INDIAN AUDIT AND ACCOUNTS DEPARTMENT

AUDITING STANDARDS

FOR

PANCHAYATI RAJ INSTITUTIONS

&

URBAN LOCAL BODIES

Comptroller and Auditor General of India

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Preface

Auditing standards govern the conduct of audit and determine what the auditor must do. The fact that an audit has been conducted in accordance with certain standards provides necessary assurance to users of accounts and stakeholders.

The Audit Institutions entrusted with responsibility of audit of Local Bodies, derive their duties and powers mainly from Articles 243-J and 243-Z of the Constitution of India, which expect the States to make provision by legislation for maintenance of accounts by the Panchayati Raj Institutions and the Urban Local Bodies and their audit. Various States' have their own legislation for maintenance of accounts and audit of local bodies. The audit mandate thus originates in a legislative statute. In most of the States the Director, Local Fund Audit or similar authority is vested with the authority for audit of accounts of the panchayats and the municipalities. As per the recommendations of the XIth Finance Commission and the Guidelines for Utilization of Local Bodies grants issued by Ministry of Finance, Govt. of India, the C & AG of India is to provide technical guidance and supervision over audit of local bodies.

Compliance with the auditing standards in the conduct of audit is an essential factor to judge whether the auditor had acted with reasonable care and skill. Any decision to deviate from the standards should, therefore, be taken at an appropriate level and should be documented.

These auditing standards are issued by the Comptroller and Auditor General of India to govern audit of accounts of the Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) taken up under the State Acts.

It is hoped that these auditing standards for audit of PRIs & ULBs would help the auditors in proper conduct of audit, foster a greater sense of responsibility among government auditors, promote public accountability and provide a valuable assurance to the concerned Union/State agencies.

(K.N.Khandelwal)
Deputy Comptroller & Auditor General

New Delhi
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Chapter-I

BASIC POSTULATES

1. INTRODUCTION

1.1 The audit of the Panchayati Raj Institutions and the Urban Local Bodies includes audit of:

(i) Receipts and Expenditure from various sources

(ii) Classification

(iii) Receipts and Payments Account (for institutions which keep accounts on cash basis), Income and Expenditure Account, Balance Sheet and other subsidiary accounts kept by these Bodies.

(iv) Utilization of Grants & Loans given by Governments to Local bodies for specific purposes.

(v) Stores and stock accounts kept by these Bodies.

1.2 The Audit Institutions entrusted with responsibility of audit of Local Bodies, derive their duties and powers mainly from Articles 243-J and 243-Z of the Constitution of India, which expect the States to make provision by legislation for maintenance of accounts by the Panchayati Raj Institutions and the Urban Local Bodies and their audit. Various States' have passed necessary legislation for maintenance of accounts and audit of local bodies. The audit mandate thus originates in a legislative statute by State Governments. In most of the States the Director, Local Fund Audit or similar authority is vested with the authority for audit of accounts of the panchayats and the municipalities. As per the recommendations of the XIth Finance Commission and the Guidelines for Utilization of Local Bodies grants issued by Ministry of Finance, Govt. of India, the C & AG of India is responsible for exercising control and supervision over the proper maintenance of accounts and their audit for all 3 levels of PRIs/ULBs.

Thus the Director Local Fund Audit/any similar statutory authority under the state acts would be the primary auditor for LBs, while the C & AG would conduct a test check by way of technical control and supervision over the primary auditor.

2. AUDIT OBJECTIVES

2.1 The broad aim of audit is to safeguard the financial interests of the Panchayats and the Urban Local Bodies by sound and economic financial management practices and to promote public accountability.

2.2 The executives of the Panchayati Raj Institutions and Urban Local Bodies are primarily 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 circumstances leading to infructous expenditure. The Audit assists the PRIs and ULBs in the exercise of financial control.

3. SCOPE OF AUDIT

3.1 The term "audit" includes both financial audit and performance audit. In pursuance of legislative responsibility, the prescribed audit authority would decide the nature, scope, extent, quantum of audit, the form and content of audit reports including certification of accounts in respect of audit to be conducted by such authority or on its behalf.

4. AUDITING STANDARDS

4.1 Auditing Standards prescribe the norms, 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 constitute the criteria or yardstick against which the quality of audit results are evaluated. The Auditor must exercise due care and concern in complying with the auditing standards.

