



Government of Kerala

Audit Manual Part-1

Kerala State Audit Department

Thiruvananthapuram



Dr. T. M. THOMAS ISAAC
MINISTER FOR FINANCE & COIR

Government of Kerala
Secretariat, Thiruvananthapuram
Room No. 130, North Block
Phone : 0471-2333294
Fax : 0471-2334648
Mobile : 9447733600
E-mail : min.fin@kerala.gov.in

March 25, 2018

Message

I express my appreciation to KSAD for formulating an audit manual on the basis of the recommendation of 4th Finance commission. The Commission suggested that such a Manual shall enhance the efficiency of the audit and thereby upgrade the transparency and efficacy of local governance. The manual was prepared with the support KLSGDP.

The manual is prepared within the frame work of KLFA Act and Rules, audit policies and GO's formulated by the Government from time to time and also considering the audit methodology in practical sense. So it is certain that the manual shall promote the professionalism in audit and bring standard in audit reports.

The International Auditing Standards being practiced worldwide have been vividly incorporated in the Manual. A whole lot of institutions with diverse characteristics such as Panchayat Raj Institutions, Universities, Devaswom Boards, and Cultural Institutions etc are being audited by Kerala State Audit Department. The Manual shall help the auditors to approach the audit of the above said institutions with global standards.

It is expected that the Manual shall bring qualitative change in the view of the auditors and shall enhance the transparency and competency of audit.

I extend my whole hearted thanks to all who dedicated their precious time for preparing the Manual in time bound manner.

Dr. T M Thomas Isaac
Minister for Finance and Coir



ഡി. സാജി

ഡയറക്ടർ

കേരള സംസ്ഥാന ഓഡിറ്റ് വകുപ്പ് &

പ്രജന്റർ

ചാരിറ്റബിൾ ഏൻഡോവ്മെന്റ്സ്
കേരളം

കേരള സംസ്ഥാന ഓഡിറ്റ് വകുപ്പ്
വികാസഭവൻ
തിരുവനന്തപുരം

തീയതി...10.04.2018

Preface

A long pending necessity of our Department, for an Audit Manual, has now attained its reality. Ever since the origin of the Department in 1942, there were discussions about preparation of an audit manual. Certain earnest efforts were also made within the Department during the past. But, the need to have an Audit Manual was debated within KSAD as well as with Government of Kerala at many forums. However, the recommendation of the fourth Finance Commission has led to a firm direction to this, which endorsed preparing an Audit manual for this Department, to improve the quality of Audit and for systematically conducting the audit.

In order to implement the Finance Commission's recommendations, it was decided to seek financial assistance from KLGSDP for preparation of an Audit Manual. Historically, Kerala State Audit Department was doing certifications for LSGI's enabling these LSGI's to get performance grants from the World Bank funded programme managed by KLGSDP. The Finance Department had consented this proposal subject to the approval of Terms of Reference by Government. With these processes and approvals in place, KLGSDP had identified a professional agency, as per the world bank procurement norms, whose services were utilized in preparing this Audit Manual.

In this process, Kerala State Audit Department had conducted various stakeholder consultations within themselves, with senior officials from auditee institutions as well as with subject matter experts. There were more than 30 large sized focus group discussions conducted throughout the State and around 250 plus individuals were met one-on-one to take their valuable inputs,

A review committee comprising about forty members was constituted within the Department, which had worked along with the Directorate to provide necessary inputs to the professional agency and this committee had been monitoring the progress of the work. The different stages of draft of Audit Manual prepared by the professional agency have been transmitted to the entire department for their remarks and to ensure utmost consensus. The opinions & suggestions of each of the staff/office have been meticulously evaluated by Directorate and the review committee. Earnest efforts have been taken to incorporate them on its merits in the draft audit manual.

