  - a. Accounts Section is identifying the transactions pertaining to Special Funds collected along with other collections
  - b. the amount of Special Fund collected is transferred from Municipal Fund to the Special Fund Account
7. there are any unpaid bills at the end of accounting period for the revenue expenditure incurred, if so, check whether provision is made at period-end
8. the purpose for which the Special Fund created is achieved, if so, check whether:
  - a. unutilized balance in the Special Fund, if any, is transferred from Special Fund to Municipal Fund
  - b. approval of the ULB is obtained wherever required

**INVESTMENTS****Check whether:**

1. investment complies with regulations applicable
2. particulars of investments made have been entered in the Register of Investments
3. a separate account code has been maintained for each type of the investments made
4. ledger balance of Investment Account is reconciled with Investment Register
5. physical verification of investments is done by checking instruments or documents with Investment Register
6. investments are properly monitored to check maturity, payment of interest/dividend and receipt of bonus etc
7. investments are recognized at cost and if so, check whether the cost components are incidental to its acquisition

8. long-term investments are carried at cost
9. short-term investments are carried at their cost or market value (if quoted) whichever is lower
10. investments are made out of Special Funds or Grants under specific purpose, if so, check whether any income received from such investments or any profit/gain on disposal of such investments are debited/credited to the Special Funds or Grants
11. (a) at the end of the financial year, Accounts Section has ascertained the amount of diminution or decline in value of the investments
  - (b) there is any diminution or decline in value of investments, if so, the amount is calculated investment-wise
    - © The amount so calculated shall be compared with the 'Accumulated Provision for Decline in Value of Investments' Account and if there is shortfall, then check whether to the extent of shortfall, adequate provision is made; and if 'Accumulated Provision' Account exceeds the decline in value of investments, check whether such excess is written back in the books
    - (d) investments are carried in Financial Statements at the reduced value after provision for diminution in the value of investments.

## **FIXED ASSETS**

### **Check whether:**

1. Budget availability is confirmed before acquisition
2. fixed assets are recognized at cost of acquisition and if so, check whether the cost components are incidental to its acquisition
3. all the fixed assets belonging to a class of assets are accounted under that/same class of asset only
4. all fixed assets are acquired only after obtaining approval of the concerned authority
5. any additions or improvements made to the fixed assets (i.e. capitalized), if so, check whether that results in increasing the utility or useful life of the asset
6. Sinking Funds are maintained to replacement of assets, if so, check whether:
  - a. an amount equivalent to the depreciation provision for the year is transferred to Asset Replacement Bank Account
  - b. the amount in the Asset Replacement Bank Account is used only for the purpose of acquisition of fixed assets
  - c. Asset Replacement Register is properly maintained asset class- wise
  - d. Payment is made from Main Bank Account instead of from Asset Replacement Bank Account for acquisition of fixed asset, if so, check whether the amount equivalent to the cost of acquisition is transferred from Asset Replacement Bank Account to the Main Bank Account.

7. Deposit Register and Deposit Ledger Account are reconciled
8. fixed assets are revalued, if so, check whether:
  - a. on which circumstances fixed assets are revalued (e.g. at the time of Lease, issue of Municipal Bonds, etc.)
  - b. appreciation is credited to the Revaluation Reserve Account under General Fund, in the case of increase in the value of asset
  - c. depreciation in the value of asset is charged to Income and Expenditure Account, in the case of decrease in value of asset
  - d. an amount equivalent to the depreciation provided on the revalued portion of fixed asset is adjusted against the Revaluation Reserve Account
  - e. In the event of appreciation of the asset after depreciation is accounted, the amount of depreciation earlier debited to Income and Expenditure Account is credited back to Revenue Account and the balance to the Revaluation Reserve Account.
  - f. In the event of depreciation of the asset after appreciation is accounted, the amount of appreciation earlier credited to Revaluation Reserve Account is adjusted and the balance charged to Income and Expenditure Account.
9. physical verification of fixed assets is done and discrepancies are reconciled with Fixed Asset Register.
10. amounts available in Asset Replacement Bank Account are used for acquisition of assets in respect of which depreciation is provided
11. Register of Immovable Properties and Register of Tools and Plants are properly maintained and reference to Payment Order is correctly made
12. depreciation is provided on each class of fixed assets at the prescribed rates
13. method of depreciation adopted is in consistent with the accounting principles of the ULB.
14. separate depreciation entry is passed for each class of fixed assets
15. depreciation is provided on the disposed asset upto the month of sale
16. fixed assets are carried at cost less accumulated depreciation

## **LOANS & ADVANCES**

### **Check whether:**

1. Loans to others are entered in the 'Loans to Others Register' in Form LA –1 and on a monthly basis, the amounts as per the register are reconciled with the amounts as per the Ledger Accounts
2. the interest accrued at the period ends is entered in the registers referred above and the interest on loans as per the registers is reconciled with the amount as per interest ledger

3. at the end of the year, an abstract of 'Loans to others' is made showing the loans outstanding at the beginning of the year, loans lent during the year, total interests accrued during the year and total amount of recoveries/ adjustments during the year.
4. Register of Loans contains record of all loans borrowed and confirmation statement as per prescribed format is sent to the lender every year
5. provision against bad and doubtful loans is made in accordance with the provisioning principle of the ULB based on norms or guidelines issued by the State Government in this regard

## **Registers/Books**

### **Demand Register**

Check whether:

1. all buildings and lands in the city/town as per the assessment list are written.
2. all details, particularly the name of the owner, the Annual Rental Value of the building and the amount of tax on each building are written
3. all new assessments as per monthly lists are brought into demand
4. all changes as per Revision Petition Register and Appeal Register are entered
5. arrears of previous years are properly brought into Arrear Demand Register of the current year
6. collections are properly posted, balance struck and DCB certified by Commissioner.

### **Mutation Register**

Check whether:

1. all permanent changes made in the assessment of buildings and lands have been recorded in this register with reference to the monthly lists, Register of Revision Petitions, Register of Appeal Petitions, and Register of Writes-off
2. demands of current year and previous year have been reconciled with reference to the above details

### **Register of Bills Issued**

Check whether:

1. Bill Collectors have acknowledged the receipt of bills together with the amount of tax covered in the bills and signed in the register
2. any bills are returned by the Bill Collectors, if so the amount covered therein, and the reasons for return of bills.

## Register of Prosecutions

### Check whether:

1. all prosecutions launched against tax defaulters for non-payment of tax are entered in the register
2. all details like the Assessment Number, amount involved, Name of Court and Case Number are clearly entered in the register
3. prosecutions are launched within time
4. a reference of prosecution has been entered against the relevant assessment in the Demand Register.

## Register of Suits

### Check whether:

1. all suits filed by the municipality for recovery of any sum due are entered
2. all suits filed against the municipality are entered
3. sanction from the Council obtained for filing/defending the suit.
4. all details like the Assessment Number, amount involved, Name of Court and Suit Number etc. are clearly entered
5. Execution Petitions are filed for recovery of sums, in cases the suits are disposed in favour of municipality
6. a reference of suit has been entered against the relevant assessment in the Demand Register

## Miscellaneous Demand Register

### Check whether:

1. all revenues under non-tax items, especially (i) market leases, (ii) slaughter house leases (iii) fish tank leases, and (iv) rents from shop rooms, shopping complexes, buildings and lands are entered in the register; and the details are gathered from the Register of Revenue Yielding Properties and the sale lists approved by the Council or the Contract Committee.
2. collections are posted from the entries of Register of Miscellaneous Receipts and penal interest is collected for belated payments
3. revenue items under plan and non-plan grants are entered in the register, and the details of receipt, like sanction orders, amount and date of remittance to municipal funds are written.
4. Demand, Collection and Balance is struck at the end of the year and certified by Commissioner.

**Establishment Audit Register**

Check whether:

1. all sections of the establishment are entered consecutively in individual pages
2. the establishments are arranged in the order of major and minor heads of account
3. orders sanctioning the establishment and the scales therefor, detailed scale of each category, the names of holders, and their pay on the first day of April etc. are entered properly
4. employee's details such as appointment, promotion, transfer, date of joining, date of relief etc., are noted.
5. gross charges for each section are entered
6. pay is recorded under the month for which it is due, and not under the month in which it is disbursed.
7. two figures, one representing the normal amount, and the other, the excess amount in case of supplemental bills are made

**Measurement Book**

Check whether:

1. all measurements of work done whether by means of daily labour or by contract, and of materials received are recorded
2. arithmetical calculations and totals in the measurement book are correct
3. the terms of works executed are in accordance with the specifications provided in the agreement
4. the rates of payment are in accordance with the rates as per agreement
5. all entries which have been transcribed into the bills are crossed out in ink
6. all erasures or alterations are attested
7. check-measurements are made

**Register of Tools and Plants**

Check whether:

1. all tools, furniture, etc., purchased are entered
2. purchases made are according to payment vouchers
3. unserviceable items deleted do have competent sanction
4. separate registers or separate sets of pages are set apart for different sections or institutions
5. amount is recovered from the person responsible, if there is short-fall

6. written off is made with competent sanction
7. annual verification has been done by the Engineer or any officer authorized by the Commissioner, and if so, a certificate to that effect is recorded

### **Register of Deposits**

#### **Check whether**

1. separate sets of pages for (i) deposits by renters for markets, shop rooms etc., (ii) deposits by contractors, and (iii) other deposits are provided
2. details of the previous year's outstanding balances are entered year-wise, the earliest year at the beginning
3. deposits received during the year are entered in the proper part as each transaction occurs
4. repayments in cash or by transfer are noted against the original credit
5. year-wise abstract is drawn at the end of year.
6. refund of deposits in cash are made on refund vouchers
7. deposits made by the renters are credited/adjusted during the year as per agreement.

### **Security Register of Municipal Employees**

#### **Check whether:**

1. security has been obtained from all employees who are required by rules to furnish it
2. the amount of security fixed in each case is noted in the register with the number and date of Council's resolution
3. security has been obtained to the full extent of the sum fixed by Council
4. security has been obtained in the form specified in the rules
5. savings bank pass books and all Government promissory notes are forthcoming in all cases where savings bank deposits and Government promissory notes have been furnished as security
6. pass books and promissory notes have been duly endorsed to, and pledged in favour of the Commissioner

### **Register of Advances**

#### **Check whether**

1. all the balances outstanding at the end of the previous year are first entered in the register and then each advance made during the year are entered as soon as it is made.
2. the name of the person/employee to whom advance is made, the voucher number and the purpose are noted in all the entries.

3. advance recovered in cash or adjusted by deduction from a bill or by transfer adjustment is noted against the original advance
4. Balances are struck at the end of the year and the outstanding balances carried forward to the next year.

### **Challan Register**

#### **Check whether**

1. Each Bill Collector and other outdoor staff entrusted with collection of any sum due to the municipality is maintaining a Challan Register.
2. Bill Collector is making entries in the Challan Register with reference to Collection Book and getting them verified
3. Bill Collector is remitting the collections in the municipal treasury on the same day of collection or the following working day
4. Shroff is receiving the amount and acknowledging it in the Challan Register

## 8 Audit Reports

### THE REQUIREMENTS FOR REPORT WRITING ARE GIVEN BELOW

- 8.1 Report shall be in written form. Auditors should prepare written audit reports communicating the results of each audit.
- 8.2 Written reports - advantages
- (1) communicate the results of audit to officials at all levels of Government,
  - (2) make the results less susceptible to misunderstanding,
  - (3) make the results available for public inspection as may be required under Rules; and
  - (4) facilitate follow-up mechanism to determine whether appropriate corrective actions have been taken.
- 8.3 When an audit is terminated prior to completion, for any reason, auditors should communicate the termination to the auditee and other appropriate officials in writing. Auditors should also write a memorandum for the record, summarizing the results of the work and explaining why the audit was terminated.

### TIMELINESS

- 8.4 Auditors should appropriately issue the reports to make the information available for timely use by the ULB, GoAP, CAG and other stake holders.
- 8.5 To be of maximum use, the report must be timely as per the Act, Rules and executive instructions from time to time. Even a carefully prepared report may be of little value to decision makers, if it arrives too late. Therefore, auditors should plan for the appropriate issuance of the audit report and conduct the audit with this goal in mind.
- 8.6 The auditors should consider interim reporting, during the audit, of significant matters to appropriate officials. Such communication, which may be oral or written, is not a substitute for a final report, but it does alert officials to matters needing immediate attention and permits them to correct themselves before the final report is completed.

### REPORT CONTENTS

- 8.7 Auditors should report the audit objectives and the audit scope and methodology. Knowledge of the objectives of the audit, as well as of the audit scope and methodology for achieving the objectives, is needed by readers to understand the purpose of the audit, judge the merits of the audit work and what is reported, and understand significant limitations.

### OBJECTIVES

- 8.8 In reporting the audit's objectives, auditors should explain why the audit was made and state what the report is to accomplish. Articulating what the report is to accomplish normally involves identifying the audit subject and the aspect of performance examined, and because what is

reported depends on the objectives, communicating what finding elements are discussed and whether conclusions and recommendations are given.

- 8.9 To preclude misunderstanding in cases where the objectives are particularly limited and broader objectives can be inferred, it may be necessary to state the objectives that are not pursued.

## **SCOPE AND METHODOLOGY**

- 8.10 In reporting the scope of the audit, auditors should describe the depth and coverage of work conducted to accomplish the audit's objectives. Auditors should, as applicable, explain the relationship between the universe and what was audited; identify organizations, geographic locations, and the period covered; report the kinds and sources of evidence; and explain any quality or other problems with the evidence. Auditors should also report significant constraints imposed on the audit approach by data limitations or scope impairments.
- 8.11 To report the methodology used, auditors should clearly explain the evidence gathering and analysis techniques used. This explanation should identify any significant assumptions made in conducting the audit; describe any comparative techniques applied; describe the criteria used; and when sampling significantly supports auditors' findings, describe the sample design and state why it was chosen.
- 8.12 Auditors should attempt to avoid misunderstanding by the reader concerning the work that was and was not done to achieve the audit objectives, particularly when the work was limited because of constraints on time or resources.

## **AUDIT RESULTS AND FINDINGS**

- 8.13 Auditors should report significant audit findings, and where applicable, auditors' conclusions. Auditors should report the significant findings developed in response to each audit objective. In reporting the findings, auditors should include sufficient, competent, and relevant information to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective. Auditors should also report appropriate background information that readers need to understand the findings.
- 8.14 Audit findings not included in the audit report, because of insignificance, should be separately communicated to the auditee in writing. Such findings, when communicated in a letter form should be referred to in the audit report. All communications of audit findings should be documented in the working papers.
- 8.15 Audit findings often have been regarded as containing the elements of criteria, condition, and effect plus cause when problems are found. However, the elements needed for a finding depend entirely on the objectives of the audit. Thus, a finding or set of findings is complete to the extent that the audit objectives are satisfied and the report clearly relates those objectives to the finding's elements.

## **CONCLUSIONS**

- 8.16 Auditors should report conclusions when called for by the audit objectives. Conclusions are logical inferences about the programme based on the auditors' findings. They should be specific and not left to be inferred by readers. The strength of the auditors' conclusions depends on the

persuasiveness of the evidence supporting the findings and the convincingness of the logic used to formulate the conclusions.

- 8.17 Undue insistence on trifling errors and technical irregularities should be avoided and more time and attention should be devoted to the really important and substantial irregularities with the object not only of securing rectification of particular irregularity and also of ensuring regularity and propriety in similar cases for future.

## **RECOMMENDATIONS**

- 8.18 Auditors should report recommendations for actions to correct problem areas and to improve operations.
- 8.19 Auditors should report recommendations when the potential for significant improvement in operations and performance is substantiated by the reported findings. Recommendations to effect compliance with laws and regulations and improve management controls should also be made when significant instances of non compliance are noted or significant weaknesses in controls are found. Auditors should also report the status of uncorrected significant findings and recommendations from prior audits that affect the objectives of the current audit.
- 8.20 Constructive recommendations can encourage improvements in the conduct of Government programmes. Recommendations are most constructive when they are directed at resolving the cause of identified problems, are action oriented and specific, are addressed to parties that have the authority to act, are feasible, and, to the extent practical, and are cost-effective.