4.2 The auditing standards of the Supreme Audit Institution of India (SAI) have been suitably adapted with due consideration of the relevant statutes and rules for the auditing standards for the Panchayati Raj Institutions and the Urban Local Bodies.

4.3 The auditing standards can be broadly considered under three headings:

(a) General Standards

(b) Field Standards

(c) Reporting Standards

4.4 The general standards define the basic professional needs of the Auditor, and are concerned with his relationship to the audited body. The Field standards regulate the audit examination, the steps or action that the Audit Institution and the Auditor have to follow in conducting or managing audit work. What the Auditor has to say at the end of the audit is governed by reporting standards.

5. BASIC POSTULATES

5.1 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 opinion and reports, particularly where no specific standards apply.

5.2 The Audit Institutions should establish a policy by which the standards are followed by these institutions for conduct of various types of audit work to ensure the high quality of work.

5.3 The Audit Institution should comply with the relevant auditing standards in all matters that are deemed material.

5.4 In general terms, a matter may be judged material if knowledge of it would be likely to influence the users of the Auditor's report.

5.5 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.

5.6 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:

(i) The overall view given to the financial information;
(ii) The total of which it forms a part;
(iii) The corresponding amount in previous years;
(iv) Associated terms.

5.7 The Audit Institution applies its own judgment to the diverse situations that arise in the course of auditing.

5.8 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 in discharge of his responsibility, must exercise his judgment in determining the auditing procedures necessary in the circumstances, to afford a reasonable basis for his opinion and the content of his report, audit of issues and areas of audit, and the nature, timing and extent of audit tests and procedures.

5.9 The Panchayati Raj Institutions and the Urban Local Bodies shall develop adequate information control, evaluation and reporting system to facilitate the accountability process and shall be responsible for correctness and sufficiency of the form and content of the financial reports and other information. As per the para 6.5 of the Guidelines for utilization of grants for local bodies, issued by Ministry of Finance, Govt. of India, in June 2001, the format for preparation of budgets and for keeping of accounts for Local Bodies shall be as prescribed by the C & A G of India.

5.10 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 adequate controls are in place and functioning to ensure that applicable laws and regulations are complied with and that probity and propriety is 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.

5.11 Auditor often expresses an opinion on the performance of 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.

5.12 Auditor has a right to inspect any office of accounts of the Panchayati Raj Institutions or of the Urban Local Bodies; he can access any books, papers and other documents which are relevant to the transactions to be sent to him and he can 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 prescribed account or report.

5.13 Information about an audited entity acquired in the course of the auditor's work shall 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 maintains confidentiality regarding audit matters and the information arising from audit task.

5.14 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. The Auditors should avail themselves of techniques and methodologies of other disciplines.

5.15 Audit Institution performs its role by carrying out audits of the accountable entities and reporting the results. To fulfill this role, it needs to maintain its independence and objectivity. The application of appropriate general auditing standards assist the Audit Institution in satisfy these requirements.

5.16 Audit Institution shall advise the appropriate authorities for the promulgation of acceptable accounting standards for financial reporting and disclosures relevant to their needs. The audited entities should develop specific and measurable objectives and performance targets.

Chapter-II

GENERAL STANDARDS

1. INTRODUCTORY

1.1 The general auditing standards define the basic professional needs of the auditor and the need for the Auditor to be aware of his responsibilities and develop necessary skills and tasks, so that the audit assignment is performed efficiently and economically. The general standards describe the qualifications of the auditor and the Audit Institutions (AI - Director Local Fund Audit, Examiner Local Fund, Accountant General or any other statutory audit authority) so that they may carry out the tasks related to the field and the reporting standards in a competent and effective manner.

1.2 The general auditing standards include standards, which apply both to the Auditors and to the Audit Institutions, and standards, which are meant for Audit Institutions. The standards common to Auditors and Audit Institutions are:

- **(a) The Auditor and the Audit Institutions must be independent.**
- **(b) The Auditor and the Audit Institutions must possess the required competence.**
- **(c) 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:

- **(a) Recruit personnel with suitable qualifications.**

(b) 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.

(c) Prepare manuals and other written guidance notes and instructions concerning the conduct of audits.

(d) 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.

(e) Review the efficiency and effectiveness of internal standards and procedures.

2. INDEPENDENCE

2.1 In all matters relating to audit work, the Auditor and the AI must be free from personal or external impairments to independence, must be institutionally independent and shall maintain an independent attitude and appearance.