The third draft of the English version of the manual was discussed by the review committee members on a three day long workshop and the same was finalized and approved by Kerala State Audit Department. Similarly, the third draft of the Malayalam version of manual was also discussed by the review committee members on a two day long workshop and the same was finalized and approved by Kerala State Audit Department. These manuals were in turn approved by the Government vide GO (RT)9674/17/Fin dated 29.12.17 and GO (RT)2563/18/ Fin. dated 25.03.18

On the occasion of this remarkable accomplishment, on behalf of the Department, I would like to place on records my profound gratitude and sincere thanks to the following, without whose valuable inputs, this manual would not have realized:

- Hon'ble Minister, Finance, Government of Kerala.
- Dr. K.M.Abraham, IAS (Retd.), former Chief Secretary, Government of Kerala.
- Principal Secretary, Finance, Government of Kerala.
- Secretary (Expenditure), Government of Kerala.
- Project Director, KLGSDP and all their staff.
- Senior officials representing various auditee institutions.

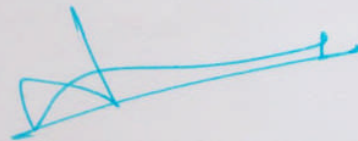
- Entire staff of Kerala State Audit Department, including the liaison team and the review committee members.
- Numerous subject matter experts.
- Each individuals who had provided their valuable inputs.

The main objective of this manual is to improve the quality of audit standards of Kerala State Audit Department and to further improve the efficiency of each and every auditor, apart from improving department's efficiency in the overall audit documentation.

I sincerely urge everyone from Kerala State Audit Department's audit team to go through this manual consistently in practical environment. Apart from referring and using this manual as a guide, every auditor is requested to use his/her skills and utmost ability while conducting audit so that, as a team, Kerala State Audit Department can take its audit standards to greater heights.

Thanking you,

Yours sincerely



D. Sanky

Director, Kerala State Audit Department

236



കേരള സർക്കാർ

സംഗ്രഹം

ധനകാര്യ വകുപ്പ് - കേരള സംസ്ഥാന ഓഡിറ്റ് വകുപ്പ് - ലോകബാങ്ക് സഹായത്തോടെ തയ്യാറാക്കിയ ഓഡിറ്റ് മാനുവലിന് അംഗീകാരം നൽകി ഉത്തരവ് പുറപ്പെടുവിക്കുന്നു

ധനകാര്യ (എസ്റ്റാബ്ലിഷ്മെന്റ് -ഡി) വകുപ്പ്

സ.ഉ (സാധാ.)നം.9674/2017/ധന തിരുവനന്തപുരം, തീയതി : 29.12.2017

- പരാമർശം:-
1. 16.07.2014 ലെ 86307/എസ്റ്റാ.ഡി1/2013/ധന നമ്പർ കത്ത്.
 2. 01.12.2015- ന് ധനകാര്യ അഡീഷണൽ ചീഫ് സെക്രട്ടറി വിളിച്ചുകൂട്ടിയ യോഗത്തിന്റെ മിനിറ്റ്സ്.
 3. 05.12.2015 ലെ സ.ഉ (സാധാ) നം.10579 /15/ധന നമ്പർ സർക്കാർ ഉത്തരവ്.
 4. 18.12.2015 ലെ സ.ഉ (സാധാ) നം. 10993/15/ധന നമ്പർ സർക്കാർ ഉത്തരവ്
 5. ഓഡിറ്റ് വകുപ്പ് ഡയറക്ടറുടെ 16.12.2017 -ലെ കെ.എസ്.എ 317/ എസ്. എസ്.2/2017 നമ്പർ കത്ത്.