## **STATEMENT ON AUDITING STANDARDS**

- 8.21 Auditors should report that the audit was made in accordance with Generally Accepted Government Auditing Standards.
- 8.22 The statement of compliance with generally accepted Government auditing standards refers to all the applicable standards that the auditors should have followed during the audit. The statement should be qualified in situations in which the auditors did not follow an applicable standard. In these situations, auditors should report in the 'Scope' section the applicable standard that was not followed, the reasons therefor, and how not following the standard affected the results of the audit.

## **COMPLIANCE WITH VARIOUS LAWS AND REGULATIONS**

- 8.23 Auditors should report all significant instances of non-compliance and all significant instances of abuse that were found during or in connection with the audit. In some circumstances, auditors should report illegal acts directly to parties external to the audited organisation.

## **NON COMPLIANCE AND ABUSE**

- 8.24 When auditors conclude, based on evidence obtained, that significant non compliance or abuse either has occurred or is likely to have occurred, they should report relevant information. The term "non compliance" comprises illegal acts (violations of laws and regulations) and violations of provisions of contracts or grant agreements. Abuse occurs when the conduct of a Government organization, programme, activity, or function falls far short of societal expectations for prudent behaviour.

- 8.25 Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to imply that they have made a determination of illegality.
- 8.26 In reporting significant instances of non-compliance, auditors should place their findings in perspective. To give the reader a basis for judging the prevalence and consequences of non-compliance, the instances of non-compliance should be related to the domain section or the number of cases examined and be quantified in terms of value, if appropriate.
- 8.27 When auditors detect no significant instances of non-compliance, they should communicate them to the auditee in writing. If the auditors have communicated such instances of non-compliance in a letter form, they should refer the letter in the audit report. Auditors should document in their working papers all communications to the auditee about non-compliance.

### **DIRECT REPORTING OF ILLEGAL ACTS**

- 8.28 Auditors are responsible for reporting illegal acts directly to parties outside the auditee in certain circumstances, as discussed in the following paragraphs. Auditors should fulfil these responsibilities even if they have resigned or stopped from the audit.
- 8.29 The auditee may be required by law or regulation to report certain illegal acts to specified external parties (for example, to CVC, CAG, CBI, RBI or Advocate General). If auditors have communicated such illegal acts to the auditee, and if the auditee fails to report them, then the auditors should communicate their awareness of that failure to the Municipal Council/Standing Committee. If the auditee does not make the required report as soon as practical after the auditors' communication with Municipal Council/Standing Committee, then the auditors should report the illegal acts directly to the external party specified in the law or regulation depending upon regulatory compliance required in this regard
- 8.30 Auditors should obtain sufficient, competent, and relevant evidence (for example, by confirmation with outside parties) to corroborate assertions by management that it has reported illegal acts. If they are unable to do so, then the auditors should report the illegal acts directly as discussed above.
- 8.31 Under some circumstances, laws, regulations, or policies may require the auditors to report promptly indications of certain types of illegal acts to law enforcement or investigatory authorities. When auditors conclude that this type of illegal act either has occurred or is likely to have occurred, they should ask those authorities and/or legal counsel if reporting certain information about that illegal act would compromise investigative or legal proceedings. Auditors should limit their reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

### **DEPARTMENT/MANAGEMENT CONTROLS**

- 8.32 Auditors should report the scope of their work on department/management controls and any significant weaknesses found during the audit.

- 8.33 Reporting on department/management controls will vary depending on the significance of any weaknesses found and the relationship of those weaknesses to the audit objectives.
- 8.34 In audits, where the sole objective is to audit the management controls, weaknesses found of significance to warrant reporting would be considered deficiencies and be so identified in the audit report. The management controls that were assessed should be identified to the extent necessary to clearly present the objectives, scope, and methodology of the audit.
- 8.35 In a performance audit, auditors may identify significant weaknesses in management controls as a cause of deficient performance. In reporting this type of finding, the control weaknesses would be described as the “cause.”

### **VIEWS OF RESPONSIBLE OFFICIALS**

- 8.36 Auditors should report the views of responsible officials of the audited programme concerning auditors’ findings, conclusions, and recommendations, as well as corrections planned.
- 8.37 One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible auditee officials and others, as may be appropriate. Including the views of responsible officials produces a report that shows not only what was found and what the auditors think about it but also what the responsible persons think about it and what they plan to do about it.
- 8.38 Auditors should normally request that the responsible officials’ views on significant findings, conclusions, and recommendations are in writing. When, in these cases, written comments are not obtained, oral comments should be requested.
- 8.39 Advance comments should be objectively evaluated and recognized, as appropriate, in the report. Advance comments, such as a promise or plan for corrective action, should be noted but should not be accepted as justification for dropping a significant finding or a related recommendation.
- 8.40 When the comments oppose the report’s findings, conclusions, or recommendations, and are not, in the auditors’ opinion, valid, the auditors may choose to state their reasons for rejecting them. Conversely, the auditors should modify their report if they find the comments valid.

### **NOTEWORTHY ACCOMPLISHMENTS/ACHIEVEMENTS**

- 8.41 Auditors should report noteworthy accomplishments, particularly when **management improvements in one area may be applicable elsewhere.**
- 8.42 Noteworthy management accomplishments identified during the audit, which were within the scope of the audit, should be included in the audit report along with deficiencies. Such information provides a more fair presentation of the situation by providing appropriate balance to the report. In addition, inclusion of such accomplishments may lead to improved performance by other Government organizations that read the report.

**ISSUES NEEDING FURTHER STUDY**

- 8.43 Auditors should refer significant issues needing further audit work to the auditors responsible for planning future audit work.
- 8.44 If, during the audit, auditors identify significant issues that warrant further work, but the issues are not directly related to the audit objectives or the auditors do not have the time or resources to expand the audit to pursue them, they should refer the issues to the Director of State Audit who is responsible for planning future audit work. When appropriate, auditors should also disclose the issues in the report and the reasons the issues justifying the need for further study.

**PRIVILEGED AND CONFIDENTIAL INFORMATION**

- 8.45 If certain information is prohibited from general disclosure, auditors should report the nature of the information omitted and the requirement that makes the omission necessary.
- 8.46 Certain information may be prohibited from general disclosure by Central, State, or local laws or regulations. Such information may be provided on a need-to-know basis only to persons authorized by law or regulation to receive it.
- 8.47 If such requirements prohibit auditors from including pertinent information in the report, they should state the nature of the information omitted and the requirement that makes the omission necessary. The auditors should obtain assurance that a valid requirement for the omission exists, and, when appropriate, consult with legal counsel.

**REPORT PRESENTATION**

- 8.48 The report should be made in a courteous and impersonal terms and must be legible and intelligible. It should also be complete, accurate, objective, convincing, and as clear and concise as the subject permits.

**COMPLETE**

- 8.49 Being complete requires that the report contain all information needed to satisfy the audit objectives, promote an adequate and correct understanding of the matters reported, and meet the report content requirements. It also means including appropriate background information.
- 8.50 Giving readers an adequate and correct understanding means providing perspective on the extent and significance of reported findings, such as the frequency of occurrence relative to the number of cases or transactions tested and the relationship of the findings to the organisation's operations.
- 8.51 In most cases, a single example of a deficiency is not sufficient to support a broad conclusion or a related recommendation. All that it supports is that a deviation, an error, or a weakness existed. However, except as necessary to make convincing presentations, detailed supporting data need not be included.

**ACCURATE**

- 8.52 Accuracy requires that the evidence presented be true and that findings be correctly portrayed. The need for accuracy is based on the need to assure readers that what is reported is credible and reliable. One inaccuracy in a report can cast doubt on the validity of the entire report and can divert attention from the substance of the report. Also, inaccurate report can damage the credibility of the audit organization and reduce the effectiveness of its report.
- 8.53 The report should include only information, findings, and conclusions that are supported by competent and relevant evidence in the auditors' working papers. If data are significant to the audit findings and conclusions, but are not audited, the auditors should clearly indicate in their report the data's limitations and do not make unwarranted conclusions or recommendations based on those data.
- 8.54 Reported evidence should demonstrate the correctness and reasonableness of the matters reported. Correct portrayal means describing accurately the audit scope and methodology, and presenting findings and conclusions in a manner consistent with the scope of audit work.

**OBJECTIVE**

- 8.55 Objectivity requires that the presentation of the entire report be balanced in content and tone. A report's credibility is significantly enhanced when it presents evidence in an unbiased manner so that readers can be persuaded by the facts.
- 8.56 The audit report should be fair and not misleading, and should place the audit results in perspective. This means presenting the audit results impartially and guarding against the tendency to exaggerate or overemphasize deficient performance. In describing shortcomings in performance, auditors should present the explanation of responsible officials including the consideration of any unusual difficulties or circumstances they faced.
- 8.57 The tone of reports should encourage decision makers to act on the auditors' findings and recommendations. Although findings should be presented clearly and forthrightly, the auditors should keep in mind that one of their objectives is to persuade, and that this can best be done by avoiding language that generates defensiveness and opposition. Although criticism of past performance is often necessary, the report should emphasize needed improvements.

**CONVINCING**

- 8.58 Being convincing requires that the audit results be responsive to the audit objectives, the findings be presented persuasively, and the conclusions and recommendations follow logically from the facts presented. The information presented should be sufficient to convince the readers to recognize the validity of the findings, the reasonableness of the conclusions, and the benefit of implementing the recommendations. Reports designed in this way can help focus the attention of responsible officials on the matters that warrant attention and can help stimulate correction.

**CLEAR**

- 8.59 Clarity requires that the report be easy to read and understand. Reports should be written in language as clear and simple as the subject permits.

- 8.60 Use of straight-forward and non-technical language is essential to simplicity of presentation. If technical terms and unfamiliar abbreviations and acronyms are used, they should be clearly defined. Acronyms should be used sparingly.
- 8.61 Logical organization of material, and accuracy and precision in stating facts and in drawing conclusions, are essential to clarity and understanding. Effective use of titles and captions and topic sentences make the report easier to read and understand. Visual aids (such as pictures, charts, graphs, and maps) should be used when appropriate to clarify and summarize complex material.

### **CONCISE**

- 8.62 Being concise requires that the report be no longer than necessary to convey and support the message. Too much detail detracts from a report, may even conceal the real message, and may confuse or discourage readers. Also, needless repetition should be avoided.
- 8.63 Although room exists for considerable judgment in determining the content of reports, those that are complete, but still concise, are likely to achieve greater results.

### **REPORT SUBMISSION**

- 8.64 Written audit reports are to be submitted by the audit organization to the appropriate officials of the auditee and external funding organizations, (as the case may be) unless legal restrictions prevent it. Copies of the reports should also be sent to other officials who have legal jurisdictional authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by Act or Rules, copies should be made available for public inspection.
- 8.65 Audit reports should be distributed in a timely manner to officials interested in the results. Such officials include those designated by the Act or Rules to receive such reports, those responsible for acting on the findings and recommendations and those of other levels of Government who have provided assistance to the auditee. However, if the subject of the audit involves material that is classified for security purposes or is not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution.
- 8.66 When Non-Government audit organizations are engaged, the engaging Government organization should ensure that the report is distributed appropriately. If the Non-Government audit organization is to make the distribution, the engagement agreement should indicate which officials or organizations should receive the report.
- 8.67 Internal auditors should follow their organisation's requirements and regulations and statutory requirements for distribution. They report to the Commissioner/Standing Committee/Council who is responsible for further action on the report.
- 8.68 The Director may authorize any of his subordinates to prepare draft audit reports and send such report after his approval to the concerned ULB.
- 8.69 The Director may authorize Regional Deputy Director/ Deputy Director to approve the draft audit report in respect of Municipal Corporations; and District Audit Officer concerned in respect of other Municipalities.

## **FOLLOW UP ACTION ON AUDIT REPORT**

8.70 The Commissioner shall rectify the defects pointed out in the audit report and submit it to the auditors within a period of two months from the date of receipt of audit report. Before submitting the rectification report to the auditors, it shall be placed before the Council/Standing Committee.

## **FORMAT AND CONTENT TO BE SUBMITTED AS PER NATIONAL MUNICIPAL**

### **ACCOUNTS MANUAL**

8.71 This chapter discusses the format and content of the Audit Report to be submitted in relation to ULBs.

8.72 This chapter briefly describes the following:

- a) Audit report on financial statements
- b) Periodicity of Reports
- c) Supplementary / test audit conducted by CAG
- d) Other audits of ULBs.

8.73 The report of the Auditor as specified in this Manual can be construed as certificate unless the State Government has any specific requirement.

### **1. AUDIT REPORT ON FINANCIAL STATEMENTS**

8.74 The municipal accounts as contained in the Financial Statements including the accounts of special funds, if any, and the Balance Sheet shall be examined and audited by Director of State Audit or an Auditor appointed by the State Government.

8.75 The Auditor so appointed shall upon completion of audit of the accounts, issue a report on the financial statements of the ULB.

8.76 The Auditor's Report on the Balance Sheet, Income and Expenditure Statement, Receipts and Payments Statement, and Cash Flow Statement shall be addressed to the Municipal Commissioner.

8.77 The Report shall state:

- a. whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;
- b. whether, in his opinion, proper books of account as required by the relevant Act and Rules, the Accounts Manual and any other stipulations have been kept by the ULB so far as it appears from his examination of those books;
- c. whether the ULB's Balance Sheet, Income and Expenditure Statement, Receipts and Payments Statement and Cash Flow Statement dealt with by the report are in agreement with the books of account;
- d. whether appropriate internal controls have been adhered to;

- e. whether all payments have been made in accordance with the law;
- f. whether any deficiency or loss appears to have been caused by the gross negligence or misconduct of any person (if yes, the amount of loss should be quantified);
- g. whether any sum received for and on behalf of the ULB which ought to have been brought into account of the ULB by any person has been so brought; and
- h. whether any material impropriety or irregularity, other than those mentioned above, has been observed by him during the course of audit of accounts.

8.78 Where any of the matters referred to above are answered adversely or with a qualification, the auditor's report shall state the reason for the same and with further explanation and inclusion of statistical impact if possible.

### **ANNEXURE TO THE REPORT OF THE AUDITOR**

8.79 Besides the above Audit Report, the Auditor shall comment in respect of the following matters in the Annexure to the Audit Report:

1. Whether all the expenditure incurred by the ULB are authorised by appropriate provision in the sanctioned budget, whether made originally or subsequently?
2. Whether all sums due to and received by the ULB have been brought to account within the prescribed time limits?
3. Whether all transactions (incomes, expenditures, assets and liabilities) are correctly classified?
4. Whether in respect of all bills for charges on account of all works and other expenditure, proper certificates have been furnished in support of them and that no deviation has been made from the sanctioned plans and estimates without the sanction of the competent authority?
5. Whether the amounts received as specific grants have been utilised for the purposes as stated in the grant sanction order?
6. Whether the Special Funds have been created as per the provision of relevant Acts and Rules and whether the Special Funds have been utilised for the purposes for which created?
7. Whether the ULB is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; whether these fixed assets have been physically verified 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?
8. Whether physical verification has been conducted by the ULB at reasonable intervals in respect of stores?
9. Whether the procedures of physical verification of stores followed by the ULB are reasonable and adequate? If not, the inadequacies in such procedures should be reported;

10. Whether any material discrepancies have been noticed on physical verification of stores as compared to book records, and if so, whether the same have been properly dealt with in the books of account?
11. Whether the valuation of stores is in accordance with the accounting principles laid down in the Accounts Manual? Whether the basis of valuation of stores is same as in the preceding year? If there is any deviation in the basis of valuation, the effect of such deviation, if material, should be reported;
12. Whether the parties to whom the loans, or advances in the nature of loans, have been given by the ULB are repaying the principal amounts as stipulated and are also regular in payment of the interest and if not, whether reasonable steps have been taken by the ULB for recovery of the principal and interest?
13. Whether there exists an adequate internal control procedure for the purchase of stores, including components, plant and machinery, equipment and other assets?
14. Whether proper procedures are in place to identify any unserviceable or damaged stores and whether provision for the loss in this respect, if any, has been made in the accounts?
15. Whether the ULB is regular in depositing Provident Fund and other deductions with the appropriate authorities and if not, the extent of arrears;
16. Whether the ULB is regular in depositing tax deducted at source (income tax, sales tax, etc.) and other statutory dues with the appropriate authorities, and if not, the nature and cause of such delay and the amount not deposited;
17. Whether any personal expenses have been charged to revenue account; if so, the details thereof.