2.2 The need for independence and objectivity in audit is vital. An adequate degree of independence is essential to the conduct of audit and to the credibility of its results.

2.3 It is important that the AI maintains its independence from any external influence including political in order to preserve an impartial approach to its audit responsibilities. This implies that the AI not be responsive nor give the appearance of being responsive to the wishes of particular political interest.

2.4 Adequate independence requires that AI not be subject to direction by the legislature in the programming, planning and conduct of audits. The AI needs freedom to set priorities and program its work in accordance with its mandate and adopt methodologies appropriate to the audits to be undertaken.

2.5 It is important for the independence of the AI that there be no power of direction by executive in relation to the performance of its mandate. The AI is not obliged to carry out, modify or refrain from carrying out, an audit or suppress or modify audit findings, conclusions and recommendations.

2.6 Maintenance of independence does not preclude requests to the AI proposing matters for audit. But if it is to enjoy adequate independence, the AI must be able to decline any such request. It is fundamental to the concept of independence of AI that decisions as to the audit tasks comprising the programme should rest finally with the AI.

2.7 Any imposition of restrictions by the executive, which would constrain the exercise of mandate by the AI would be an appropriate matter for reporting to the appropriate authority.

2.8 The audit mandate provides for full and free access by the AI to all premises and records relevant to audited entities and their operations and provides adequate powers to it to obtain relevant information from persons or entities possessing it.

2.9 By legal provision and accepted convention, the executive permits access by the AI to sensitive information, which is necessary and relevant to the discharge of its responsibilities.

2.10 In order that the AI not only exercises its functions independently of the executive but also be seen to do so, it is important that its mandate and its independent status be understood in the community. The AI should, as appropriate opportunities arise, undertake an educational role in that regard.

2.11 The AI's functional independence need not preclude arrangements with executive entities in regard to the AI'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 jeopardize the AI's independence in discharging its mandate.

2.12 The AI must remain independent from audited entities. The Audit should, however, seek to create among audited entities an understanding of its role and functions, with a view to maintaining amicable relationships with them. Good relationship can help the Audit to obtain information freely and frankly and to conduct discussions in an atmosphere of mutual respect and understanding. In this spirit, the AI while retaining its 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 its competence or its authority. In these cases it is not, however, a matter of the AI interfering in administrative management but a matter of co-operating with certain administrative services by giving them technical assistance or by putting AI's financial management experience at their disposition.

2.13 In contrast to private sector audit, where the Auditor's agreed task is specified in an management letter, the audited entity is not in a client relationship with the AI. The AI has to discharge its 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.

2.14 The AI 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.

2.15 Any AI 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.

2.16 Personnel of the AI should not become involved in any decision making or approval process, which is considered the auditee's management responsibility.

2.17 The AI may cooperate with academic institutions and enter formal relationships with professional bodies, provided the relationships do not inhibit his 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 AI must possess the required competence.

3.2 The following paragraphs explain competence as an auditing standard:

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

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

3.2.3 Since the duties and responsibilities thus borne by the AI are crucial to the concept of public accountability, the AI must apply to its 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.

3.2.4 The Audit 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 should equip itself with the full range of up-to-date audit methodologies.

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

4. DUE CARE

4.1 The general standards for the Auditor and the AI include due professional care in conducting audit, 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 Audit Institution must be, and be seen to be, objective in its audit. 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 to detect control weaknesses, inadequacies in record keeping, errors and unusual transactions or results which could be indicative of fraud, improper or unlawful expenditure, unauthorized operations, waste, inefficiency or lack of probity.**

4.2.3 Where an authorized or recognized entity sets standards or guidelines for accounting and reporting, the audit may use such guidelines in the course of its examination.

4.2.4 Should the AI, in the performance of its functions, need to seek advice from external specialists, 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 of responsibility for the opinions formed or conclusions reached on the audit task.

4.2.5 When the audit uses the work of another auditor(s), it must apply adequate procedures to provide assurance that the other auditor(s) has (have) 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.

4.2.6 Information about an audited entity acquired in the course of 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 maintains confidentiality regarding audit matters and information arising from its audit task. However, the Audit should report offences against the law to proper prosecuting authorities.

5. QUALITY ASSURANCE REVIEW

5.1 AI 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, it should pay particular attention to quality assurance programs in order to improve audit performance and results. The benefits to be derived from such programs 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 AI should institute its own internal audit function to assist the Audit to achieve effective management of its own operations and sustain quality of its performance.