ഉത്തരവ്

തദ്ദേശ സ്വയംഭരണ സ്ഥാപനങ്ങളുടെ പ്രവർത്തനം മെച്ചപ്പെടുത്തുന്നതിന് ഓഡിറ്റിന്റെ കാര്യക്ഷമത ഉയർത്തുക വഴി സാധ്യമാകുമെന്ന നാലാം സംസ്ഥാന ധനകാര്യ കമ്മീഷൻ ശുപാർശ പ്രകാരം കേരള സംസ്ഥാന ഓഡിറ്റ് വകുപ്പ് ഓഡിറ്റ് നടത്തുന്ന എല്ലാ മേഖലകളെയും ഉൾപ്പെടുത്തിക്കൊണ്ട് ലോക ബാങ്കിന്റെ സഹായത്തോടെ ഓഡിറ്റ് മാനുവൽ തയ്യാറാക്കുന്നതിന് പരാമർശം(1) പ്രകാരം സർക്കാർ അനുമതി നൽകിയിരുന്നു. സംസ്ഥാനത്തെ തദ്ദേശ സ്വയംഭരണ സ്ഥാപനങ്ങളുടെ സുസ്ഥിര വികസനം ഉറപ്പാക്കുന്നതിന് സർക്കാർ രൂപീകരിച്ച KLGSDP മുഖേന ലോകബാങ്ക് സഹായത്തോടെ മാനുവൽ തയ്യാറാക്കുന്നതിനാണ് അനുമതി നൽകിയിരുന്നത്. ഓഡിറ്റ് മാനുവൽ തയ്യാറാക്കുന്നതിനുള്ള വിഷയ നിർദ്ദേശങ്ങളുടെ ('Terms of Reference') കരടിന് സർക്കാർ പരാമർശം (3) പ്രകാരം ഭരണാനുമതി നൽകുകയുണ്ടായി. കെ.എൽ.ജി.എസ്.ഡി.പി. (Kerala Local Government Service Delivery Project) യുടെ നിർദ്ദേശ പ്രകാരം കുറഞ്ഞ തുക കോട്ട് ചെയ്ത M/S പ്രൈവറ്റ് വാട്ടർ ഹൗസ് കൂപ്പേഴ്സ് എന്ന സ്ഥാപനത്തിന് കരാർ നൽകിയാണ് മാനുവൽ തയ്യാറാക്കിയത്.

ഓഡിറ്റ് വകുപ്പ് ഓഡിറ്റ് ചെയ്യുന്ന സ്ഥാപനങ്ങളുടെ പ്രതിനിധികൾ ഉൾപ്പെടുന്ന ഫോക്കസ് ഗ്രൂപ്പ് ചർച്ചയിലൂടെയാണ് ഓഡിറ്റ് മാനുവലിന്റെ കരട് രൂപീകരിച്ചത് എന്നും കരാറുകാരൻ സമർപ്പിച്ച ഒന്നും രണ്ടും മൂന്നും ഡ്രാഫ്റ്റിന്റെ വെറ്റിംഗ് വകുപ്പ് തല വിദഗ്ധരുടെ സഹായത്തോടെ ക്രോഡീകരിച്ച് കരാറുകാരന് നൽകുകയും, ഓഡിറ്റ് മാനുവലിന്റെ അന്തിമ കരട് തയ്യാറാക്കുന്നതിന് വേണ്ടി വകുപ്പുതല വിദഗ്ധരും കരാറുകാരൻ നിയോഗിച്ച പ്രതിനിധികളും ഉൾപ്പെടുന്ന ഒരു ശിൽപശാല നടത്തി ആയതിലെ നിർദ്ദേശങ്ങൾ പരിഗണിക്കുകയും ഓഡിറ്റ് മാനുവലിനു അന്തിമ രൂപം നൽകുകയും ചെയ്തു എന്നും ആയത് അംഗീകരിക്കണമെന്നും സൂചന (5) പ്രകാരം ആഡിറ്റ് വകുപ്പ് ഡയറക്ടർ ആവശ്യപ്പെട്ടിരിക്കുന്നു.

ലോകബാങ്ക് ധനസഹായത്തോടെ നടത്തുന്ന പദ്ധതികൾ 2017 ഡിസംബർ അവസാനത്തോടെ അവസാനിക്കുന്ന സാഹചര്യത്തിൽ സർക്കാർ അംഗീകാരം ലഭ്യമാക്കണമെന്ന് പരാമർശം (5) പ്രകാരം സ്റ്റേറ്റ് ഓഡിറ്റ് വകുപ്പ് ഡയറക്ടർ അഭ്യർത്ഥിക്കുകയുണ്ടായി. ഓഡിറ്റ് മാനുവലിന്റെ അന്തിമ കരട് സർക്കാരിലേക്ക് സമർപ്പിച്ച് സമയബന്ധിതമായി അംഗീകാരം ലഭിച്ചാലെ ലോകബാങ്ക് വായ്പ ലഭിക്കുകയുള്ളൂ എന്നും ടി പദ്ധതി സമയബന്ധിതമായി തീർപ്പാക്കേണ്ടതിന്റെ പ്രാധാന്യത്തെക്കുറിച്ചും ഓഡിറ്റ് വകുപ്പ് ഡയറക്ടർ ധനകാര്യ വകുപ്പുതല ചർച്ച നടത്തി വ്യക്തമാക്കിയിട്ടുണ്ട്. ഓഡിറ്റ് മാനുവലിന്റെ ഇംഗ്ലീഷ് പതിപ്പ് 5 വാല്യങ്ങളായി (part I -General, Part II(Volume I -Institutions other than Devaswom Boards, Welfare Funds and LSGI, Volume II -Devaswom Boards, Volume III -Welfare Funds, Volume IV -LSGIs) അംഗീകാരത്തിന് സമർപ്പിച്ചിരിക്കുകയാണ്.