8.80 The Report of the Auditor shall also specifically report on any other matter which the Government, ULB and/or any Authority as required by any Act, may have specifically required to be covered as a part of the Audit.

## **2. PERIODICITY OF REPORTS**

8.81 At the end of each audit, the auditor may furnish a certificate on the periodic coverage to the Municipal Commissioner. The suggested format of the certificate can be as follows:

“Certified that the accounts from \_\_\_\_\_ to \_\_\_\_\_ have been audited by me and found correct with the exception of the following items:” *(The exceptions shall be explained in detail).*

8.82 While furnishing periodical certificate/report, the auditor shall atleast verify the following:

1. Whether the postings of the entries in the books of original entry have been correctly carried in the respective ledger accounts;
2. Whether all the books of account and supplementary registers that are prescribed in the Accounts Manual / other Rules have been properly maintained by the ULB;

3. Whether the Quarterly Financial Statements have been compiled on the basis of the actual entries in the books of account;
4. Whether the period-end and reconciliation procedures prescribed have been carried out.
5. Whether the Bank Reconciliation statements have been prepared and are appropriate.
6. Whether all grants from Government have been accounted at gross value with proper entries to various accounts

### **3. SUPPLEMENTARY / TEST AUDIT CONDUCTED BY CAG**

8.83 State Government may empower CAG to undertake Test Audit under relevant Act or under technical guidance and supervision arrangement. The Audit report prepared by the CAG shall also be placed before the Council/Standing Committee.

### **4. OTHER AUDITS OF ULBs**

8.84 Besides, the above audit, the accounts of specific loan funds, grants, donations, etc., would continue to be audited by auditors of agencies which have given grants, loans, etc., in the same manner as is currently happening.

### **ADDITIONAL AUDIT**

8.85 In addition to the audit by the auditors, the Government or a ULB may additionally get the accounts of the ULB audited under the following circumstances:

- Internal Audit
- Concurrent Audit
- Special Audit (investigative or audit in depth)
- Special Audits ordered by the State Government;

8.86 The State Government can also define the guidelines under which these audits are to be undertaken. It is recommended that Internal Audit can be undertaken whenever the revenue collections are greater than 25 crores rupees per annum and concurrent audit can be undertaken when the revenue collections are greater than 100 crores rupees per annum.

8.87 These Special audits may be required to ensure that the accounts and financial statements of the ULBs have been prepared in accordance with the provisions of the Accounts Manual and other relevant provisions of the Act or the objectives under which the audits have been ordered by the State Government.

## 9 Surcharge

### SURCHARGE CERTIFICATE

9.1 The AP State Audit Act, 1989 made a provision relating to 'surcharge'. 'Surcharge' has been defined under clause (q) of Section 2 as follows:

'Surcharge' means the amount for which the auditor, in exercise of powers vested in him under this Act, makes a person liable for the loss, waste, misapplication or misappropriation of any money or other property belonging to any local authority.

9.2 Under section 9 of the Act, the Commissioner, on receipt of the audit report, shall rectify the defects and irregularities pointed out in the report and shall place the audit report, together with a statement of action taken or proposed to be taken before the Council meeting. It should be done within a period of two months. Further, within one month of the said meeting, the Commissioner shall send to the Director a report of his having rectified the defects or irregularities pointed out in the audit report. The Commissioner may also supply further explanation in regard to such defects or irregularities to the Director, if so required.

9.3 On receipt of rectification report from the Commissioner, the Director may either

- accept the reply, or
- direct further investigation and to report, or
- condone the objection, or
- hold that the defect or irregularity pointed out in the report is neither rectified nor removed.

9.4 Further, under section 10 of the Act, the Director may disallow any item of expenditure on the ground that it has been incurred against law, and surcharge the same on the person incurring or authorizing the incurring of such expenditure. He may charge against any person responsible therefor, the amount of any deficiency, loss, unprofitable outlay or unaccounted for due to his negligence or misconduct, and shall certify the amount due from such person.

9.5 A person who has been accordingly certified cannot contend that another person is responsible for the loss due to negligence and misconduct of (that another) person.

9.6 The Director has to state in writing the reasons for his decision in respect of every disallowance, surcharge or charge. He shall communicate a copy of his decision to the person on whom a surcharge is made. The decision to surcharge the person will be communicated in a form known as surcharge certificate.

9.7 Any person aggrieved by any disallowance, surcharge or charge may within two months of receipt of surcharge certificate, may

- make an application to competent civil court to set aside the orders of the Director, or
- appeal to Government.

- 9.8 While making a civil suit, the person has to make the Director alone as a respondent, and no other agency or person to be added as respondents. From the decision of the court, appeal lies to the High Court.
- 9.9 If the person on whom a surcharge certificate is served do not make a civil suit in a court or make an appeal to Government within 2 months, and do not make the payment (covered under surcharge) to the municipality, it can be recovered as if it were an arrear of land revenue.
- 9.10 The appellate authority in the Government is not the Municipal Administration & Urban Development Department. It has been clarified by Government in Govt. Memo No.18682/280/A1/Admn II/01 dated 13-9-2001 of Finance Department, that since the appeal is made against the orders of Director of State Audit and since he is under the administrative control of Finance Department, the appellate authority is the Finance Department in the Government.
- 9.11 Andhra Pradesh State Audit Rules, 2000 issued in GO Ms. No.130 Fin & Plg Department dated 8-9-2000 provide some more details on 'surcharge'. Other officers of the department, like Regional Deputy Director and Audit Officer are also empowered to issue surcharge certificates in respect of certain designated institutions.
- 9.12 It is mentioned in the rules that the responsibility for production of records for the audit lies on the Commissioner and failure to produce records is also liable for surcharge proceedings.

## 10 e-Municipality - An Audit Challenge

### FUTURE TRENDS –

#### THE AUDIT CHALLENGE IN INFORMATION TECHNOLOGY REVOLUTION

10.1 The process of auditing in a **computerized environment** has thrown open **new challenges** to audit function. The current trends are:

- Decentralized processing of data
- Rapidly increasing end-user computing
- Relational Data Base Management Systems are increasingly being used.
- Commonly used commercial documents like cheques, invoices, are being replaced by paperless Electronic Data Interchange.
- Conventional data entry is slowly getting replaced by scanners, digitized image processors, voice recognition system, etc.
- Data communications and networking are on the increase.
- Enterprise Resource Planning system for effective real time management information systems are being developed
- Total computerization and Local, Regional, Zonal, Central, and National level networking of ULBs are on the anvil.

#### EXPECTED DEVELOPMENTS IN ULBs-

##### AUTOMATED COMPUTERIZED ENVIRONMENT

10.2 Even organizations of modest size cannot operate today without support from information technology to streamline operations, improve services, and assist management in monitoring organizational performance. To ensure that automated information systems are managed, developed, and controlled effectively and efficiently in order to support the ULBs' objectives by providing information for informed decision making and reporting, several thousands of crores of rupees of investment is planned to achieve this objective.

10.3 In order to protect the investment in technology, processes must be in place to ensure that financial resources are used efficiently and effectively. Information systems should be carefully planned and guided. Implementing processes for project management, life-cycle development, and system controls will provide management with a means for making automated systems reliable and secure. In addition, data must be protected against unauthorized changes and access. Also, physical assets and property should be protected from unauthorized use or destruction

#### 10.4 DEFINITIONS OF TERMS USED IN AUTOMATED ENVIRONMENT

1. An **application** refers to a set of programmes on a computer (such as a payroll system or accounting system) which supports a particular business function or portion of a function.
2. **Application controls** are the controls designed for a specific automated information system application to help ensure that processed information is authorized, valid, complete, accurate, and timely.
3. **Batch processing** exists when inputs are captured and grouped in transaction files over a period of time, and these files are subsequently released to process and update application master files.
4. **Controls** are procedures or mechanisms used to protect assets, most notably data.
5. **General controls** are specific controls for developing, operating, managing, and assessing all automated information system applications. General controls include the organization's methods and procedures that apply to the overall computer operations in an agency.
6. **Information resources** include the procedures, equipment, and software that are designed, built, operated, and maintained to collect, record, process, store, retrieve, display, and transmit information, and associated personnel including consultants and contractors.
7. An **information system** is the combination of all communication methods in an organization (computers, telephones, personal contact). An information system collects, records, processes, stores, retrieves, and displays information. Its major purpose is to enable an organization to meet its mission. "Major Information Resource" projects are subject to review by the Quality Assurance Team.

#### MAJOR INFORMATION TECHNOLOGY PROJECTS

10.5 Major Information Technology projects are subject to review by the Quality Assurance Agency. A Major Information Technology project is defined as an automation project whose development costs are over ten lakhs rupees, or

- has a development schedule of one year or more,
  - involves more than one consulting agency or Governmental unit, or
  - materially alters the work methods of agency personnel or delivery of services involving process re-engineering.
- 10.6 On-line batch processing exists when inputs are entered on-line (usually with some automated editing) to create a transaction file which is used to update application master files within a short period of time.
- 10.7 Post-implementation evaluations are reviews of computer systems after the system has been adequately tested and implemented for the organization's use. These reviews generally focus on (1) inputs to the system, (2) processing by the system, and (3) outputs from the system.

- 10.8 Programmers write sets of related instructions (referred to as programmes) that perform operations or tasks. Application Programmers write specific, task-oriented programmes designed to satisfy particular user needs. System Programmers write programmes needed for a computer system to function. Programmers often work from programme specifications developed by Systems Analysts. These specifications serve as a blueprint for programme design.
- 10.9 The Quality Assurance Team (QAT) is composed of representatives from the department of Information Technology and the State Auditor's office.
- 10.10 Real-time or interactive processing exists when inputs are entered and immediately update or access the application master files.
- 10.11 Systems Analysts develop programme specifications for a project to guide programmers. Systems Analysts define project information requirements, user requirements, and necessary system functions. They focus more on the design of a system and what it will do rather than on operational programming details.
- 10.12A System Design Development Methodology (SDDM) is a set of procedures intended to aid Systems Analysts, Programmers, and Users in creating and maintaining a computer application. It should guide the information system staff through needs analysis to design, development, testing, implementation, and maintenance. The required software can be internally developed or a ready made package can be bought.

## **OVERVIEW OF THE PROCESS**

- 10.13 The principal steps in the process of managing the deployment of automated information technology are as follows:
- Develop an understanding of the ULB and its objectives / procedures / policies / programmes to identify automation opportunities and make a pre-feasibility study with SWOT analysis.
  - Establish an effective project management process.
  - Implement an effective SDDM
  - Ensure that appropriate controls are built into the system to protect the investment

## **WHY AUDIT UNDER AUTOMATED COMPUTERIZED ENVIRONMENT:**

- 10.14 The automated computerized systems are susceptible for abuse. Therefore the need for development of information system audit as a tool to check abuse and report findings is essential.
- 10.15 Some major types of computer abuse that the organizations are likely to encounter are described below:

Type of Abuse	Description
Hacking	Person gains unauthorized accesses to a computer system to read, modify, or delete programmes or data to disrupt services.
Viruses	Viruses are programmes that attach themselves to executable files, system areas on diskettes, or data files that contain macros to cause disruption to computer operations or damage to data and programmes.
Illegal physical access	A person gains unauthorized physical access to computer facilities by illegal entry to cause physical damage to hardware or make unauthorized copies of data.
Abuse of privileges	A person uses the privileges they have been assigned for making unauthorized copies of confidential data

#### 10.16 Types of computer audit

- Operational computer system/network audits: review the controls within and surrounding operational computer systems and networks, at various levels, *e.g.* network, operating system, layered software, application software, databases, logical/procedural controls, preventive/detective/corrective controls, crypto, logging.
- IT installation audits: take a look at the computer building, suite, room or cupboard, including aspects such as physical security (walls, CCTV, locks, guards, barbed wire, visitor procedures), environmental controls (fire and flood protection, power supply, air conditioning), computer and network operation processes and management systems, and the IT equipment itself.
- Developing systems audits: typically cover either or both of two aspects: (1) project/programme management controls (often, the auditor is the only person with the knowledge, experience to point out that the average Project Manager's progress reporting is "somewhat optimistic" at best); and (2) the specification, development, testing, implementation and operation of technical and procedural controls, including classical technical information security controls and the related business process controls.
- IT management audits: review the organization, structure, strategy, work planning, resource planning, budgeting, cost controls *etc.* and, where applicable, relationships with outsourced IT providers (in some cases, these aspects may be audited by operations and financial auditors, leaving the computer auditors to the more technological aspects).
- IT process audits: review processes which take place within IT such as application development, testing, implementation, operations, maintenance, housekeeping (backups, preventive maintenance *etc.*) support, incident handling.
- Change management audits: review the planning and control of changes to systems, networks, applications, processes, facilities *etc.*, including configuration management, control over the promotion of code from development through testing to production, and the management of changes to the organisation.

- Information security and control audits: review controls relating to confidentiality, integrity and availability of systems and data.
- IT legal compliance audits: review legal and regulatory aspects of IT systems (e.g. software copyright compliance, protection of personal data).
- Disaster contingency/business continuity planning/disaster recovery audits: review arrangements to restore some semblance of normality after a disaster affecting the IT systems, and perhaps assess the organisation's approach to risk management.
- IT strategy audits: review various aspects of IT strategy, vision and plans, including their relationship to other strategies, visions and plans.
- "Special investigations": this is audit-speak for contingency and un-pre-planned work such as investigating suspected frauds or information security breaches, performing due diligence review of IT assets for mergers and acquisitions *etc.*

## **IMPACT ON AUDIT**

10.17 Once all the ULBs get into computerized environment, the likely impact on audit function would be:

- (1) Inadequate documentation and loosely defined assumptions could lead to improper use of key decision support system.
- (2) Unless the auditor is involved in system development, internal control could become porous.
- (3) Conventional methods of auditing become redundant and usage of sophisticated computer aided audit techniques need to be used.
- (4) Training and Capacity building for auditors is required.
- (5) Electronic Data Interchange (EDI) would eliminate traditional audit trail which radically impacts audit evidence.
- (6) There is an urgent need to initiate reforms in auditor's minimum capabilities, capacity building, and continuous skill up-gradation to meet rapidly changing environment.

## **AUDIT PROCEDURE UNDER AUTOMATED COMPUTERIZED ENVIRONMENT**

### **BASIC GUIDELINES FOR APPLICATION SYSTEMS CONTROL**

#### **INTRODUCTION**

10.18 There are strong incentives to incorporate control procedures in computer-based application systems. Not only will the system possess a higher degree of reliability, but the resulting accuracy and orderliness can lead to greater processing efficiency by reducing the number of errors that require manual intervention and reprocessing.

#### **OBJECTIVES**

10.19 The objective of an audit through information technology is to review and evaluate the controls intended to mitigate risks related to information and process integrity. The responsibility of the auditor is to identify controls over information and process integrity and to test such controls for evidence of ongoing compliance and effectiveness.

10.20 Application controls should provide reasonable assurance that the recording, processing and reporting of data are properly performed. To do this, the design of an application system should assure that:

- (1) All authorized transactions are completely processed once and only once.
- (2) Transaction data is complete and accurate.
- (3) Transaction processing is correct and appropriate to the circumstances.
- (4) Processed results are utilized for the intended purpose.
- (5) The application can continue to function.

#### **I. INPUT CONTROL**

10.21 Input controls are designed to provide reasonable assurance that data received for processing have been properly authorized, converted into machine sensible form and identified, and that data (including data transmitted over communication lines) has not been lost, suppressed, added, duplicated, or otherwise improperly changed. Input controls include controls that relate to rejection, correction and resubmission of data that were initially incorrect ("The Effects of EDP on the Auditor's Study and Evaluation of Internal Control", Statements on Auditing Standards (SAS No.3), American Institute of Certified Public Accountants).

10.22 The chart below lists the general function (input-related control areas) that requires control. Within each control area are control types that address specific functions. Specific controls are listed for each control type.