5.2.3 The quality of the work done by the Audit can be enhanced by strengthening internal review and by the independent appraisal of its work.

5.2.4 AI should establish systems and procedures to confirm that internal quality assurance process operates satisfactorily, ensure the quality of the reports and secure improvements and avoid repetition of weaknesses.

5.2.5 In-built systems of detailed directions, guidance and supervision of audit, careful and critical examination of audit conclusions, written down manuals and job specific audit guidelines/plans, internal control and inspection systems and procedures secure a high degree of quality assurance and credibility of audit conclusions.

6. OTHER GENERAL STANDARDS FOR AUDITING INSTITUTIONS

6.1 The AI should adopt policies and procedures to recruit personnel with suitable qualifications.

6.2 The personnel of the AI should possess suitable academic qualifications and be equipped with appropriate training and experience. The AI should establish, and regularly review, minimum educational requirements for the appointment of Auditors.

6.3 The AI should adopt policies and procedures to develop and train its employees to enable them to perform their task effectively and to define the basis for the advancement of Auditors and other staff.

6.4 The following paragraphs explain training and development as an auditing standard:

6.4.1 The AI 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.

6.4.2 The AI should identify professional development needs of its personnel.

6.4.3 The AI should establish and regularly review criteria, including educational requirements, for the advancement of Auditors and other staff of the AI.

6.4.4 The AI should also establish and maintain policies and procedures for the professional development of audit staff regarding the audit techniques and methodologies applicable to the audits of Panchayats including Urban Local Bodies.

6.4.5 AI personnel should have a good understanding of the institutional environment, including such aspects as the role of the legislature, the legal and institutional arrangements governing the operations of the Panchayati Raj Institutions and the Urban Local Bodies. Likewise, trained audit staff must possess an adequate knowledge of the auditing standard, policies, procedures and practices.

6.4.6 Audit of financial systems, accounting records and financial statements requires training in accounting and related disciplines as well as a 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.

6.4.7 The AI should encourage its personnel to become members of a professional body relevant to their work and to participate in the body's activities.

6.5 The AI should adopt policies and procedures to prepare manuals and other written guidance and instructions concerning the conduct of audits.

6.6 The following paragraphs explains written guidance as an auditing standard:

6.6.1 Communication to staff of the AI by means of circulars containing guidance, and the maintenance of an up-to-date audit manuals setting out the AIs policies, standards, practices and procedures, is important in maintaining the quality of audits.

6.6.2 The manuals, instructions and procedures of the audited entity should also be consulted by the staff of the AI.

6.7 The AI should adopt policies and procedures to support the skills and experience available with it 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 of due care and concern.

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

6.8.1 Resources required to undertake 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.

6.8.2 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 possesses 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.

6.8.3 It should be open to the AI to acquire specialized 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 AI to judge, in the particular circumstances, to what extent its requirements are best met by in-house expertise as against employment of outside experts.

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

6.8.5 Where the AI mandate includes the audit of financial statements which cover the Panchayati Raj Institutions as a whole, the audit teams deployed should be equipped to undertake a co-ordinated evaluation of the institutional accounting systems as well as the co-ordination arrangements and control mechanisms. Audit teams will require knowledge of the relevant institutional accounting and control systems and an adequate expertise in the auditing techniques applied by the AI.

6.8.6 Unless the AI is equipped to undertake, within a reasonable time-frame, 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.

6.8.7 In determining the allocation of its resources among different audit activities, the AI 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.

6.8.8 Assignment of priorities compatible with maintaining the quality of performance across the mandate involves exercise of the AI's judgment in the light of available information. Maintenance of a portfolio of data pertaining to the structure, functions and operations of the Panchayati Raj Institutions and the Urban Local Bodies will assist the AI in identifying areas of materiality and vulnerability and areas holding potential for improvements in administration.

7. SCOPE IMPAIRMENTS

7.1 When factors external to the Auditor and AI restrict the audit or interfere with Auditor's ability to form objective opinions and conclusions, the Auditor should attempt to remove the limitation, failing that, report the limitation to the appropriate authority.

Chapter-III

FIELD STANDARDS

1. OVERALL FRAMEWORK OR CRITERIA

The field standards establish the criteria or overall framework for the purposeful, systematic and balanced steps or actions that the auditor has to follow in conducting or managing audit work. 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 of 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. APPLICABILITY

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 audit covering non-expendable assets, an assessment should be made of compliance with the applicable rules and procedures for acquisition, recording, physical verification and disposal of non-expendable assets.