സർക്കാർ ആയത് വിശദമായി പരിശോധിച്ചതിന്റെ അടിസ്ഥാനത്തിൽ ഓഡിറ്റ് നിയമവും ചട്ടവും അനുശാസിക്കുന്ന രീതിയിൽ വേണ്ടി വന്നാൽ ഉചിതമായ കാലാനുസൃത മാറ്റം വരുത്താം എന്ന നിബന്ധനയോടെ ഓഡിറ്റ് മാനുവലിന്റെ 5 വാല്യങ്ങളായുള്ള ഇംഗ്ലീഷ് പതിപ്പിന് അംഗീകാരം നൽകി ഉത്തരവാകുന്നു.

**ഗവർണ്ണറുടെ ഉത്തരവിൻ പ്രകാരം
ഡോ. ഷർമിള മേരി ജോസഫ് ഐ.എ.എസ്
സെക്രട്ടറി (ഫിനാൻസ് എക്സ്പെൻഡിച്ചർ)**

പ്രിൻസിപ്പൽ അക്കൗണ്ടന്റ് ജനറൽ (എ&ഇ /ജി&എസ്എസ്എ) കേരള, തിരുവനന്തപുരം
അക്കൗണ്ടന്റ് ജനറൽ (ഇ&ആർഎസ്എ) കേരള, തിരുവനന്തപുരം
ഡയറക്ടർ, കേരള സംസ്ഥാന ഓഡിറ്റ് വകുപ്പ്, തിരുവനന്തപുരം

പ്രോജക്ട് ഡയറക്ടർ, തദ്ദേശ മിത്രം (കെ.എൽ.ജി.എസ്.ഡി.പി) തിരുവനന്തപുരം 695 014.
വെബ് & ന്യൂ മീഡിയ, പബ്ലിക് റിലേഷൻസ് വകുപ്പ്
നോഡൽ ഓഫീസർ, ധനകാര്യ വകുപ്പ് (www.finance.kerala.gov.in)
സ്റ്റോക്ക് ഫയൽ / ഓഫീസ് കോപ്പി

ഉത്തരവിൻ പ്രകാരം



അക്കൗണ്ട്സ് ഓഫീസർ

| ACRONYMS | |
|-----------------|--|
| ADC | Assistant Development Commissioner |
| AIMS | Audit Information Management System |
| ATR | Action Taken Report |
| CAG | Comptroller and Auditor General of India |
| CAR | Consolidated Audit Report |
| DAG | Deputy Accountant General |
| DCB | Demand Collection and Balance |
| DDP | Deputy Director of Panchayat |
| GO | Government Order |
| ICAI | Institute of Chartered Accountants of India |
| INTOSAI | International Organization of Supreme Audit Institutions |
| ISSAI | International Standards of Supreme Audit Institutions |
| KLSGDP | Kerala Local Self Government Development Project |
| KSAD | Kerala State Audit Department |
| LFAD | Local Fund Audit Department |
| LSGI | Local Self Government Institutions |
| PRI | Panchayat Raj Institutions |
| RJDUA | Regional Joint Director – Urban Affairs |
| SAI | Supreme Audit Institution |
| SAS | Statutory Audit Standard |
| SFC | State Finance Commission |
| SPAO | State Performance Audit Officer |
| TNA | Training Needs Assessment |
| ULB | Urban Local Body |