Control Area	Control Type	Specific Controls
Source document origination	Written procedures	Control documentation
		User Procedures and Manuals
	Source document design	Special purpose forms
		Source document numbers
		Transaction identification
		Cross reference
		Sequence log
	Source document handling	Dual custody
Authorization	Source document preparation	Separation of duties
		Signatures
	Written procedures	Written authorization
	Approval of source documents	Evidence of approval
		Transaction conflicts matrix
Data processing input preparation	Transaction identification	Transaction numbering schedule desk
		User identification
	User review of input	Manual review
	Batching	Batch serial number
		Limit the number of transactions

		Batch and balance source data at point of origin
	Logging	Logs of source document transmittal between organizations
	Transmittal	Transmittal document
		Retention dates on source documents
		Source document storage index
	Filing of source documents	File of source documents
		Batch storage
		Source documents maintained at origin
	Retention storage	Filing in user areas
		Limited access to retention facilities
		Removal from retention
Source document error handling	Error procedures	Source document correction procedures
		Written error handling procedures
		Responsibility for error correction
	Error detection	Error logging
		Visual review of source documents
	Error correcting processing	Error notification
		Identification of error correction

	Corrected data resubmission	Verification of re-entered data
		Monitoring of error corrections
Transaction data entry	Written procedures	Control documentation
		User procedures
	Physical hardware	Location of data conversion operation
		Simultaneous recording
Terminal data entry	Terminal software features	Security of data entry terminal
		Pre-formatting
		Interactive display
		Computer-aided instruction
		User application system access
		Terminal sign-on procedures
		Review of terminal assignments
	Hardware control features	Terminal features
		Intelligent terminals
Transaction data	Transaction verification	Key verification
		Pre-programmed keying formats
	Data content validation techniques	Editing and validating routines

		Transaction data cutoff
		Passwords
Batch proof and balancing	Data input controls	Processing schedules
		Turn-around documents
		Cancellations of source documents
		Logging
	Proof and balancing methods	Manual check of control figures
		Batch control
		Batch header records
Transaction entry error handling	Error detection	Error display
		Unauthorized access attempts
		Error listings
	Error	Warning messages
		Error message
	Corrected data resubmission	Corrected data editing
		Control totals and rejects

## II. PROCESSING CONTROL

10.23 Processing controls are designed to provide reasonable assurance that electronic data processing (EDP) has been performed as intended for the particular application; i.e. that all transactions are processed as authorized, that no authorized transactions are omitted or improperly changed and that no unauthorized transactions are added

10.24 The following lists the general functions (processing related control area) that require controls. Within each control area are control types that address specific controls. Specific controls are listed for each control type.

Control Area	Control Type	Specific Controls	
Computer process integrity	Transaction identification	Transaction codes	
		Monitoring of computer generated transaction	
	Computation and logic	Control totals	
		Default option	
		Anticipation control	
		Dual fields	
		Arithmetic accuracy	
		Exception reporting	
		File control totals	
		File completion check	
		File maintenance	Balancing the computer file
			Dummy records
			Operator instructions
Computer programme run books			
Computer processing error handling	Error reporting	Computer console	
		Display messages	
		Error reporting	
		Batch control header	
	Error correction	Production report of rejected conditions	
		Automated error suspense file	
		Discrepancy report	

		Error serial numbers
	Corrected data resubmission	Destructive update
		Error suspense re-entry

### III. OUTPUT CONTROL

10.25 Output controls are designed to assure the accuracy of the processing result (such as account listings or displays, reports, magnetic files, invoices or disbursement checks) and to assure that only authorized personnel receive the output.

10.26 The chart below lists the general functions (output related control area) that require control. Within each control area are control types that address specific controls. Specific controls are listed for each control type.

Control Area	Control Type	Specific Controls
Data processing, balancing and reconciliation	Data processing control group	Reconciliation Transaction log
		Computer console log
		Systems output logs
		Record of output reports
		Monitoring process flow
		Job control card review
		Graphical charts
Output distribution	Output handling	Handling procedures for computer output
		Output report distribution
		Report copies
User balancing and reconciliation	Monitoring procedures	User section changes in master files
		Report heading
		Transaction tracing list

		Internally generated transactions
		Control totals
	Testing procedures	Statistical sampling of final report
		List of all transactions
Records retention	User retention and disposal methods	Waste disposal procedures / Deletion of unused reports
Accountable documents	Accountable document handling	Negotiable documents storage / printing of additional sequence number on forms
Output error handling	Error reporting	Independent history file of errors
		Aging open items
		Error logging by control groups
		Output activity review
	Error correction	Error correction processing
		Identification of error correction
		Correction procedures
		Responsibility for error correction
	Correction re-entry	Error logging
		Verification of re-entered data
		Monitoring of error conditions

#### IV. USER CONTROL

10.27 Validity of computer application systems output lies ultimately with the user. The user is responsible for data submission and for correction of errors that are the result of inaccurately submitted data.

10.28 User controls over data being processed should include:

- a) User Instruction Manuals defining responsibilities and actions;
- b) Input controls that identify all data entering the processing cycle;
- c) Processing control information that includes edits, error handling, audit trails and master file changes;
- d) Output controls that define how to verify the correctness of the reports;
- e) Separation of duties between preparing the input and balancing the output.

10.29 To provide the user with the tools to achieve their responsibilities, the User Instruction Manual should include:

- a) A narrative description of the system (IT and Manual)
- b) A detailed flowchart of all clerical processes
- c) A detailed document flowchart
- d) A copy of each input document, completed as an example, together with instructions for preparation
- e) A list of approvals required on each input document
- f) Copies of any batch control forms or other transmittal forms used together with instructions on their preparation and reconciliation to batch edit reports
- g) A listing of computerized input and processing edits performed, the error messages that result therefrom, and instructions for correcting, resubmitting and balancing the resubmitted items
- h) A copy of each report produced by the system with a description of its purpose, the number of copies, distribution and instructions for balancing output to original input
  - i) A list of retention periods for:
    - i. input source documents
    - ii. data file (tape or disk)
    - iii. output report.
- j) A system recovery section including user responsibilities for assisting in the restoration of the system.

## V. APPLICATION CONTROLS

10.30 Application controls can also be described by the characteristics- preventive, detective and corrective.

### Preventive Controls

- Definition or responsibilities
- Reliability of personnel
- Training
- Competence
- Segregation of duties
- Rotation of duties
- Standardization
- Authorization
- Secure custody
- Dual custody
- Forms design
- Pre-numbered
- Pre-printed
- Simultaneous preparation
- Turnaround document
- Endorsement
- Cancellation
- Documentation
- Exception input
- Default option
- Passwords

**Detective Control**

- Anticipation
- Transmittal document
- Batch serial numbers
- Control register
- Amount control total
- Document control count
- Line control count
- Hash totals
- Batch totals
- Batch balancing
- Visual verification
- Sequence check
- Overflow check
- Format check
- Completeness check
- Check digit
- Reasonableness
- Limit check
- Feedback
- Dating
- Expiration
- Keystroke verification
- Approval
- Run-to-run totals
- Balancing
- Reconciliation
- Aging
- Suspense file
- Suspense account

- Batching
- Clearing account
- Tickler file
- Periodic audit
- Redundant process
- Summary process
- Label
- Trailer record
- Validity check

### **Corrective Controls**

- Discrepancy reports
- Transaction trail
- Error source statistics
- Automated error correction
- Upstream resubmission
- Backup and recovery

10.31 The combinations and arrangements of application control techniques over a particular application function are almost infinite. Adequate control can be achieved in many ways. The question of adequate controls is highly subjective and involves a balance between costs of control versus an assessment as to the probabilities of loss due to error, omission and fraud.

### **SYSTEMS AUDITABILITY AND CONTROL (SAC)**

10.32 SAC is the largest study ever sponsored by the IIA Research Foundation. Mr. Price Waterhouse was the Project Researcher. The study was intended to serve auditors, data processing professionals, and management, both in the United States and around the world, by compiling an encyclopedia of the current body of knowledge. Research was conducted at the world's most progressive organizations, using a form of hypotheses testing. First, a draft report was written, based upon an extensive literature search and a plenary conference of experts. It was then field-tested at forty leading organizations from around the world. To supplement and support the field-site research, a mail survey was sent to the internal auditors at an additional 371 organizations; a 73% response rate was achieved. The study was organized into twelve modules, with "focus boxes" to highlight the technical issues, as well as appropriate case studies.

- 10.33 The major conclusions from the study are in the *Executive Summary*. The SAC researchers concluded that compatibility of information systems with organizational objectives is management's primary concern, that management is placing greater emphasis on internal controls, and that data security and contingency planning are top management control concerns. They also concluded that changing technology provides new control and audit opportunities, and that internal auditors are providing greater support to executive and information systems management. Internal auditors reported improved system controls, identified key systems areas for improved controls and indicated that they planned to increase coverage of information technology components. None of these conclusions should surprise any auditor who has kept current with the literature.
- 10.34 The *Audit and Control Environment* module addresses the principles of auditing at the conceptual level; it emphasizes control issues, auditing techniques and major changes since the original 1977 SAC study. *Using Information Technology in Auditing* is all about using the computer to assist the auditor. It covers specific audit techniques, electronic work-papers and audit support packages.
- 10.35 The heart of the SAC research is to be found in the modules whose titles parallel the nomenclature of the auditor's assignments and audit objectives. Managing and controlling physical computer assets and systems software is addressed in *Managing Computer Resources*. In *Managing Information and Developing Systems*, the creation and maintenance of business data systems, strategic systems planning, data architecture, systems engineering and audit roles in systems development are all discussed. *Business Systems* cover application systems, including guidelines for implementing and auditing software controls, with practical examples across industries. In the *End-User and Sectional Computing* module, everything that is different about these systems is described. *Telecommunications* cover voice, data and image transmission. The *Security* module addresses access controls and the role of the Security Officer.
- 10.36 *Contingency Planning* discusses preparedness to recover from all disruptions or loss of systems, communications or data. The time required to consult the applicable module, before constructing an audit programme and beginning the audit, would be time well spent, even for the more experienced auditor.
- 10.37 The *Emerging Technologies* module includes knowledge-based systems, voice recognition/response, image/pattern recognition, processing and storage trends, new approaches in systems design and development and emerging technologies in auditing. Since these technologies are not yet established, audit and control guidance cannot be as firmly grounded as it is in the other modules. The *Index* is the twelfth module
- 10.38 In 1994, *Advanced Technology Supplement* was published. It includes topics such as client/server architecture and implementation, LANs, EDI, Business Process Reengineering, Private Branch Exchanges and E-mail. In addition, a client / server implementation management case study was provided in the 1994 update.
- 10.39 Every audit organization should ensure that the SAC study is in their reference library, so that it is always available to their auditors, to use as needed.

## 11 Responsibilities of Auditors

- 11.1 The concept of accountability for public resources is the key in our governing processes. Legislators, other Government officials, and the public want to know whether:
- Government resources are managed properly and used in compliance with laws and regulations,
  - Government programmes are achieving their objectives and desired outcomes, and
  - Government services are being provided efficiently, economically, and effectively. Chief Executive Officers of these organizations are accountable to elected legislative bodies and the public. Auditors of these organisations, when they adhere to Generally Accepted Audit Standards (GAAS) provide reports that enhance the credibility and reliability of the information that is reported by or obtained from officials of the audited organization.
- 11.2 In discharging their professional responsibilities, auditors need to observe the principles of serving the public interest and maintaining the highest degree of integrity, objectivity, and independence. The public interest is defined as the collective well-being of the community of people and organisations for which the auditors serve.
- 11.3 These principles are fundamental to the responsibilities of auditors. Auditors should act in a way that will serve the public interest, honor the public trust, and uphold their professionalism. A distinguishing mark of a profession is acceptance of its responsibility to the public. This responsibility is critical when auditing in the Government environment.
- 11.4 Auditors need to make decisions that are consistent with the public interest in the programme or activity under audit. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited organization, various levels of Government, and others who rely on the objectivity and independence of the auditors. In resolving those conflicts, auditors are responsible for acting with integrity, guided by the precept that when auditors fulfill their responsibilities to the public, these individuals' and organizations' interests are best served.
- 11.5 To maintain and broaden public confidence, auditors need to perform all professional responsibilities with a highest degree of integrity. Auditors need to be professional, objective, fact-based, non-partisan, and non-ideological in their relationship with audited organisations and users of the auditors' reports. Auditors should be honest and candid with the audited organization and users of the auditors' work in the conduct of their work, within the constraints of the audited organization's confidentiality laws, rules or policies. Auditors need to be prudent in the use of information acquired in the course of their duties. They should not use such information for any personal gain or in any manner that would be detrimental to the legitimate and ethical objectives of the audited organization.
- 11.6 Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or of principle. Integrity requires auditors' subordination to observe both

the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment. Integrity also requires auditors to observe the principles of objectivity and independence.

- 11.7 Auditors should be objective and free of conflicts of interest in discharging their professional responsibilities. Auditors are also responsible for being independent in fact and appearance when providing services. Objectivity is a state of mind that requires auditors to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may in fact or appearance impair auditors' objectivity in performing the audit or attestation engagement. The maintenance of objectivity and independence requires continuing assessment of relationships with the audited organisations in the context of the auditors' responsibility.
- 11.8 In applying standard audit practices and procedures, auditors are responsible for using professional judgment when establishing scope and methodologies for their work, determining the tests and procedures to be performed, conducting the work, and reporting the results. Auditors need to maintain integrity and objectivity when doing their work to make decisions that are consistent with the broader public interest in the organisations or activity under review. When reporting on the results of their work, auditors are responsible for disclosing all material or significant facts known to them which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal improper or unlawful practices.

## 12 Ethics for Auditors

- 12.1 In all parts of society, there is an imminent need for credibility. In order to sustain public confidence, the conduct of auditors should be above suspicion and reproach. Integrity is the core value which lays the foundation for defining framework and code of ethics.
- 12.2 An auditor is expected to conduct himself in a manner which is not derogatory to the profession. It is important for upholding the dignity and prestige of the profession. The Chartered Accountants Act defines different forms of behavior which are considered improper and are classified as misconduct in two separate schedules to the Act. The CAG who is the head of Supreme Audit Institution of India derives his duties and powers from the Constitution of India and CAG's (Duties, Powers, and Conditions of Service) Act, 1971. The CAG has the responsibility to ensure that all its auditors acquaint themselves with the values and principles contained in the conduct rules for government servants in India and they act accordingly. Director of State Audit, GoAP appointed under the Andhra Pradesh Audit Act, 1989 is responsible for upholding and continuously maintaining the conducive environment to his auditors to achieve their objectives and be a role model. Provisions of AP Civil Services (Conduct) Rules 1964 are applicable in respect of auditors in regard to failure in discharge of their duties.
- 12.3 The independence, powers and responsibilities of the public sector auditor place high ethical demands on the auditor. All the auditors are required to acquaint themselves with the applicable values and principles under their applicable code of ethics and act accordingly. A code of ethics plays an important role in promotion of trust and confidence in auditors. **Integrity, independence, objectivity, confidentiality, and competence determine ethical requirements.** The legislative/executive authority, general public, and auditee should be fully assured of the fairness and impartiality of auditor's work.

### Integrity

- 12.4 Auditors have a duty to adhere to highest standards of behaviour in regard to honesty and candidness in their relations with personnel working with auditee. They are required to be independent, objective, and make decisions with the public interest in mind while being absolutely honest in discharge of their responsibilities.

### Independence, Objectivity and Impartiality

- 12.5 Independence from personal or outside interest groups is an indispensable pre-requisite for auditors. While being independent, auditor should strive to be objective in dealing with the task on hand. Auditor should be free from individual prejudices, personal or financial dealings which may cause undue influence in their judgment. They should not involve in any dealings either with the auditee or any other related party which may result in vested interest, thereby impairing their independence and impartiality.

### Political Neutrality

- 12.6 Auditor is expected to maintain neutrality as he works very closely with legislative authorities, executives and other empowered authorities appointed to review reports of auditors.

## Conflict of Interest

- 12.7 Auditors must ensure that their advice does not include management responsibilities or powers, otherwise that may lead to conflict of interest in provision of services. They should not accept any gifts or gratuities which may be perceived as influencing their independence and integrity.
- 12.8 Auditors should always avoid misuse of their position for personal purposes which would expose them to risk of corruption and impair their objectivity and independence.