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 regularity audit is an essential aspect of auditing of local bodies. The Audit Institution (AI) is to make sure, by all the means put at its disposal, that the auditee's budget and accounts are complete and valid. This will provide users of the audit report with assurance about the size and development of the financial obligations of the auditee. To achieve this objective the AI will examine the accounts and financial statements of the auditee with a view to assuring that all operations have been correctly undertaken, completed, passed, paid and registered.

In conducting audit of revenue receipts such as taxes, duties and other levies, the Auditor should satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment and collection of revenue and are being duly observed.

The Auditor's alertness to fraud is most important factor in detecting fraud during routine audits. Auditor should be alert to situations or transactions that could be indicative of fraud, abuse and illegal acts and if evidence exists 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.

(e) Competent, relevant and reasonable evidence should be obtained to support the Auditor's judgment and conclusions regarding the body, program, activity or function under audit.

(f) In regularity (financial) audit and in other types of audit when applicable, Auditors should analyze the financial statements to establish whether prescribed accounting procedure 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 In planning an audit of Panchayati Raj Institutions and Urban Local Bodies, the Auditor should:

(a) Identify important aspects of the environment in which the audited entity operates;

(b) Develop an understanding of the 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 program;

(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 fieldwork.

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

(a) Collect information about the audited entity and its organization in order to assess risk and to determine materiality;

(b) Define the objective, scope and methodology of the audit. Objectives are what the audit is intended to accomplish. Scope of audit is the boundary of audit and should be directly linked to the objectives. Methodology comprises the work involved in gathering and analyzing data to achieve the objectives. Auditors should design the methodology to provide sufficient, competent and relevant evidence to achieve the objectives.

(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) Identity staff requirements and a team for the audit: and

(g) Familiarize the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary.

4.2.3 The audit plan may be revised during the audit when necessary.

4.2.4 Auditor 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 conducted in conformity with the auditing standards and practices and in accordance with the professional judgment of the Auditor;

(c) The audit plan and action steps specified in that plan are followed unless a variation is authorized;

(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 finalized. It should be carried out as each part of the audit progresses. Review brings more than one level of experience and judgment 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 officer(s) of the AI;

(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 emphasizes the importance of involvement of each higher level of supervision and does not in any way 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.

6.2 The following paragraphs explain internal control as an auditing standard:

6.2.1 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 case of performance audit, the study and evaluation shall be made of the internal control systems applicable to the audited body, programme, activity or function under audit.

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

6.2.3 Where accounting or other information systems are computerized, the Auditor should determine whether internal controls are operating effectively to provide reliability of and security over the data being processed.

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 audit covering non-expendable assets the Auditor should see that the internal procedure adequately secures correct accountal of non-expendable assets, verification of their physical existence and obsolescence and disposal.

7.3 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.

7.4 Efficiency-cum-performance audit is directed to the examination of the systems, procedures, planning, implementation, field performance and monitoring of programmes, schemes and activities. It brings out among other things, weaknesses and deficiencies as also lapses to individual transactions for appropriate action.

7.5 Economy and efficiency determine whether the audited institution is managing and utilizing its resources economically and efficiently, the cases of inefficiency or uneconomical practices and whether the institution complies with laws and regulations concerning matters of economy and efficiency.

7.6 Programme results determine whether the desired results or benefits established by the authorizing body are being achieved and whether the institution has considered alternatives that might yield desired results at a lower cost.

7.7 The regularity audit is an essential aspect of the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) auditing. One important objective that this type of audit assigns to the AI is to make sure, by all the means put at its disposal, that the auditee's budget and accounts are accurate, complete and valid. This will provide users of the Auditor's report with assurance about the size and development of the financial obligation of the audited body. To achieve this objective, the AI will examine the accounts and financial statements with a view to assuring that all operations have been correctly undertaken, completed, passed, paid and registered.

7.8 In verifying compliance with the applicable tax laws, audit of receipts is regulated mainly with reference to the statutory provisions as judicially interpreted. Interpretation of law is a judicial function; the Auditor does not review a judicial decision. Audit may, however, point out cases where there is an apparent lacuna or loophole in law and make suggestions for their amendments.