Table of contents

| Chapter No | | Paragraph | Page No |
|------------|---|-----------|-----------|
| 1 | Introduction | | 1 |
| 2 | Institutional Arrangements - KSAD | | 3 |
| | Overview of the KSAD | 2.1 | 3 |
| | Functions of KSAD | 2.2 | 4 |
| | Functions & Responsibilities of Directorate | 2.3 | 6 |
| | Functions and Responsibilities of Officers in Sub Offices | 2.4 | 7 |
| | Powers of the Director and Auditors | 2.5 | 11 |
| | Other Institutional Framework | 2.6 | 14 |
| 3 | Basis of Audit Authority | | 17 |
| | Regulatory Framework for Local Fund Audit | 3.1 | 17 |
| | Audit Mandate | 3.2 | 17 |
| 4 | Audit of Accounts-Concepts & Types | | 20 |
| | Concepts and Definition | 4.1 | 20 |
| | Types of Audit | 4.2 | 22 |
| | Basic Principles of Audit | 4.3 | 34 |
| | Fundamental Principles of Public-Sector Auditing | 4.4 | 35 |
| | Level of Assurance provided by Auditors | 4.5 | 43 |
| | Audit Standards and their Applicability | 4.6 | 44 |
| 5 | Internal Controls | | 50 |
| | Understanding Control Environment | 5.1 | 50 |
| | Testing of Internal Controls | 5.2 | 54 |
| | Documenting Audit Observations | 5.3 | 57 |
| | Illustrative Internal Control Checklists | 5.4 | 57 |
| 6 | Audit Sampling and Test Checking | | 58 |
| | Why Sampling | 6.1 | 58 |
| | Sampling Approaches | 6.2 | 59 |
| | Sample Size | 6.3 | 60 |
| 7 | Audit Materiality | | 62 |
| | Setting Materiality for audits | 7.1 | 62 |
| | Types of Errors | 7.2 | 64 |
| | Issues with Materiality | 7.3 | 64 |
| | Audit Risk and Materiality | 7.4 | 64 |
| 8 | Audit Evidence | | 66 |
| | Sufficiency and Appropriateness | 8.1 | 67 |
| | Reliability of Audit Evidence | 8.2 | 67 |
| | Audit Evidence and Assertions | 8.3 | 68 |
| | Procedures to collect Audit Evidence | 8.4 | 68 |
| | Evaluation of Evidence | 8.5 | 70 |

| Chapter No | | Paragraph | Page No |
|-------------------|--|------------------|----------------|
| 9 | Audit Planning | | 71 |
| | Audit Plan for the entire KSAD | 9.1 | 71 |
| | Audit Plan for Specific Institutional Audits | 9.2 | 72 |
| 10 | Conducting Audit – Field Work | | 80 |
| | Communication and Entry Conference | 10.1 | 80 |
| | Testing Opening Balances | 10.2 | 81 |
| | Analytical Procedures | 10.3 | 82 |
| | Audit Testing | 10.4 | 83 |
| | Documentation of observations/audit results | 10.5 | 86 |
| | Exit Conference | 10.6 | 88 |
| | Audit Completion Procedures | 10.7 | 88 |
| 11 | Audit Reporting | | 92 |
| | Regulatory Framework for Reporting | 11.1 | 92 |
| | Reporting Process | 11.2 | 93 |
| | Basic Form and Content of an Audit Report | 11.3 | 93 |
| | Certification of Annual Financial Statements | 11.4 | 96 |
| | Form and Content of Audit Report | 11.5 | 96 |
| | Review of Draft Audit Reports | 11.6 | 98 |
| | Submission of Audit Reports | 11.7 | 98 |
| | Audit charge / Audit fee | 11.8 | 99 |
| | Consolidated Audit Report to Government (CAR) | 11.9 | 99 |
| 12 | Audit Documentation | | 100 |
| | Form and content of audit working papers | 12.1 | 100 |
| | Permanent audit file –content | 12.2 | 101 |
| | Current audit file –content | 12.3 | 101 |
| 13 | Procedures for Charge/Surcharge | | 102 |
| | Circumstances under which persons responsible can be charged / surcharged | 13.1 | 102 |
| | Fixing Loss and Responsibility | 13.2 | 102 |
| | Procedure for Surcharge/ Charge proceedings | 13.3 | 103 |
| | Procedure to dispose of or carry over surcharge/ charge related matters in audit reports | 13.4 | 104 |