### What is conflict of interest?

- 12.9 Most of the time, when we hear the term *conflict of interest*, it is in connection with a public servant or judge. This is because people in positions of power are more likely to face charges of a conflict of interest at some point in their career. Many of the decisions they make must not be tainted by the possibility of favouritism or personal gain. It is not unusual for public officials to divest themselves of anything which could even be construed as a conflict of interest, including stocks, pensions, board memberships and former clients.
- 12.10 In order to understand what a conflict of interest means, it may help to examine what we mean by 'interest'. Almost all of us have personal or professional interests, whether it is a hobby, an investment in a business or a desire to help our friends and family members succeed in their own interests.
- 12.11 But people placed in positions of judgment or power in government must take extra steps to insure that their private interests do not compete with their professional duties. A conflict of interest may arise, for example, if Chairman of public sector entity awards a lucrative contract to a company owned by his brother. It would not be illegal to award such a contract to the best qualified company, even if that company were indeed owned by a relative, but the Chairman himself could not be part of the decision making process. There would be an obvious conflict of interest, because the Chairman's own family would benefit financially from his position of power.
- 12.12 Definitions of *conflict of interest* are often spelt out in contracts or employee manuals. Enforcement of these agreements, however, is not always easy. Elected officials and judges usually fill out extensive disclosure forms which would reveal a potential conflict of interest, but private sector executives may not be so forthcoming. Often a conflict of interest may not be revealed until the decision has already been made or the contract has been approved. Revealing some personal interests may be more of an ethical responsibility than a legal obligation.
- 12.13 Because there are some legal gray areas surrounding conflict of interest, it often falls on the official or executive to recognize potential problems before they interfere with his duties. When Mr. Dick Cheney was elected Vice President in 2000, for example, he first had to resign from his own company, M/s. Halliburton. If he had kept his financial interest in that company, any future government contracts might have appeared to be a conflict of interest. Because M/s. Halliburton did receive lucrative government contracts for war reparations, Mr. Cheney could still be accused of a conflict of interest, but he can demonstrate he has nothing to gain financially from the awarding of those contracts.

- 12.14 One Minister was earlier engaged in private practice as a Lawyer. Now, if a proposal involving financial benefit from the Government is put up before him for a decision where the counter party was earlier his client; it would give rise to a conflict of interest impairing his judgment, wherein the best course of action for him would be to abstain from exercising decision and declare his interest in the proposal and leave the decision making process to someone else.

**Professional Secrecy**

- 12.15 Auditor is expected to maintain utmost secrecy and should not disclose information obtained in course of the audit process to any third party.

**Competence**

- 12.16 Auditors should know and adopt applicable accounting, auditing, and financial management standards, and should avoid any work which they are not competent to undertake.

**AUDITING AND ASSURANCE STANDARDS****ICAI - Auditing and Assurance Standards**

AAS 1 - Basic Principles Governing an Audit

AAS 2 - Objective and Scope of the Audit of Financial Statements

AAS 3 - Documentation

AAS 4 - The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (Revised)

AAS 5 - Audit Evidence

AAS 6 - Risk Assessment and Internal Control (Revised)

AAS 7 - Relying Upon the Work of an Internal Auditor

AAS 8 - Audit Planning

AAS 9 - Using the Work of an Expert

AAS 10 - Using the Work of Another Auditor

AAS 11 - Representations by Management

AAS 12 - Responsibility of Joint Auditors

AAS 13 - Audit Materiality

AAS 14 - Analytical Procedures

AAS 15 - Audit Sampling

AAS 16 - Going Concern

AAS 17 - Quality Control for Audit Work

AAS 18 - Audit of Accounting Estimates

AAS 19 - Subsequent Events

AAS 20 - Knowledge of the Business

AAS 21 - Consideration of Laws and Regulations in an Audit of Financial Statements

AAS 22 - Initial Engagements - Opening Balances

AAS 24 - Audit Consideration relating to Entities Using Service Organisations

AAS 25 - Comparatives

AAS 26 - Terms of Audit Engagements

AAS 27 - Communications of Audit Matters with those Charged with Governance

AAS 28 - The Auditor's Report on Financial Statements

AAS 29 - Auditing in a Computer Information Systems Environment

AAS 30 - External Confirmation

AAS 31 - Engagements to Compile Financial Information

AAS 32 - Engagements to Perform Agreed Upon Procedures regarding Financial Information

**Source: [www.icaai.org](http://www.icaai.org)**

## 2 Annexure

### **CAG - AUDITING STANDARDS**

#### **CHAPTER - I**

##### **Introduction**

- Mandate
- Auditing Standards
- Basic Postulates

#### **CHAPTER - II**

##### **General Standards in Government Auditing**

- Introductory
- Independence
- Competence
- Due Care
- Quality Assurance Review
- Other General Standards for Audit Institutions
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#### **CHAPTER - III**

##### **Field Standards in Government Auditing**

- Planning
- Supervision and Review
- Study and Evaluation of Internal Control
- Compliance with Applicable Laws and Regulations
- Audit Evidence
- Analysis of Financial Statements

#### **CHAPTER - IV**

##### **Reporting Standards in Government Auditing**

- Follow up of Audit Reports
- Report distribution
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- Value for money audit
- Audit of financial statements
- Non-compliance and Abuse
- Internal Controls
- Fraud, illegal act and other non-compliance
- Deficiencies in Internal Control
- Form and content of audit opinion and report

## CHAPTER - 1

### INTRODUCTION

#### 1. Mandate

1.1 The Comptroller and Auditor General of India (CAG), who is the head of the Supreme Audit Institution of India (SAI) derives his duties and powers mainly from Articles 149 to 151 of the Constitution of India and the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. Under the provisions of the Constitution of India and the Act, the CAG is the sole auditor of the accounts of the Central (Union) Government and the State Governments. CAG is also responsible for the audit of local bodies (i.e. panchayati raj institutions and urban local bodies) under the provisions of some of the State Acts and provides technical and administrative guidance for accounting and audit functions in all States as per orders issued by Ministry of Finance, Government of India. The reports of the CAG relating to the accounts of the Union/States are submitted to the President/Governor for being laid before the Parliament/State Legislature. The CAG is also responsible for ensuring a uniform policy of accounting and audit in the government sector as a whole. The Act authorises the CAG to lay down for the guidance of the government departments, the general principles of government accounting and the broad principles in regard to audit of receipts and expenditure.

1.2 The mandate of CAG includes audit of:

- Receipts and expenditure from the Consolidated Fund of India and of the States and Union Territories.
- Transactions relating to the Contingency Funds and Public Accounts.
- Trading, manufacturing, profit and loss accounts and balance sheets, and other subsidiary accounts kept in any government department.
- Accounts of stores and stock kept in government offices or departments.
- Government companies as per the provisions of the Companies Act, 1956.
- Corporations established by or under laws made by Parliament
- Authorities and bodies substantially financed from the Consolidated Funds.
- Any Body or Authority even though not substantially financed from the Consolidated Fund, the audit of which may be entrusted to SAI.
- Grants and loans given by Government to Bodies and Authorities for specific purposes.
- Panchayati Raj Institutions and Urban Local Bodies

1.3 The audit mandate also provides for the periodic inspection of records and accounts of the government departments to supplement the audit of vouchers and sanctions that are with the accounts compiling offices.

## 2. Auditing Standards

- 2.1 Auditing Standards prescribe the norms of principles and practices, which the auditors are expected to follow in the conduct of audit. They provide minimum guidance to the auditors that help determine the extent of auditing steps and procedures that should be applied in the audit and constitute the criteria or yardstick against which the quality of audit results are evaluated.
- 2.2 The auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI) have been suitably adapted with due consideration of the Constitution of India, relevant statutes and rules for the auditing standards for the Supreme Audit Institution of India (SAI).
- 2.3 The auditing standards consist of four parts:
  - (a) Basic postulates
  - (b) General standards
  - (c) Field standards
  - (d) Reporting standards
- 2.4 While basic postulates are discussed in this chapter, the rest are discussed in separate chapters, (II), (III) and (IV).

## 3. Basic Postulates

- 3.1 The basic postulates for auditing standards are basic assumptions, consistent premises, logical principles and requirements which help in developing auditing standards and serve the auditors in forming their opinions and reports, particularly in cases where no specific standards apply.
- 3.2 The basic postulates are:
  - a) The SAI should comply with the INTOSAI auditing standards in all matters that are deemed material.
  - b) The SAI should apply its own judgement to the diverse situations that arise in the course of government auditing.
  - c) With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a need for the accountability process to be in place and operating effectively.
  - d) Development of adequate information, control, evaluation and reporting systems within the Government will facilitate the accountability process; Management is responsible for correctness and sufficiency of the form and content of the financial reports and other information.
  - e) Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the Government, and audited entities should develop specific and measurable objectives and performance targets.
  - f) Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations.

- g) The existence of an adequate system of internal control minimises the risk of errors and irregularities.
- h) Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit.
- i) All audit activities should be within the SAI's audit mandate.
- j) SAIs should work towards improving techniques for auditing the validity of performance measures.
- k) SAIs should avoid conflict of interest between the auditor and the entity under audit.

4. The following paragraphs elaborate on the above basic postulates for auditing standards.

**4.1 The SAI should comply with the INTOSAI Auditing Standards in all matters that are deemed material.**

- The SAI should establish a policy by which standards followed for various types of work carried out by the SAI ensures that the work and products are of high quality.
- In general terms, a matter may be judged material, if knowledge of it would be likely to influence the user of the audit report.
- Materiality is often considered in terms of value but the inherent nature of an item or a group of items may also render a matter material, as for example, mandatory disclosure requirements of statutes regardless of the amounts involved.
- In addition to materiality by value and by nature, a matter may be material because of the context in which it occurs, for example, considering an item relating to:
  - (a) The overall view given to the financial information;
  - (b) The total of which it forms a part;
  - (c) Associated terms;
  - (d) The corresponding amount in previous years.

**4.2 The SAI applies its own judgment to the diverse situations that arise in the course of government auditing.**

- It would be impracticable to establish a code of rules, sufficiently elaborate, to cater to all situations and circumstances which an auditor might encounter. In the observance of auditing standards, therefore, the auditor must exercise his judgement in determining the auditing procedures necessary in the circumstances, to afford a reasonable basis for his opinion and the content of his report.
- In regard to audit of financial statements of public sector enterprises, the SAI audit objectives may be akin to the objectives of audit in private sector. Correspondingly, for the audit of financial statements of the corporate sector, the Government Auditor may apply standard audit practices issued by the Institute of Chartered Accountants.

**4.3 With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a need for the accountability process to be in place and operating efficiently.**

- The broad aim of SAI is to safeguard the financial interests of the State and to uphold and promote public accountability, and sound and economical financial management practices.
- Audit assists the legislatures in the exercise of financial control over the executive.
- The executive, and not the audit, is responsible for enforcing economy and efficiency in the expenditure of public money. It is, however, the duty of audit to bring to light wastefulness, failures, system weaknesses, deficiencies and the circumstances leading to infructuous expenditure.
- The entities managing public resources include commercial undertaking, e.g., entities established by statute or public sector undertakings established under the Companies Act in which the Government has a controlling interest. Irrespective of the manner in which they are constituted, their functions, degree of autonomy or funding arrangements, such entities are ultimately accountable to the supreme law making body.

**4.4 Development of adequate information control, evaluation and reporting systems within the Government will facilitate the accountability process.**

- Management of the audited entity is responsible for correctness and sufficiency of the form and content of the financial reports and other information.
- As a special arrangement dictated by mandate, the Accounts and Entitlement offices working under the SAI compile the financial reports of the State Governments based on the initial accounts rendered to them by the respective State Government agencies. Such offices also, in some States, maintain the accounts of long term loans given to Government servants, the Provident Fund accounts and the Entitlement accounts of Government personnel. Also, the SAI advises the President of India on the form of Government accounts.

**4.5 Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the Government and audited entities should develop specific and measurable objectives and performance targets.**

- SAI shall advise the Government for the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of Government. The audited entities should develop specific and measurable objectives and performance targets.

**4.6 Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations.**

- The auditor often expresses an opinion on the performance of an auditee based on comparison of the information given in the financial statements over a period of time. Consistency in following the accounting standards will facilitate expression of a fair opinion.

**4.7 The existence of an adequate system of internal control minimises the risk of errors and irregularities.**

- It is the responsibility of audited entity to develop adequate internal control systems to

protect its resources. It is also its obligation to ensure that controls are in place and functioning to help ensure that applicable statutes and regulations are complied with and that probity and propriety are observed in decision making. However, this does not relieve the auditor from submitting proposals and recommendations to the audited entity where controls are found to be inadequate or missing.

- Auditors should make use of the INTOSAI guidelines on evaluation of internal controls and reporting thereon.

#### **4.8 Legislative enactment exists to facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit.**

- An auditor has a right to inspect any office of accounts of the Union or of a State, to require that any books, papers and other documents which are relevant to the transactions to be sent to him and to put such questions to the persons in charge of the office or make such observations and call for such information as he may require for the preparation of any account or report which it is his duty to prepare.
- Information about an audited entity acquired in the course of the auditor's work must not be used for purposes outside the scope of audit and formation of an opinion or in reporting not in accordance with the auditor's responsibility. It is essential that audit must maintain confidentiality regarding audit matters and the information obtained while carrying out audit engagements.

#### **4.9 All audit activities shall be within the mandate of SAI**

- The term 'Audit' includes Financial Audit, Regularity Audit and Performance Audit. In pursuance of the Constitutional responsibility, the SAI is empowered to decide the nature, scope, extent and quantum of audit including the form and content of the audit reports in respect of audit to be conducted by him or on his behalf.

#### **4.10 SAI should work towards improving techniques for auditing the validity of performance measures.**

- The expanding audit role of the auditors will require them to improve and develop new techniques and methodologies to assess whether reasonable and valid performance measures are used by the audited entity. Wherever practicable, the auditors should acquaint themselves with techniques and methodologies of other relevant disciplines.

#### **4.11 SAI should avoid conflict of interest between the auditor and the entity under audit.**

- The SAI performs its role by carrying out audits of various public sector entities and by reporting the results in conformity with Reporting Standards. To fulfill this role, the SAI needs to maintain its independence and objectivity. The application of appropriate general auditing standards assists the SAI in satisfying these requirements.

## CHAPTER – II

### GENERAL STANDARDS IN GOVERNMENT AUDITING

#### 1. Introductory

1.1 This section deals with general standards in government auditing. The general auditing standards describe the qualifications of the auditor and the auditing institution so that they may carry out the tasks related to field and reporting standards in a competent and effective manner.

1.2 The general auditing standards apply both to the auditors and the audit institutions. They are:

- i) The auditor and the audit institutions must be independent.
- ii) The auditor and the audit institutions must possess the required competence.
- iii) The auditor and the audit institutions must exercise due care and concern in complying with these auditing standards.

This embraces due care in planning, specifying, gathering and evaluating evidence, and in reporting findings, conclusions and recommendations.

1.3 The general auditing standards for the audit institutions are that they should adopt policies and procedures to

- i) Recruit personnel with suitable qualifications.
- ii) Develop and train employees to enable them to perform their tasks effectively, and to define the basis for the advancement of auditors and other staff.
- iii) Prepare manuals and other written guidance notes and instructions concerning the conduct of audits.
- iv) Support the skills and experience available within the audit institutions, and identify the skills which are absent; provide a good distribution of skills to auditing tasks and assign a sufficient number of persons for the audit; and have proper planning and supervision to achieve its goals at the required level of due care and concern.
- v) Review the efficiency and effectiveness of internal standards and procedures.

#### 2. Independence

**2.1 The general standards for the auditor and the audit institutions include independence from the legislature, independence from the executive, and independence from the audited entity.**

2.2 Whatever the form of government, the need for independence and objectivity in audit is vital. An adequate degree of independence from both the legislature and the executive branch of government are essential to the conduct of audit and to the credibility of its results.

2.3 The legislature is one of the main users of audit services. It is from the Constitution of India that SAI derives his mandate, and a frequent feature of the audit function is its reporting to the legislature. The SAI works closely with the legislature, including with committees empowered by the legislature to consider audit reports.