7.9 The Auditor should see that the internal procedure adequately secures correct and regular accounting of demands, collections and refunds, that no amounts due are left outstanding on its books without sufficient reason and that the claims are pursued with due diligence and are not abandoned or reduced except with adequate justification and with proper authority.

7.10 Auditor's alertness to fraud is important in detecting fraud during routine audit. The Auditor should be alert to situations or transactions that could be indicative of fraud, abuse and illegal acts and if such evidence exists, Auditor should extend audit steps and procedures to identify the effect on the entity's operations and programmes.

Some fraud may be impossible to detect even by the best Auditors. Skillfully prepared false documents, collusion to circumvent separation of duties, and unrecorded transactions are not usually discovered through accepted audit methods.

An audit made in accordance with the standards will not guarantee the discovery of all fraud, abuse or illegal acts that might have been committed. Nor does the subsequent discovery of fraud, abuse or illegal acts committed during the period covered under audit necessarily means that the Auditor's performance was inadequate. However, if the audit was conducted in accordance with the prescribed auditing standards, the Auditors have fulfilled their professional responsibility.

Where there are reasonable grounds for suspicion, the Auditors must go beyond the mechanical performance of auditing procedures and extant audit steps and procedures to track down improprieties.

7.11 The following paragraphs explain compliance as an auditing standard:

7.11.1 Reviewing compliance with laws and regulation is especially important when auditing programs of the PRIs and the ULBs because decision-makers need to know if the laws and regulation are being followed, whether they are having the desired results, and, if not, what revisions are necessary. Additionally the Panchayats and the Urban Local Bodies, programs, services, activities, and functions are created by laws and are subject to more specific rules and regulations.

7.11.2 Those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited. Because the laws and regulation that may apply to a specific audit are often numerous, the

Auditors need to exercise professional judgment in determining those laws and regulations that might have a significant impact on the audit objectives.

7.11.3 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.

7.11.4 In conducting audits in accordance with this standard, the Auditors should choose and perform audit steps and procedures that, in their professional judgment, 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 judgment and conclusions.

7.11.5 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.

7.11.6 Without affecting the independence of the AI 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 consulting appropriate legal counsel and the applicable law enforcement organization to determine the audit steps and procedures to be followed.

8. AUDIT EVIDENCE

8.1 Sufficient, competent, relevant and reliable evidence should be obtained to support the Auditor's judgment and conclusions regarding the body, program, 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 AI 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 sufficient, competent, relevant, reliable 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 analyze the financial statements to establish whether prescribed accounting procedures 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 analyze the financial statements and ascertain whether:

(a) Financial statements are prepared in accordance with prescribed accounting procedures;

(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.

(e) The auditors should take into account that some entities may use cash basis accounting, whereas others may use accrual or modifies accrual basis of accounting.

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 judgment of the Auditor.

9.2.4 Where the AI 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, whether the audit of taxes, rates and duties recorded, and imputed receipts, can be carried out by comparison with the budget of the audited entity;

(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 AI is required to report on systems of tax administration or systems for realizing non-tax receipts, along with a systems study and analysis of realization 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

1. INTRODUCTORY

1.1 The culmination of the audit process is the reporting which summarizes the evidence gathered during the conduct of audit and communicates the audit opinion and other findings. It is essential for the Auditor to prepare report in such a way so that audit observations are easy for readers to understand. Timeliness of the report is the essence as delay may make the report irrelevant and corrective action may not be practicable. Discussions are held with the audited institutions and the Auditor considers their responses. Significant audit findings are detailed in the annual audit reports. The reporting standards set down the framework for reporting the results of audit concisely, objectively with accuracy, and clarity and for appropriate, conclusive and preventive follow up action.

2. AUDIT INSPECTION REPORT

2.1 On the completion of each audit assignment, the Auditor should prepare a written report setting out the audit observation and conclusions in an appropriate form; its content should be easy to understand and free from vagueness or ambiguity supported by sufficient, relevant and reliable audit evidence and be independent, objective, fair, complete, accurate, constructive and concise.

2.2 The Auditor should issue the reports without undue delay for use by management and other interested users. The audit report may be presented on other media that are retrievable by other interested users and the audit institutions. Retrievable audit reports include those, which are in electronic formats and may be released on the Internet once it is public document. Any report is not a public document till it is presented to the appropriate authority in the manner prescribed as per the provisions of the relevant legislative statute.