1. Introduction

Local Fund Audit Department was constituted at Travancore in 1942. The department was re-organised in 1957 with three Zonal Offices at Thiruvananthapuram, Ernakulam and Kozhikode terming them as South Zone, Central Zone and North Zone respectively. For administrative convenience and for regulating the Audit process systematically, in 1960 Kerala Local Fund Audit Service was constituted followed by the Kerala Local Fund Audit Subordinate Service. Subsequently, in order to streamline and improve the Audit process, the department was re-organised dispensing with the Zonal Offices. Thus, the Head Office, District Offices and Functional Audit Offices came into existence. The Department was renamed as Kerala State Audit Department in 2015. The Department functions under the administrative control of Finance Secretariat of the Government of Kerala.

The 73rd and 74th Amendments of the Indian Constitution, passed in 1993, devolved a significant amount of power to the Panchayat Raj Institutions (PRI) and Nagarapalika Institutions in the matter of local self-government and recognized them as “institutions of self-government”. In the matter of maintenance of their accounts and audit, the States were required to make necessary provisions by law. In response to that requirement, the Kerala State Legislature has passed the Kerala Local Fund Audit Act, 1994 (“the Act”) which was notified vide notification No.11671/Leg.A2/93/Law dated 11/05/1994 and vide G.O (P) No.77/96/Fin dated 10/01/1996, the Finance Department has notified the commencement of the Act with effect from 15/01/1996. The Kerala Local Fund Audit Rules, 1996 (“the Rules”) were notified vide G.O (P) No.180/96/Fin dated 09/02/1996 (S.R.O 176/96 published as Extra Ordinary Gazette No.222 dated 12/02/1996). This provides the overall framework for and to regulate the audit of the local funds under the management or control of certain local authorities in the State of Kerala.

The **Fourth State Finance Commission** (SFC) in its report of March 2011, had recommended that the Local Fund Audit Department (LFAD- later named as Kerala State Audit Department- KSAD) to have an audit manual for systematically conducting the audit. The main objectives of the recommendations were [a] to improve the quality of audit; [b] to have uniformity across audit functions; [c] use as reference document by any new KSAD employee, etc. In June 2012, Government of Kerala had directed LFAD to implement the recommendations by Fourth State Finance Commission. Following this, KSAD had submitted a detailed project proposal to Government of Kerala and followed it up with several discussions with the government and the Kerala Local Government Service Delivery Project (KLGSDP). In July 2014, a committee headed by Additional Chief Secretary (Finance) approved the KSAD proposal and Government of Kerala approved the preparation of Audit Manual vide its GO number 86307/Estd.D-1/13/Fin dated 16th July 2014.

An ‘Audit Manual’ is a compilation of current audit policies, procedures and guidelines of an auditing authority. The purpose of the Audit Manual is to promote the highest level of professional competence of the auditors, to provide auditors with guidelines for applying audit techniques and to create a basis for measuring audit performance. The Audit Manual should serve as a companion and primary reference source for audit process for the auditors and assist new auditors in their professional development and provide guidance on all relevant aspects of the audit function, including standards and procedures to be followed and adhered to. Its contents, provisions and procedures are intended to supplement the experience, competencies, skills, and judgement of auditors in planning, conducting and reporting on audits. The Audit Manual is meant to assist the Audit staff in effectively performing their auditing duties in time and to serve as a ‘user-friendly guidance notes’, offering standardized templates, checklists and forms. The Manual and its appendices are dynamic documents and need to be updated from time to time, by the appropriate

authorities, based on the experience gained from actual usage. The proposed Audit Manual is intended to ensure a more practical, professional and focussed approach among the audit fraternity in KSAD.

The Audit Manual has been designed to guide all KSAD auditors to conduct audit in accordance with a standardised audit methodology, programs, checklists and reporting procedures as detailed in this manual. In developing these methodology, process and procedures, due consideration has been given to the Auditing Standards as recommended by the Comptroller and Auditor General of India (CAG) and in particular to the Auditing Standards for the audit of PRIs and ULBs as issued by the CAG. As the purpose of Audit Standards is to enhance the quality and credibility of the audit, KSAD is to adopt all the Field Audit Standards of CAG and the relevant Audit Standards issued by ISSAI which are listed in chapter 4 of this Manual. The principles, practices and programs set out in this manual need to be applied for all audits irrespective of the nature and type of the auditee institution. The standards and practices set out in this manual should be incorporated as the minimum benchmark for all audits. However, the audit approach and the test procedures may be “tailored” by the auditors to suit the specific needs of institutions based on their size and complexities.