- 2.4 The SAI may give members of the legislature factual briefings on audit reports, but it is important that the SAI maintains his independence from political influence, in order to preserve an impartial approach to its audit responsibilities. This implies that the SAI not be responsive, nor give the appearance of being responsive, to the wishes of particular political interests.
- 2.5 While the SAI must observe the laws enacted by the legislature, adequate independence requires that it not otherwise be subject to direction by the legislature in the programming, planning and conduct of audits. The SAI needs freedom to set priorities and programme its work in accordance with his mandate and adopt methodologies appropriate to the audits to be undertaken.
- 2.6 It is essential that the legislature provide the SAI with sufficient resources, for which the SAI is accountable, as well as for the effective exercise of his mandate. While the expenditure of SAI's office is charged to the Consolidated Fund, the expenditure on the other offices of the Indian Audit and Accounts Department is subject to the vote of the central legislature.
- 2.7 The executive branch of Government and the SAI may have some common interests in the promotion of public accountability. But the essential relationship with the executive is that of an external auditor. As such the SAI's reports assist the executive by drawing attention to deficiencies in administration and recommending improvements. Care should be taken to avoid participation in the executive's functions of the kind that would militate against the SAI's independence and objectivity in the discharge of his mandate.
- 2.8 It is important for the independence of the SAI that there be no power of direction by the executive in relation to the SAI's performance of his mandate. The SAI is not be obliged to carry out, modify or refrain from carrying out, an audit or suppress or modify audit findings, conclusions and recommendations.
- 2.9 A degree of co-operation between the SAI and the executive is desirable in some areas. The SAI should be ready to advise the executive in such matters as accounting standards and policies and the form of financial statements. The SAI must ensure that in giving such advice, it avoids any explicit or implied commitment that would impair the independent exercise of his audit mandate.
- 2.10 Maintenance of the SAI's independence does not preclude requests to the SAI by the executive proposing matters for audit. But if it is to enjoy adequate independence, the SAI must be able to decline any such request. It is fundamental to the concept of SAI independence that decisions as to the audit tasks comprising the programme should rest finally with the SAI.
- 2.11 A sensitive area in relationships between the SAI and the executive concerns the provision of resources to the SAI. In varying degrees, reflecting constitutional and institutional differences, arrangements for the SAI's resource provision may be related to the executive branch of Government's financial situation and general expenditure policies. As against that, effective promotion of public accountability requires that the SAI be provided with sufficient resources to enable it to discharge its responsibilities in a reasonable manner.
- 2.12 Any imposition of resource or other restrictions by the executive, which would constrain the SAI's exercise of its mandate, would be an appropriate matter for report by the SAI to the legislature.

- 2.13 The legal mandate in the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 provides for full and free access for the CAG and his auditors to all premises and records relevant to audited entities and their operations and provides adequate powers to the CAG to obtain relevant information from persons or entities possessing it.
- 2.14 By legal provision and accepted convention, the executive permits access to the SAI of sensitive information, which is necessary and relevant to the discharge of the SAI's responsibilities.
- 2.15 In order that the SAI not only exercise his functions independently of the executive but also be seen to do so, it is important that his mandate and his independent status be well understood in the community. The SAI should, as appropriate opportunities arise, undertake an educational role in that regard.
- 2.16 The SAI's functional independence need not preclude arrangements with executive entities in regard to the SAI's administration in matters such as industrial relations, personnel management, property management or common purchasing of equipment and stores, though executive entities should not be in a position to take decisions that would jeopardise the SAI's independence in discharging his mandate.
- 2.17 The SAI must remain independent from audited entities. The audit department under the SAI should, however, seek to create among audited entities an understanding of its role and function, with a view to maintaining amicable relationships with them. Good relationships can help the SAI to obtain information freely and frankly and to conduct discussions in an atmosphere of mutual respect and understanding. In this spirit, the SAI, while retaining his independence, can agree to be associated with reforms which are planned by the administration in areas such as public accounts or financial legislation or agree to be consulted about the preparation of draft laws or rules affecting his competence or his authority. In these cases, it is not however, a matter of the SAI interfering in administrative management but a matter of co-operating with certain administrative services by giving them technical assistance or by putting SAI's financial management experience at their disposition.
- 2.18 In contrast to private sector audit, where the auditor's agreed task is specified in an engagement letter, the audited entity is not in a client relationship with the SAI. The SAI has to discharge his mandate freely and impartially, taking management views into consideration in forming audit opinions, conclusions and recommendations, but owing no responsibility to the management of the audited entity for the scope or nature of the audits undertaken.
- 2.19 The SAI should not participate in the management or operations of an audited entity. Audit personnel should not become members of management committees and, if audit advice is to be given, it should be conveyed as audit advice or recommendation and acknowledged clearly as such.
- 2.20 Any SAI personnel having close affiliations with the management of an audited entity, such as social, kinship or other relationship conducive to a lessening of objectivity should not be assigned to audit that entity.
- 2.21 Personnel of the SAI should not become involved in instructing personnel of an audited entity as to their duties. In those instances, where the SAI decides to establish a resident office at the

audited entity with the purpose of facilitating the ongoing review of its operations, programmes and activities, SAI personnel should not engage in any decision making or approval process which is considered the auditee's management responsibility.

2.22 The SAI may co-operate with academic institutions and enter formal relationships with professional bodies, provided the relationships do not inhibit its independence and objectivity, in order to avail of the advice of experienced members of the profession at large.

### **3. Competence**

#### **3.1 The auditor and the SAI must possess the required competence.**

3.2 The following paragraphs explain competence as an auditing standard:

3.2.1 The mandate of a SAI generally imposes a duty of forming and reporting audit opinions, conclusions and recommendations.

3.2.2 Discussions within the audit department promote the objectivity and authority of opinions and decisions.

3.2.3 Since the duties and responsibilities thus borne by the SAI are crucial to the concept of public accountability, the SAI must apply to his audits, methodologies and practices of the highest quality. It is incumbent upon it to formulate procedures to secure effective exercise of its responsibilities for audit reports, unimpaired by less than full adherence by personnel or external experts to its standards, planning procedures, methodologies and supervision.

3.2.4 The audit department needs to command the range of skills and experience necessary for effective discharge of the audit mandate. Whatever the nature of the audits to be undertaken under that mandate, persons whose education and experience is commensurate with the nature, scope and complexities of the audit task should carry out the audit work. The audit department should equip itself with the full range of up-to-date audit methodologies, including systems-based techniques, analytical review methods, statistical sampling, and audit of automated information systems.

3.2.5 Since the nature of audit mandate is wide and discretionary and leaves the SAI discretion in the frequency of audits to be carried out and the nature of reports to be provided, there is a high standard of management expected within the audit department.

### **4. Due Care**

#### **4.1 The general standards for the auditor and the SAI include due care in specifying, gathering and evaluating evidence, and in reporting findings, conclusions and recommendations.**

4.2 The following paragraphs explain due care as an auditing standard:

4.2.1 The SAI must be, and be seen to be, objective in its audit of entities and public enterprises. It should be fair in its evaluations and in its reporting the outcome of audits.

4.2.2 Performance and exercise of technical skill should be of a quality appropriate to the complexities of a particular audit. Auditors need to be alert for situations, control weaknesses, inadequacies

in record keeping, errors and unusual transactions or results, which could be indicative of fraud, improper, or unlawful expenditure, unauthorised operations, waste, inefficiency or lack of probity.

- 4.2.3 Where an authorised or recognised entity sets standards or guidelines for accounting and reporting by public enterprises, the SAI may use such guidelines in the course of his examination. The Accounting Standards and Standard Audit Practices issued by the Institute of Chartered Accountants of India (ICAI) should be kept in view by SAI while carrying out the audit of companies registered under the Companies Act 1956.
- 4.2.4 If the SAI employs external experts as consultants, he must exercise due care to assure him of the consultants' competence and aptitude for the particular tasks involved. This standard applies also where outside auditors are engaged on contract with the SAI. In addition, care must be taken to ensure that audit contracts include adequate provision for the SAI to determine the planning, the audit scope, the performing, and the reporting on the audit.
- 4.2.5 Should the SAI, in the performance of his functions, need to seek advice from specialists external to the SAI, the standards for exercise of due care in such arrangements have a bearing also on the maintenance of quality of performance. Obtaining advice from an external expert does not relieve the audit department of the responsibility for the opinions formed or conclusions reached on the audit task.
- 4.2.6 When the audit department uses the work of another auditor(s), it must apply adequate procedures to provide assurance that the other auditor(s) has exercised due care and complied with relevant auditing standards, and may review the work of the other auditor(s) to satisfy itself as to the quality of that work.
- 4.2.7 Information about an audited entity acquired in the course of the auditor's work must not be used for purposes outside the scope of an audit and the formation of an opinion or in reporting in accordance with the auditor's responsibilities. It is essential that the audit department maintain confidentiality regarding audit matters and information arising from its audit task. However, the SAI should report offences against the law to proper prosecuting authorities.

## **5. Quality Assurance Review**

- 5.1 SAI should have an appropriate quality assurance system in place.
- 5.2 The following paragraphs explain quality assurance reviews as an auditing standard:
- 5.2.1 Because of the importance of ensuring a high standard of work by the audit department, it should pay particular attention to quality assurance programmes in order to improve audit performance and results. The benefits to be derived from such programmes make it essential for appropriate resources to be available for this purpose. It is important that the use of these resources be matched against the benefits to be obtained.
- 5.2.2 The SAI should establish systems and procedures to:
- Confirm that internal quality assurance processes have operated satisfactorily;
  - Ensure the quality of the audit report; and
  - Secure improvements and avoid repetition of weaknesses.

- 5.2.3 As a further means of ensuring quality of performance, additional to the review of audit activity by personnel having line responsibility for the audits concerned, it is desirable for the audit departments to establish their own quality assurance arrangements. That is, planning, conduct and reporting in relation to a sample of audits may be reviewed in depth by suitably qualified SAI personnel not involved in those audits, in consultation with the relevant audit line management regarding the outcome of the internal quality assurance arrangements and periodic reporting to the SAI's top management.
- 5.2.4 It is appropriate for audit institutions to institute their own internal audit function with a wide charter to assist the audit department to achieve effective management of its own operations and sustain the quality of its performance.
- 5.2.5 The quality of the work done by the audit department can be enhanced by strengthening internal review and by the independent appraisal of its work.

## **6. Other General Standards for Audit Institutions**

- 6.1 The SAI should adopt policies and procedures to recruit personnel with suitable qualifications and train them professionally.
- 6.1.1 SAI personnel should possess suitable qualifications and be equipped with appropriate training and experience. The SAI should establish, and regularly review, minimum training requirements for the appointment of auditors at each level within the organisation.
- 6.2 The SAI should adopt policies and procedures to develop and train SAI employees to enable them to perform their task effectively and to define the basis for the advancement of auditors and other staff.**
- 6.2.1 The following paragraphs explain training and development as an auditing standard:
- 6.2.2 The SAI should take adequate steps to provide for continuing professional development of its personnel, including, as appropriate, provision of in-house training and encouragement of attendance at external courses.
- 6.2.3 The SAI should identify professional development needs of its personnel.
- 6.2.4 The SAI should establish and regularly review criteria, including educational requirements, for the advancement of auditors and other staff of the SAI.
- 6.2.5 The SAI should also establish and maintain policies and procedures for the professional development of audit staff regarding the audit techniques and methodologies applicable to the range of audits it undertakes.
- 6.2.6 SAI personnel should have a good understanding of the government environment, including such aspects as the role of the legislature, the legal and institutional arrangements governing the operations of the executive and the charters of public enterprises. Likewise, trained audit staff must possess an adequate knowledge of the SAI's auditing standards, policies, procedures and practices.
- 6.2.7 Audit of financial systems, accounting records and financial statements requires training in accounting and related disciplines as well as knowledge of applicable legislation and executive

orders affecting the accountability of the audited entity. Further, the conduct of performance audits may require, in addition to the above, training in such areas as administration, management, economics and the social sciences.

6.2.8 The SAI should encourage his personnel to become members of a professional body relevant to their work and to participate in that body's activities.

**6.3 The SAI should adopt policies and procedures to prepare manuals and other written guidance and instructions concerning the conduct of audits.**

6.3.1 The following paragraph explains written guidance as an auditing standard:

6.3.2 Communication to staff of the SAI by means of circulars containing guidance, and the maintenance of an up-to-date audit manual setting out the SAI's policies, standards and practices, is important in maintaining the quality of audits.

**6.4 The SAI should adopt policies and procedures to support the skills and experience available within the SAI and identify those skills which are absent; provide a good distribution of skills to auditing tasks and a sufficient number of persons for the audit; and have proper planning and supervision to achieve its goals at the required level with due care and concern.**

6.4.1 The following paragraphs explain the use of skills as an auditing standard:

6.4.2 Resources required for undertaking each audit need to be assessed so that suitably skilled staff may be assigned to the work and a control placed on staff resources to be applied to the audit.

6.4.3 The extent to which academic attainments should be related specifically to the audit task varies with the type of auditing undertaken. It is not necessary that each auditor possess competence in all aspects of the audit mandate. However, policies and procedures governing the assignment of personnel to audit tasks should aim at deploying personnel who have the auditing skills required by the nature of the audit task so that the team involved on a particular audit collectively possesses the necessary skills and expertise.

6.4.4 It should be open to the SAI to acquire specialised skills from external sources if the successful carrying out of an audit so requires in order that the audit findings, conclusions and recommendations are perceptive and soundly based and reflect an adequate understanding of the subject area of the audit. It is for the audit institution to judge, in its particular circumstances, to what extent its requirements are best met by in-house expertise as against employment of outside experts.

6.4.5 Policies and procedures governing supervision of audits are important factors in the performance of the SAI's role at an appropriate level of competence. The SAI should ensure that audits are planned and supervised by auditors who are competent, knowledgeable in the SAI's standards and methodologies, and equipped with an understanding of the specialties and peculiarities of the environment.

6.4.6 Where the SAI's mandate includes the audit of financial statements which cover the executive branch of government as a whole, the audit teams deployed should be equipped to undertake a coordinated evaluation of departmental accounting systems, as well as of central agency co-ordination arrangements and control mechanisms. Teams will require knowledge of the relevant governmental accounting and control systems, and an adequate expertise in the auditing techniques applied by the SAI to this type of audit.

- 6.4.7 Unless the SAI is equipped to undertake, within a reasonable time-scale, all relevant audits, including performance audits covering the whole of every audited entity's operations, criteria are needed for determining the range of audit activities which, within the audit period or cycle, will give the maximum practicable assurance regarding performance of public accountability obligations by each audited entity.
- 6.4.8 In determining the allocation of its resources among different audit activities, the SAI must give priority to any audit tasks, which must, by law, be completed within a specified time frame. Careful attention must be given to strategic planning so as to identify an appropriate order of priority for discretionary audits to be undertaken.
- 6.4.9 Assignment of priorities compatible with maintaining the quality of performance across the mandate involves exercise of the SAI's judgement in the light of available information. Maintenance of a portfolio of data pertaining to the structure, functions and operations of audited entities will assist the SAI in identifying areas of materiality and vulnerability and areas holding potential for improvements in administration.
- 6.4.10 Before each audit is undertaken, designated personnel within the SAI should give proper authorisation for its commencement. This authorisation should include a clear statement of the objectives of the audit, its scope and focus, resources to be applied to the audit in terms of skills and quantum, arrangements for reviews of progress at appropriate points, and the dates by which field work is to be completed and a report on the audit is to be provided.

## **7. Standards with ethical significance**

These standards apply to individual auditors, head of the SAI, executive officers and all individuals working for and on behalf of the SAI. The SAI has the responsibility to ensure that all its auditors acquaint themselves with the values and principles contained in the Conduct Rules for government servants in India and they act accordingly. The following audit standards have ethical significance:

- The auditor and the SAI should be independent and should avoid conflicts of interest with the audited entity on matters that may impair their independence materially.
- The auditor and the SAI must possess the required competence.
- The auditor must exercise due care and concern in complying with the auditing standards.
- The auditor should at all times maintain absolute integrity and devotion to duty.
- Auditors should not disclose information obtained in the auditing process to third parties, either orally or in writing.

## **CHAPTER - III**

### **FIELD STANDARDS IN GOVERNMENT AUDITING**

1. The purpose of field standards is to establish the criteria or overall framework for the purposeful, systematic and balanced steps or actions that the auditor has to follow. These steps and actions represent the rules of investigation that the auditor, as a seeker of audit evidence, implements to achieve a specific result.
2. The field standards establish the framework for conducting and managing audit work. They are related to the general auditing standards, which set out the basic requirements for undertaking the tasks covered by the field standards. They are also related to the reporting

standards, which cover the communication aspect of auditing, as the results from carrying out the field standards constitute the main source for the contents of the opinion or report.