2.3 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 statements. Certificate shall state expressly:

- the financial statements to which it relates;
- that the audit has been carried out in accordance with the relevant statutory authority and with auditing standards;
- an opinion about the accounts which the Auditor has formed as a result of the audit.

Form and content of this report and the nature of opinion are discussed in succeeding paragraphs.

2.4 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 specific scope of audit, the 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. Where the right to information about the affairs of the State and the public bodies is available, it may require release of the reports publicly after it has been presented before the house of the elected body. However, premature disclosure of suspects and the details of the fraud in an audit report can seriously jeopardize criminal prosecution, it is important that the report is first made to the management confidentially and legal counsel obtained concerning its release to public.

2.5 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 recommendation suggesting the improvements that are needed.

2.6 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.

2.7 Reporting standards constitute the framework for the audit organization and the Auditor to report the results of audit of regularity or performance audit or expressing his opinion on a set of financial statements.

2.8 These standards are to assist and not to supercede the prudent judgment of the Auditor in making audit observations, conclusions and report.

2.9 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 auditee.

2.10 **The audit inspection 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.

2.10.1 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.

2.11 **Accuracy** requires that the evidence presented is true and the conclusions are 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.

2.11.1 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.

2.11.2 **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.

2.12 **Objectivity** requires that the presentation throughout the report be balanced in content and tone. The audit report should be fair and impartial and not misleading and should place the audit results in proper perspective. This means presenting audit results impartially and guarding against the tendency or over emphasize deficient performance. In describing shortcomings in performance, the Auditors should present the explanation of the audited entity and stray instances of deviation should not be used to reach broad conclusions.

2.12.1 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 Auditors should keep in mind that one of their objectives is to persuade and this can best be done by avoiding language that generate defensiveness and opposition.

2.13 **Being convincing** requires that the audit results are presented persuasively and the conclusions and recommendations followed logically from the facts presented. The information presented should be sufficient to convince the readers to recognize 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.

2.14. **Clarity** requires that the report be easy to read and understand. Use of straightforward, non-technical language is essential. If technical terms and unfamiliar abbreviations are used, they should be clearly defined. Both logical organization 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 summarize complex material.

2.15 **Being concise** requires that the report is not longer than necessary to convey the audit opinion and conclusions. Too much detail 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.

2.16 **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, field constraints and the prevailing milieu. The suggestions should be discussed with sufficiently high level functionaries of the entities and as far as possible, their acceptance obtained before these are incorporated in the report.

2.17 **Timeliness** requires that the audit report should be made available promptly to be of utmost use to all users, particularly to the audited institution or body and/or the authorities who have to take requisite action.

3. FOLLOW UP OF AUDIT INSPECTION REPORTS

3.1 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.

3.2 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 Auditors should examine and report whether satisfactory action was taken on the audit reports.

4. REPORT DISTRIBUTION

4.1 Written audit reports are submitted by the Audit to the appropriate officials of the institution or the body audited. Copies are sent to other officials who may be responsible for taking action on audit observations and conclusions. Some State Governments having enacted the "Right to Information Act" to provide citizens the right to information about the affairs of the State and the public bodies, it may require, unless restricted by any other law or regulations, release of the reports publicly i.e. made available for public inspection after it has been presented to the house of the local body. However, the report is not a public document till it is presented as per provisions of the legislative statute.

5. REPORTING ON COMPLIANCE WITH LAWS AND REGULATIONS AND ON INTERNAL CONTROL

5.1 This standard is discussed under two sections, viz.

(a) Value for Money/Performance audit; and

(b) Audit of financial statements

6. VALUE FOR MONEY AUDIT

6.1 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.

7. NON-COMPLIANCE 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 PRI or Local Body, 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 the 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 Where audit reveals sufficient grounds to infer corruption/illegal acts/irregularity, which are serious enough to merit attention of the investigative authorities, auditors may report such cases directly to the concerned Secretary of the government department in the auditee Government with a request for concurrence and approval, to refer the matter to specified office for investigation and action (for example, State Vigilance Commission, Lokayukta etc.)

7.6 The auditee may also be required by law or regulation to report certain illegal acts to specified internal or external parties (for example, an investigating agency or State Vigilance Commission, etc.). If Auditors have communicated such illegal acts to the auditee, and it fails to report them, 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 findings, the control weaknesses would be described as the “cause”.