The Audit Manual is intended to assist the KSAD auditors in the conduct of audit of all Local Funds, bodies and institutions that are statutorily subjected to audit under various statues of the Kerala Government and relevant High Court Orders which subject the accounts of such institutions to the audit by KSAD auditors. These institutions may have varying objectives, may be commercial or non-commercial, or even if they are commercial but expected to perform services of public utility or execute all or specific programs of the Government and may have different risk profiles and stakeholder expectations. As development of an audit manual for each institution is neither feasible nor practical the auditee institutions have been grouped into 20 categories based on certain homogenous characteristics and audit programs/ checklists have been made for each homogenous group.

The Audit Manual has been structured as follows:

| Volume | Summary of Content |
|-----------------|--|
| Part I | Mandate, Institutional Arrangements, Audit Methodology and Audit Processes. |
| Part II – Vol 1 | Audit Procedures for all institutions other than Devaswom Boards, Welfare Funds and LSGI |
| Part II – Vol 2 | Audit Procedures for Devaswom Boards |
| Part II – Vol 3 | Audit Procedures for Welfare Funds |
| Part II – Vol 4 | Audit Procedures for LSGIs |

2. Institutional Arrangements - KSAD

2.1. Overview of the KSAD

The State Audit Department (Local Fund Audit Department - LFAD) was formed in Travancore in 1942. It was reorganized in 1957 vide GPR Dis.29061/56/Fin dated 17/04/57 into three zones namely (i) South Zone with H.Q at Thiruvananthapuram, (ii) Central Zone with H.Q at Ernakulam and (iii) North Zone with H.Q at Kozhikode. Subsequently, in the year 1960, the Kerala Local Fund Audit Service was constituted vide G.O (P) No.638/P.D (Rules) dated 03/10/1960 followed by the Kerala Local Fund Audit Subordinate Service vide G.O (P) No.639/PD dated 03/10/1960. In the year 1979, the Department was again reorganized vide G.O (Ms) No.733/79/Fin dated 13/08/1979, into (i) Head Office, (ii) District Offices and (iii) Functional Audit Offices and the zonal system was abolished.

The Local Fund Audit Department was renamed as Kerala State Audit Department (KSAD) vide GO (Ms) No.24/15/Fin dated 14-1-2015 and GO (Ms) No. 103/15/Fin dated 28.2.2015. KSAD functions under the administrative control of the Finance Department, Government of Kerala. KSAD has for its vision “promotion of excellence in Local Fund Audit and Accounting Services towards improving the quality of Governance in Local Bodies”. Its stated mission is to enhance accountability of the executives to the Local authority/Local fund and State Legislatures by carrying out audits in the Local Bodies and providing accounting services in the Local Bodies in accordance with the provisions of the Act and its Rules. Director, Kerala State Audit Department is the State level Head of the Department who also functions as the Treasurer of Charitable Endowments.

KSAD has 56 sub-offices spread across the State. Out of these, 14 offices are District Offices located at each district headquarters. Remaining 42 sub-offices are located at various places (mostly these are situated inside an auditee institution). Out of 14 District Offices, four (Thiruvananthapuram, Ernakulam, Thrissur and Kozhikkode) are headed by Joint Directors. Remaining ten district offices are headed by Senior Deputy Directors. There are 39 sub-offices which are functioning as concurrent audit offices, performing concurrent audit at various auditee institutions.

The Director, KSAD is the Head of the KSAD. There are five Joint Directors directly reporting to the Director at the Directorate.