3. The field standards applicable to all types of audit are:

- (a) The auditor should plan the audit in a manner, which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner.
- (b) The work of the audit staff at each level and audit phase should be properly supervised during the audit; and a senior member of the audit staff should review documented work.
- (c) The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.
- (d) In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.

In conducting performance audits, an assessment should be made of compliance with applicable laws and regulations when necessary to satisfy the audit objectives. The auditor should design the audit to provide reasonable assurance of detecting illegal acts that could significantly affect audit objectives. The auditor also should be alert to situations or transactions that could be indicative of illegal acts that may have an indirect effect on the audit results.

Any indication that an irregularity, illegal act, fraud or error may have occurred which could have a material effect on the audit should cause the auditor to extend procedures to confirm or dispel such suspicions. The regularity audit is an essential aspect of government auditing. One important objective, which this type of audit assigns to the SAI, is to make sure, by all the means put at its disposal, that the State budget and accounts are complete and valid. This will provide Parliament and other users of the audit report with assurance about the size and development of the financial obligations of the State. To achieve this objective, the SAI will examine the accounts and financial statements of the administration with a view to assuring that all operations have been correctly undertaken, completed, passed, paid and registered. The audit procedure normally results, in the absence of irregularity, in the granting of a 'discharge.'

- (e) Competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, programme, activity or function under audit.
- (f) In regularity (financial) audit and in other types of audit when applicable, auditors should analyse the financial statements to establish whether acceptable accounting standards

for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements.

#### 4. Planning

4.1 The field standards include:

**The auditor should plan the audit in a manner, which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner.**

4.2 The following paragraphs explain planning as an auditing standard.

4.2.1 The SAI should give priority to any audit tasks, which must be undertaken by law and assess priorities for discretionary areas within the SAI's mandate.

4.2.2 In planning an audit of specific auditees, the auditor should:

- (a) Identify important aspects of the environment in which the audited entity operates;
- (b) Develop an understanding of accountability relationships;
- (c) Consider the form, content and users of audit opinions, conclusions or reports;
- (d) Specify the audit objectives and the tests necessary to meet them;
- (e) Identify key management systems and controls and carry out a preliminary assessment to identify both their strengths and weaknesses;
- (f) Determine the materiality of matters to be considered;
- (g) Review the internal audit of the audited entity and its work programme;
- (h) Assess the extent of reliance that might be placed on other auditors, for example, internal audit;
- (i) Determine the most efficient and effective audit approach;
- (j) Provide for a review to determine whether appropriate action has been taken on previously reported audit findings and recommendations; and
- (k) Provide for appropriate documentation of the audit plan and for the proposed field work.

4.3 The following planning steps are normally included in an audit:

- (a) Collect information about the audited entity and its organisation in order to assess risk and to determine materiality;
- (b) Define the objective and scope of the audit;
- (c) Undertake preliminary analysis to determine the approach to be adopted and the nature and extent of enquiries to be made later;
- (d) Highlight special problems foreseen when planning the audit;

- (e) Prepare a budget and a schedule for the audit;
- (f) Identify staff requirements and a team for the audit; and
- (g) Familiarise the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary.

4.4 The SAI may revise the plan during the audit when necessary.

4.5 Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from non-compliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. If specific information comes to the auditor's attention that provides evidence concerning the existence of possible non-compliance that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether that non-compliance has occurred.

## 5. Supervision and Review

5.1 The field standards include:

**The work of the audit staff at each level and audit phase should be properly supervised during the audit, and a senior member of the audit staff should review documented work.**

5.2 The following paragraphs explain supervision and review as an auditing standard:

5.2.1 Supervision is essential to ensure the fulfillment of audit objectives and the maintenance of the quality of the audit work. Proper supervision and control is therefore necessary in all cases, regardless of the competence of individual auditors.

5.2.2 Supervision should be directed both to the substance and to the method of auditing. It involves ensuring that:

- (a) The members of the audit team have a clear and consistent understanding of the audit plan;
- (b) The audit is carried out in accordance with the auditing standards and practices of the SAI;
- (c) The audit plan and action steps specified in that plan are followed, unless a variation is authorised;
- (d) Working papers contain evidence adequately supporting all conclusions, recommendations and opinions;
- (e) The auditor achieves the stated audit objectives; and
- (f) The audit report includes the audit conclusions, recommendations and opinions, as appropriate.

5.2.3 All audit work should be reviewed by a senior member of the audit staff before the audit opinions or reports are finalised. It should be carried out as each part of the audit progresses. Review brings more than one level of experience and judgement to the audit task and should ensure that:

- (a) All evaluations and conclusions are soundly based and are supported by competent, relevant and reasonable audit evidence as the foundation for the final audit opinion or report;
- (b) All errors, deficiencies and unusual matters have been properly identified, documented and either satisfactorily resolved or brought to the attention of a more senior SAI officer(s); and
- (c) Changes and improvements necessary to the conduct of future audits are identified, recorded and taken into account in later audit plans and in staff development activities.

5.2.4 This standard emphasises the importance of involvement of each higher level of supervision and does not in anyway absolve the lower levels of audit staff carrying out field investigations from any negligence in carrying out assigned duties.

## 6. Study and Evaluation of Internal Control

### 6.1 The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.

The following paragraphs explain internal control as an auditing standard.

6.1.1 The study and evaluation of internal control should be carried out according to the type of audit undertaken. In the case of regularity (*financial*) *audit*, study and evaluation are made mainly on controls that assist in safeguarding assets and resources, and assure the accuracy and completeness of accounting records. In the case of regularity (*compliance*) *audit*, study and evaluation are made mainly on controls that assist management in complying with laws and regulations. In the case of *performance audit*, they are made on controls that assist in conducting the business of the audited entity in an economic, efficient and effective manner, ensuring adherence to management policies, and producing timely and reliable financial and management information.

6.1.2 The extent of the study and evaluation of internal control depends on the objectives of the audit and on the degree of reliance intended.

6.1.3 Where accounting or other information systems are computerized, the auditor should determine whether internal controls are functioning properly to ensure the integrity, reliability and completeness of the data.

## 7. Compliance with Applicable Laws and Regulations

7.1 In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts

**that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.**

- 7.2 In conducting performance audits, an assessment should be made of compliance with applicable laws and regulations when necessary to satisfy the audit objectives. The auditor should design the audit to provide reasonable assurance of detecting illegal acts that could significantly affect audit objectives. The auditor also should be alert to situations or transactions that could be indicative of illegal acts that may have an indirect effect on the audit results.
- 7.3 The regularity audit is an essential aspect of government auditing. One important objective that this type of audit assigns to the SAI is to make sure, by all the means put at its disposal, that the State budget and accounts are complete and valid. This will provide Parliament and other users of the audit report with assurance about the size and development of the financial obligations of the State. To achieve this objective, the SAI will examine the accounts and financial statements of the administration with a view to assuring that all operations have been correctly undertaken, completed, passed, paid and registered. The audit procedure normally results, in the absence of irregularity, in the granting of a 'discharge.'
- 7.4 The following paragraphs explain compliance as an auditing standard.
- 7.4.1 Reviewing compliance with laws and regulations is especially important when auditing government programmes because decision-makers need to know if the laws and regulations are being followed, whether they are having the desired results, and, if not, what revisions are necessary. Additionally government organisations, programmes, services, activities, and functions are created by laws and are subject to more specific rules and regulations.
- 7.4.2 Those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited. Because the laws and regulations that may apply to a specific audit are often numerous, the auditors need to exercise professional judgement in determining those laws and regulations that might have a significant impact on the audit objectives.
- 7.4.3 The auditor also should be alert to situations or transactions that could be indicative of illegal acts that may indirectly impact the results of the audit. When audit steps and procedures indicate that illegal acts have or may have occurred, the auditor needs to determine the extent to which these acts affect the audit results.
- 7.4.4 In conducting audits in accordance with this standard, the auditors should choose and perform audit steps and procedures that, in their professional judgement, are appropriate in the circumstances. These audit steps and procedures should be designed to obtain sufficient, competent, and relevant evidence that will provide a reasonable basis for their judgement and conclusions.
- 7.4.5 Generally, management is responsible for establishing an effective system of internal controls to ensure compliance with laws and regulations. In designing steps and procedures to test or assess compliance, auditors should evaluate the entity's internal controls and assess the risk that the control structure might not prevent or detect non-compliance.

7.4.6 Without affecting the SAI's independence, the auditors should exercise due professional care and caution in extending audit steps and procedures relative to illegal acts so as not to interfere with potential future investigations or legal proceedings. Due care would include considering the concerned laws and relevant legal implications through appropriate forum to determine the audit steps and procedures to be followed.

## 8. Audit Evidence

**8.1 Competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, programme, activity or function under audit.**

8.2 The following paragraphs explain audit evidence as an auditing standard.

8.2.1 The audit findings, conclusions and recommendations must be based on evidence. Since auditors seldom have the opportunity of considering all information about the audited entity, it is crucial that the data collection and sampling techniques are carefully chosen. When computer-based system data are an important part of the audit and the data reliability is crucial to accomplishing the audit objective, auditors need to satisfy themselves that the data are reliable and relevant.

8.2.2 Auditors should have a sound understanding of techniques and procedures such as inspection, observation, enquiry and confirmation, to collect audit evidence. The SAI should ensure that the techniques employed are sufficient to reasonably detect all quantitatively material errors and irregularities.

8.2.3 In choosing approaches and procedures, consideration should be given to the quality of evidence, i.e. the evidence should be competent, relevant, reasonable and as direct as possible so as to reduce the need for inferences to be made.

8.2.4 Auditors should adequately document the audit evidence in working papers, including the basis and extent of the planning, work performed and the findings of the audit. Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant findings and conclusions.

8.2.5 Adequate documentation is important for several reasons. It will:

- (a) Confirm and support the auditor's opinions and reports;
- (b) Increase the efficiency and effectiveness of the audit;
- (c) Serve as a source of information for preparing reports or answering any enquiries from the audited entity or from any other party;
- (d) Serve as evidence of the auditor's compliance with auditing standards;
- (e) Facilitate planning and supervision;
- (f) Help the auditor's professional development;
- (g) Help to ensure that delegated work has been satisfactorily performed; and
- (h) Provide evidence of work done for future reference.

8.2.6 The auditor should bear in mind that the content and arrangement of the working papers reflect the degree of the auditor's proficiency, experience and knowledge. Working papers should be sufficiently complete and detailed to enable an experienced auditor having no previous connection with the audit subsequently to ascertain from them what work was performed to support the conclusions.

## 9. Analysis of Financial Statements

9.1 In regularity (financial) audit, and in other types of audit when applicable, auditors should analyse the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements.

9.2 The following paragraphs explain analysis of financial statements as an auditing standard:

9.2.1 Financial statement analysis aims at ascertaining the existence of the expected relationship within and between the various elements of the financial statements, identifying any unexpected relationships and any unusual trends.

9.2.2 The auditor should therefore thoroughly analyse the financial statements and ascertain whether:

- (a) Financial statements are prepared in accordance with acceptable accounting standards;
- (b) Financial statements are presented with due consideration to the circumstances of the audited entity;
- (c) Sufficient disclosures are presented about various elements of financial statements; and
- (d) The various elements of financial statements are properly evaluated, measured and presented.

9.2.3 The methods and techniques of financial analysis depend to a large degree on the nature, scope and objective of the audit, and on the knowledge and judgement of the auditor.

9.2.4 Where the SAI is required to report on the execution of budgetary laws, the audit should include:

- (a) for revenue accounts - ascertaining whether forecasts are those of the initial budget, and whether the audit of taxes, rates and duties recorded; and imputed receipts can be carried out by comparison with the annual financial statements of the audited activity;
- (b) for expenditure accounts - verifying credits to assist budgets, adjustment laws and, for carryovers, the previous year's financial statements.

9.2.5 Where the SAI is required to report on systems of tax administration or systems for realising non-tax receipts, along with a systems study and analysis of realisation of revenues/receipts, detection of individual errors in both assessment and collection is essential to highlight audit assertions regarding the system defects and comment on their efficiency to ensure compliance.

## CHAPTER - IV

### REPORTING STANDARDS IN GOVERNMENT ACCOUNTING

**Government auditors submit different kinds of reports to the Executive and the Legislature. The audit reporting process begins with submission of an Inspection Report to the Head of Office or Department which has been audited with a request to submit replies and clarifications/comments on the audit observations. Depending on the veracity and relevance of replies/clarifications received and the materiality of the observations in the Inspection Reports, these are further processed for reporting in the Audit Report submitted by the SAI for being placed in the concerned Legislature. Besides this basic distinction, there are audit certificates of financial statements or of statements of expenditure, which are issued to the management of a company/corporation and departments dealing with them. The following standards apply equally to all these reports with variations in the scope of these reports.**

- 1.1 On completion of each audit assignment, the auditor should prepare a written report setting out the audit observations and conclusions in an appropriate form; its content should be easy to understand, free from ambiguity and supported by sufficient, competent and relevant audit evidence and be independent, objective, fair, complete, accurate, constructive and concise.
- 1.2 The auditor should issue the reports in a timely manner for use by management, legislature and other interested users.
- 1.3 The audit report may be presented on other media that are retrievable by other users and the audit organisations. Retrievable audit reports include those, which are in electronic formats and may be released on the Internet.
- 1.4 With regard to audit of financial statements, the auditor should prepare a report expressing opinion on the fair presentation of the financial position of the audited entity in the financial statement. Form and content of this report and the nature of opinion is discussed in the following paragraphs.
- 1.5 With regard to fraudulent practice or serious financial irregularities detected during audit or examined by audit, a written report should be prepared. This report should indicate the scope of audit, main findings, total amount involved, modus operandi of the fraud or the irregularity, accountability for the same and recommendations for improvement of internal control system, fraud prevention and detection measures to safeguard against recurrence of fraud / serious financial irregularity.
- 1.6 With regard to Performance or Value for Money Audits, the report should include a description of the scope and coverage of audit, objective of audit, area of audit, main findings in respect of the efficiency, economy and effectiveness (including impact) aspects of the area (subject matter) which was audited and recommendations suggesting the improvements that are needed.
- 1.7 With regard to regularity audits, the auditor should prepare a written report which may either be a part of the report on the financial statements or the Value for Money Audit or a separate report on the tests of compliance of applicable laws and regulations. The report should contain a statement on the results of the tests to indicate the nature of assurance i.e. positive or negative obtained from the tests.

- 1.8 Reporting standards constitute the framework for the audit organization; and the auditor has to report the results of regularity audit or performance audit or expressing his opinion on a set of financial statements.
- 1.9 These standards are to assist and not to supercede the prudent judgement of the auditor in making audit observations, conclusions and report.
- 1.10 The expression 'reporting' embraces both the auditor's opinion on a set of financial statements and the auditor's report on regularity, performance or value for money audit and also the reports prepared on periodical inspection of the records of an audit entity.
- 1.11 **The audit report should be complete.** This requires that the report contains all pertinent information needed to satisfy the audit objectives, and to promote an adequate and correct understanding of the matter reported. It also means including appropriate background information.
- 1.11.1 In most cases, a single example of a deficiency is not sufficient to support a broad conclusion or a related recommendation. All that it supports is that a deviation, an error or a weakness existed. However, except as necessary, detailed supporting data need not be included in the report.
- 1.12 **Accuracy** requires that the evidence presented is true and the conclusions be correctly portrayed. The conclusions should flow from the evidence. The need for accuracy is based on the need to assure the users that what is reported is credible and reliable.
- 1.12.1 The report should include only information, findings and conclusions that are supported by competent and relevant evidence in the auditor's working papers. Reported evidence should demonstrate the correctness and reasonableness of the matters reported.
- 1.12.2 Correct portrayal means describing accurately the audit scope and methodology and presenting findings and conclusions in a manner consistent with the scope of audit work.
- 1.13 **Objectivity** requires that the presentation throughout the report be balanced in content and tone. The audit report should be fair and not be misleading and should place the audit results in proper perspective. This means presenting the audit results impartially and guarding against the tendency to exaggerate or over-emphasise deficient performance. In describing shortcomings in performance, the auditor should present the explanation of the audited entity and stray instances of deviation should not be used to reach broad conclusions.
- 1.13.1 The tone of reports should encourage decision-makers to act on the auditor's findings and recommendations. Although findings should be presented clearly and forthrightly, the auditor should keep in mind that one of the objectives is to persuade and this can best be done by avoiding language that generate defensiveness and opposition.
- 1.14 Being **convincing** requires that the audit results be presented persuasively and the conclusions and recommendations followed logically from the facts presented. The information presented should be sufficient to convince the readers to recognise the validity of the findings and reasonableness of audit conclusions. A convincing report can help focus the attention of management on matters that need attention and help stimulate correction.