9. AUDIT OF FINANCIAL STATEMENTS

9.1 Reporting Standards determine what the Auditors are obliged to cover in the certificate given to the accounts. As the certificate is the means by which the Auditor’s conclusions are conveyed to the users of accounts, the wording of the report is important. The certificate should state:

- the financial statements to which it relates;
- that the audit has been carried out in accordance with the relevant statutory authority and with auditing standards; and
- the opinion about the accounts which the Auditors have formed as a result of audit.

9.2 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 reporting 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 as per the instructions/orders on the subject.

9.3 These responsibilities are in addition to and do not modify Auditors' responsibilities to (i) address the effect, fraud or illegal acts may have on the report on the financial statements, and (ii) determine that the appropriate authority are adequately informed about fraud, illegal acts and reportable conditions.

9.4 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.

9.5 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.

10. FRAUD, ILLEGAL ACTS AND OTHER NON-COMPLIANCE

10.1 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 on 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.

10.2 Whether a particular act is, in fact, illegal may have to await final determination by a court of law.

10.3 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.

10.4 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 be 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.

10.5 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.

10.6 Management is responsible for taking timely and appropriate steps to remedy fraud or illegal acts that Auditors report to it. When fraud or an illegal act involves assistance received directly or indirectly from government or any other agency (for example, State Government Grants), the Auditors may have a duty to report it directly (to the government/any other agency) if management fails to take remedial steps.

10.7 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.

11. DEFICIENCIES IN INTERNAL CONTROL

11.1 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 out put 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 institution;
- 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.

11.2 Audit follow-up standard requires Auditors to report whether satisfactory action was taken or not, on the audit reports

11.3 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.

11.4 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 the 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.

12. THE FORM AND CONTENT OF AUDIT OPINION AND REPORT

12.1 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 up to 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 free standing. The Auditor's opinions and reports should be presented as prepared by the Auditor. In exercising its independence audit authority 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 and mention 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.

12.2 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.

12.3 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.

12.4 **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 in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references that are meant as "emphasis 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.

12.5 An Auditor may not be able to express an unqualified opinion when any of the following circumstances exist and, in the Auditor's judgment, their effect is or may be material to the financial statements:

(a) There has been limitation on the scope of the audit;

(b) The auditor considers that the financial statements are incomplete or misleading or there is an unjustified departure from prescribed accounting procedures; and

(c) There is uncertainty affecting the financial statements.

12.6 **Qualified Opinion** – Where the Auditor disagrees with or is uncertain about one or more particular items in the financial statements that are material but not fundamental to understanding of the statements, a qualified opinion should be given. The wording of the opinion normally indicates a satisfactory outcome to the audit , subject to a clear and concise statement of the matters of disagreement or uncertainty giving rise to the qualified opinion. It helps the users of the statements if the Auditor quantifies the financial effect of the uncertainty or disagreement although this is not always practicable or relevant.

12.7 **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.

12.8 **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 it clear that an opinion cannot be given, mentioning clearly and concisely all matters of uncertainty.

12.9. It is customary to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.

12.10 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 regulation or on fraud and corrupt practices.

12.11 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.

12.12 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.

12.13 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 judgment 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. The report should present factual data accurately and fairly, include only information, findings, and conclusions that are adequately supported by sufficient evidence in the Auditor's working papers to demonstrate or prove the basis for the matters reported and their correctness and reasonableness.

12.14 The performance audit report should state clearly the scope and objectives 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.

12.15 The Auditor is not normally expected to provide an overall opinion on the achievement of 3-Es of economy, efficiency and effectiveness by an audited entity in the same way as the opinion on financial statements. However, an expression of overall opinion on 3-Es may sometimes be necessary in case of performance audit. 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 standardized 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.

12.16 Auditors should recognize 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 weakness 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 views pertinent to the matters raised during audit either verbatim or in summary, especially where an Auditor presents his own views or recommendations.

12.17 The reports should place primary emphasis on improvements rather than on criticism of the past. Critical comments should be presented in a balanced perspective, considering any unusual difficulties or circumstances by the operating officials concerned. 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 recommendations, for example to correct a defect in the law in order to bring about an administrative improvement.

12.18 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.

12.19 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.

12.20 For regularity (financial) audits, 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.

12.21 In the case of performance audits that judgment will be more subjective as the report does not relate so 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 amount.

12.22 In the case of performance audits, the report shall include pertinent views of officers of the audited entity, those looking after the function, programme or activity audited concerning the Auditor's findings, conclusions and recommendations.