- 1.15 **Clarity** requires that the report be easy to read and understand. Use of non-technical language is essential. Wherever technical terms and unfamiliar abbreviations are used, they should be clearly defined. Both logical sequencing of the material and precision in stating the facts and in drawing conclusions significantly contribute to clarity and understanding. Appropriate visual aids (such as photographs, charts, graphs and maps etc.) should be used to clarify and summarise complex material.
- 1.16 Being **concise** requires that the report is not longer than necessary to convey the audit opinion and conclusions. Too much of details detracts from the report and conceals the audit opinion and conclusions and confuses the readers. Complete and concise reports are likely to receive greater attention
- 1.17 Being **constructive** requires that the report also includes well thought out suggestions, in broad terms, for improvements, rather than how to achieve them. In presenting the suggestions, due regard should be paid to the requirements of rules and orders, operational constraints and the prevailing milieu. The suggestions should be discussed with sufficiently high level functionaries of the entities and as far as possible, their acceptances obtained before these are incorporated in the report.
- 1.18 **Timeliness** requires that the audit report should be made available promptly to be of utmost use to all users, particularly to the auditee organisations and/or Government who have to take requisite action.

## 2. Follow up of Audit Reports

- 2.1 Adequate, prompt and proper follow up action by the entity on and in the light of audit conclusions projected will enhance the effectiveness of audit and promote public accountability.
- 2.2 Systems and procedures should be in place and implemented for securing appropriate conclusions and preventive follow up action on audit reports. In subsequent audits and otherwise, the auditor should examine and report whether satisfactory action was taken on the audit reports.

## 3. Report distribution

Written audit reports are submitted by the audit to the appropriate officials of the organisation audited. Copies are also sent to other officials who may be responsible for taking action on audit observations and conclusions. However, the report is not a public document till it is presented to the legislature.

## 4. Reporting on compliance with laws and regulations and on internal control

This standard is discussed under two sections, viz.,

- (a) Value for money/Performance audit; and
- (b) Audit of Financial statements.

## 5. Value for money audit

Auditors should report all significant instances of non-compliance and all significant instances of abuse that were found during or in connection with the audit. In some circumstances, auditors should report illegal acts promptly to the audited entity without waiting for the full report to be prepared after the audit.

## **6. Audit of financial statements**

- 6.1 The report on the financial statements should either (1) describe the scope of the auditors' testing of compliance with laws and regulations and internal control over financial report and present the results of those tests or (2) refer to the separate report(s) containing that information. In presenting the results of those tests, auditors should report fraud, illegal acts, other material non-compliance, and reportable conditions in internal control over financial reporting. In some circumstances, auditors should report fraud and illegal acts promptly to the specified authority in the audited entity.
- 6.2 These are additional responsibilities and do not modify auditors' basic responsibilities to (1) address the effect about fraud or illegal acts may have on the report on the financial statements, and (2) determine that the approximate authority are adequately informed about fraud, illegal acts, and reportable conditions.
- 6.3 Auditors may report on compliance with laws and regulations and internal control over financial reporting in the report on the financial statements or in separate reports.
- 6.4 When auditors report separately (including separate reports bound in the same document) on compliance with laws and regulations and internal control over financial reporting, the report on the financial statements should state that they are issuing those additional reports. The report on the financial statements should also state that in considering the results of the audit, these reports should be read along with the auditor's report on the financial statements.
- 6.5 Auditors should report the scope of their testing of compliance with laws and regulations and of internal control over financial reporting, including whether or not the tests they performed provided sufficient evidence to support an opinion on compliance or internal control over financial reporting and whether the auditors are providing such opinions.

## **7 Noncompliance and Abuse**

- 7.1 When auditors conclude, based on evidence obtained, that significant non-compliance or abuse either has occurred or is likely to have occurred, they should report relevant information. The term 'non-compliance' comprises illegal acts (violations of laws and regulation) and violations of provisions of contracts or grant agreements. Abuse occurs when the conduct of a government organisation, programme, activity or function falls far short of societal expectations for prudent behavior.
- 7.2 Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to imply that they have made a determination of illegality.
- 7.3 In reporting significant instances of non-compliance, auditors should place their findings in perspective. To give the reader a basis for judging the prevalence and consequences of non-compliance, the instances of non-compliance should be related to the universe or the number of cases examined and be quantified in terms of money value, if appropriate.

- 7.4 When auditors detect non-significant instances of non-compliance, they should communicate them to the auditee, preferably in writing. If the auditors have communicated such instances of non-compliance to top management, they should refer to such communication in the audit report. Auditors should document in their working papers all communications to the auditee about non-compliance.
- 7.5 Auditors may report illegal acts directly to specified parties in the auditee Government [for example, to the CVC (Central Government) and State Vigilance Authority etc] in certain circumstances.
- 7.6 The auditee may also be required by law or regulation to report certain fraud or illegal acts to specified internal or external parties (for example, to a Central/State Government investigating agency or Central/State Vigilance Commission). If auditors have communicated such illegal acts to the auditee, and fails to report the external parties, then the auditors should include such matters in their report.

## **8. Internal Controls**

- 8.1 Auditors should report the scope of their work on management controls and any significant weaknesses found during the audit.
- 8.2 Reporting on management controls will vary depending on the significance of any weaknesses found and the relationship of those weaknesses to the audit objectives.
- 8.3 In audits where the sole objective is to audit the management controls, weaknesses found of significance to warrant reporting would be considered deficiencies and be so identified in the audit report. The management controls that were assessed should be identified to the extent necessary to clearly present the objectives, scope and methodology of the audit. In a performance audit, auditors may identify significant weaknesses in management controls as a cause of deficient performance. In reporting this type of finding, the control weaknesses would be described as the 'cause'.

## **9. Fraud, illegal acts and other non-compliance**

- 9.1 When auditors conclude based on evidence obtained, that fraud or an illegal act either has occurred or is likely to have occurred, they should report relevant information. Auditors need not report information about fraud or an illegal act that is clearly inconsequential. Auditors should also report other non-compliance (for example, a violation of a contract provision) that is material to the financial statements.
- 9.2 Whether a particular act is, in fact, illegal may have to await final determination by a court of law.
- 9.3 Thus when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to imply that they have made a determination of illegality.
- 9.4 In reporting material fraud, illegal acts, or other non-compliance, the auditors should place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified should be related to the universe or the number of cases examined and is quantified in terms of money value, if appropriate. In

presenting material fraud, illegal acts or other non-compliance, auditors should ensure that standard for objectives, scope and methodology, audit results and presentation standards, as appropriate are observed. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense.

- 9.5 When auditors detect fraud, illegal acts, or other non-compliance that are not of material nature, they should communicate those findings to the auditee, preferably in writing and should refer to such communications in their report on compliance. Auditors should document in their working papers all communications to the auditee about fraud, illegal acts, and other non-compliance.
- 9.6 Management is responsible for taking timely and appropriate steps to remedy fraud or illegal acts that auditors report to it. When fraud or illegal act involves assistance received directly or indirectly from another government or agency, (for example, Central Government Grants received by the State Government or a government agency including an autonomous body received a government grant) auditors may have a duty to report it directly to the other government/agency, if management fails to take remedial steps.
- 9.7 Auditors should obtain sufficient, competent and relevant evidence (for example, by confirmation with outside parties) to corroborate assertions by management that it has reported fraud or illegal acts.
- 9.8 Auditors under some circumstances may be required to report promptly indications of certain types of fraud or illegal acts to law enforcement or investigatory authorities. When auditors conclude that these types of fraud or illegal act either have occurred or is likely to have occurred, they should ask those authorities and/or legal counsel if reporting certain information about that fraud or illegal act would compromise investigative or legal proceedings. Auditors should limit their reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

## 10 Deficiencies in Internal Control

- 10.1 Auditors should report deficiencies in internal control that they consider to be **reportable conditions**. The following are examples of matters that may be reportable conditions:
- Absence of appropriate segregation of duties consistent with appropriate control objectives;
  - Absence of appropriate reviews and approvals of transactions, accounting entries or systems output;
  - Inadequate provisions for the safeguarding of assets;
  - Evidence of failure to safeguard assets from loss, damage or misappropriation;
  - Evidence that a system fails to provide complete and accurate output consistent with the auditee's control objectives because of the misapplication of control procedures;
  - Evidence of intentional override of internal control by those in authority to the detriment of the overall objectives of the system;

- Evidence of failure to perform tasks that are part of internal control, such as reconciliation not prepared or not timely prepared;
- Absence of a sufficient level of control consciousness within the organisation;
- Significant deficiencies in the design or operation of internal control that could result in violations of laws and regulations having a direct and material effect on the financial statements; and
- Failure to follow up and correct previously identified deficiencies in internal control.

## **10.2 Audit follow-up standard requires auditors to report whether satisfactory action was taken or not, on the audit reports.**

10.3 In reporting reportable conditions, auditors should identify those that are individually or cumulatively material weaknesses. Auditors should ensure that standard for objectives, scope, methodology, audit results and report presentation standards, as appropriate are followed in their reports on audit of financial statements.

10.4 When auditors detect deficiencies in internal control that are not of material nature, they should communicate those deficiencies to the auditee, preferably in writing. If the auditors have communicated other deficiencies in internal control to top management, they should refer to such communication when they report on internal control. All communications to the auditee about deficiencies in internal control should be documented in the working papers.

## **11. The form and content of audit opinion and report**

11.1 The form and content of all audit opinions and reports are founded on the following general principles:

- (a) Title.** The opinion or report should be preceded by a suitable title or heading, helping the reader to distinguish it from statements and information issued by others.
- (b) Signature and date.** The opinion or report should be properly signed. The inclusion of a date informs the reader that consideration has been given to the effect of events or transactions about which the auditor became aware upto that date (which, in the case of regularity (financial) audits, may be beyond the period of the financial statements).
- (c) Objectives and scope.** The opinion or report should include reference to the objectives and scope of the audit. This information establishes the purpose and boundaries of the audit.
- (d) Completeness.** Opinions should be appended to and published with the financial statements to which they relate, but performance reports may be freestanding. The auditor's opinions and reports should be presented as prepared by the auditor. In exercising its independence, CAG may acquire information from time to time, which in the national interest cannot be freely disclosed. This can affect the completeness of the audit report. In this situation, the auditor should consider the need to make a report, possibly including confidential or sensitive material in a separate, unpublished report.

- (e) **Addressee.** The opinion or report should identify those to whom it is addressed, as required by the circumstances of the audit engagement and local regulations or practice. This is unnecessary where formal procedures exist for its delivery.
- (f) **Identification of subject matter.** The opinion or report should identify the financial statements [in the case of regularity (financial) audits] or area [in the case of performance audits] to which it relates. This includes information such as the name of the audited entity, the date and period covered by the financial statements and the subject matter that has been audited.
- (g) **Legal basis.** Audit opinions and reports should identify the legislation or other authority providing for the audit.
- (h) **Compliance with standards.** Audit opinions and reports should indicate the auditing standards or practices followed in conducting the audit, thus providing the reader with an assurance that the audit has been carried out in accordance with generally accepted procedures.
- (i) **Timeliness.** The audit opinion or report should be available promptly to be of greatest use to readers and users, particularly those who have to take necessary action.

11.2 An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse or a disclaimer of opinion.

11.3 An unqualified opinion is given when the auditor is satisfied in all material respects that:

- (a) The financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- (b) The statements comply with statutory requirements and relevant regulations;
- (c) The view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and
- (d) There is adequate disclosure of all material matters relevant to the financial statements.

11.4 **Emphasis of Matter.** In certain circumstances, the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle, the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements on the ground that it would be misconstrued as being a qualification. In order to avoid giving that impression, references that are meant as 'emphases of matter' are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

- 11.5 **Adverse Opinion.** Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.
- 11.6 **Disclaimer of Opinion.** Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction that is so fundamental that an opinion, which is qualified in certain respects, would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.
- 11.7 It is customary to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.
- 11.8 In addition, regularity audits often require that reports are made where weaknesses exist in systems of financial control or accounting (as distinct from performance audit aspects). This may occur not only where weaknesses affect the audited entity's own procedures but also where they relate to its control over the activities of others. The auditor should also report on significant irregularities, whether perceived or potential, on inconsistency of application of regulations or on fraud and corrupt practices.
- 11.9 In reporting on irregularities or instances of non-compliance with laws or regulations, the auditors should be careful to place their findings in the proper perspective. The extent of non-compliance can be related to the number of cases examined or quantified monetarily.
- 11.10 Reports on irregularities may be prepared irrespective of a qualification of the auditor's opinion. By their nature they tend to contain significant criticisms, but in order to be constructive they should also address future remedial action by incorporating statements by the audited entity or by the auditor, including conclusions or recommendations.
- 11.11 In contrast to regularity audit, which is subject to fairly specific requirements and expectations, performance audit is wide-ranging in nature and is more open to judgement and interpretation; coverage is also more selective and may be carried out over a cycle of several years, rather than in one financial period; and it does not normally relate to particular financial or other statements. As a consequence, performance audit reports are varied and contain more discussion and reasoned argument.
- 11.12 The performance audit report should state clearly the objectives and scope of the audit. Reports may include criticism (for example where, in the public interest or on grounds of public accountability, matters of serious waste, extravagance or inefficiency are drawn to attention) or may make no significant criticism but give independent information, advice or assurance as to whether and to what extent economy, efficiency and effectiveness are being or have been achieved.

- 11.13 The auditor is not normally expected to provide an overall opinion on the achievement of economy, efficiency and effectiveness by an audited entity in the same way as the opinion on financial statements. Where the nature of the audit allows this to be done in relation to specific areas of an entity's activities, the auditor should provide a report, which describes the circumstances and arrives at a specific conclusion rather than a standardised statement. Where the audit is confined to consideration of whether sufficient controls exist to secure economy, efficiency or effectiveness, the auditor may provide a more general opinion.
- 11.14 Auditors should recognise that their judgment is being applied to actions resulting from past management decisions. Care should therefore be exercised in making such judgments, and the report should indicate the nature and extent of information reasonably available (or which ought to have been available) to the audited entity at the time the decisions were taken. By stating clearly the scope, objectives and findings of the audit, the report demonstrates to the reader that the auditor is being fair. Fairness also implies the presentation of weaknesses or critical findings in such a way as to encourage correction, and to improve systems and guidance within the audited entity. Accordingly the facts are generally agreed with the audited entity in order to ensure that they are complete, accurate and fairly presented in the audit report. There may also be a need to include the audited entity's responses to the matters raised, either verbatim or in summary, especially where an auditor presents its own views or recommendations.
- 11.15 Performance reports should not concentrate solely on criticism of the past but should be constructive. The auditor's conclusions and recommendations are an important aspect of the audit and, where appropriate, are written as a guide for action. Generally, these recommendations suggest what improvements are needed rather than how to achieve them, though circumstances sometimes arise which warrant a specific recommendation, for example, to correct a defect in the law in order to bring about an administrative improvement.
- 11.16 In formulating and following up recommendations, the auditor should maintain objectivity and independence and thus focus on whether identified weaknesses are corrected rather than on whether specific recommendations are adopted.
- 11.17 In formulating the audit opinion or report, the auditor should have regard to the materiality of the matter in the context of the financial statements audit or regularity audit as the case may be or the nature of the audited entity or activity being audited where performance audit is being conducted.
- 11.18 If the auditor concludes that, judged against the criteria most appropriate in the circumstances, the matter does not materially affect the view given by the financial statements, the opinion should not be qualified. Where the auditor decides that a matter is material, the opinion should be qualified having determined the type of qualification.
- 11.19 In the case of performance audits, the judgments will be more subjective as the report does not relate directly to financial or other statements. Consequently, the auditor may find that materiality by nature or by context is a more important consideration than materiality by monetary amounts involve.

**Source:** [http://cagofindia.delhi.nic.in/cag/html/auditing\\_standards.htm](http://cagofindia.delhi.nic.in/cag/html/auditing_standards.htm)