An organization chart of Directorate of KSAD is attached as Appendix-1. KSAD has currently 1,155 employees, including law officer from law department of Government, as shown below:

| Sl. No. | Name of Post | No. of positions |
|---------|------------------------|------------------|
| 1. | Director | 1 |
| 2. | Joint Director | 20 |
| 3. | Senior Deputy Director | 23 |
| 4. | Law Officer | 1 |
| 5. | Deputy Director (HG) | 36 |
| 6. | Deputy Director | |
| 7. | Audit Officer (H.G) | 200 |
| 8. | Audit Officer | |

| Sl. No. | Name of Post | No. of positions |
|----------------|-------------------------|-------------------------|
| 9. | Assistant Audit Officer | 211 |
| 10. | Auditor (Senior Grade) | 211 |
| 11. | Auditor | 213 |
| 12. | Office Superintendent | 6 |
| 13. | Confidential assistant | 3 |
| 14. | Computer assistant | 97 |
| 15. | Office attender | 34 |
| 16. | Office attendant | 96 |
| 17. | Driver | 1 |
| 18. | Binder | 1 |
| 19. | Roneo operator | 1 |
| | Total | 1,155 |

2.2. Functions of KSAD

Kerala Local Fund Audit Act, 1994 (Act) has vested KSAD with necessary powers and responsibilities to verify and ensure the accountability of institutions managed or financially supported by the Government of Kerala. Kerala Local Fund Audit Rules, 1996 (Rules) provide for the manner of conducting the audit, form and contents of the audit reports, procedure for charge and surcharge etc.

As per sub-sections 4 (1) & 4 (2) of the Act, the Director of KSAD is entrusted with the audit of accounts of the Local Self Government Institutions included in the Schedule to the Act. In addition, institutions notified by the Government from time to time, institutions to be audited by other enactments/rules as well as those ordered to be audited by the Honourable Kerala High court also come under the purview of the audit by KSAD. In addition, approval of pay fixation/certification of last pay of employees of LSGIs, verification and certification of pensionary claims of Municipal Employees, employees of Development Authorities, Corporations, Devaswom Boards and Hindu Religious and Charitable Endowment Institutions, Universities, Kerala State Housing Board, Kerala Medical Council, State Institute of Languages, etc., is also done by the Kerala State Audit Department. The Director of KSAD also functions as the Treasurer of Charitable Endowments of Kerala State.

The primary functions of KSAD are given below:

- i. Audit of accounts and issue of Audit Reports of the Institutions under its audit control by virtue of the Kerala Local Fund Audit Act, 1994.
- ii. Discharge the functions as treasurer of Charitable Endowments.
- iii. Matters relating to financial administration of Local Bodies and other Auditee Institutions referred to the Department by Government from time to time are also being attended to and remarks offered thereon.
- iv. The Director shall send to the Government annually a Consolidated Audit Report of the accounts audited by him during the previous year containing such particulars which he intends to bring to their notice and the Government shall within a period of three months after the receipt of the same cause it to be laid before the Legislative Assembly.
- v. To take charge and surcharge actions against the persons /body of persons, held responsible for the losses detected in audit and included in Audit Reports. (Vide section 16 of The Kerala Local Fund Audit Act, 1994 and Rule 20 of The Kerala Local Fund Audit Rules, 1996.)
- vi. Approval of pay fixation of Grama, District Panchayat Employees/ Municipal Employees/ Employees of Cultural Institutions, Universities, Devaswom Boards, Housing Board, Library Council, etc.
- vii. Verification and recommendation of pensionary claims of Municipal Employees/ Employees of Kerala State Housing Board / Kerala Medical Council / Cultural Institutions/ Universities/ Devaswom Board, Library Council, etc., and other institutions in which such verification / recommendation / certification are to be done as per existing rules / orders.
- viii. Certification of last pay and qualifying service in respect of Grama/District Panchayat employees

The Director, KSAD or the person delegated by him shall include in the Audit Reports, a statement of:

- i. every payment which appears to him to be contrary to law;
- ii. the amount of any deficiency or loss which appears to have been caused by the negligence or misconduct of any person;
- iii. cases of misappropriation or mis-utilization of the local fund;
- iv. the amount, if any, received which is required to be brought into account but has not been brought into account by any person; and
- v. any other material impropriety or irregularity which he has observed in the accounts.

2.3. Functions & Responsibilities of Directorate

The Head Office of KSAD (Directorate) is responsible for the following functions.

| | | |
|--|---------------------------------------|--|
| FUNCTIONS & RESPONSIBILITIES OF DIRECTORATE | PLANNING | Infrastructure Development Strategic Plan New Audit Assignments |
| | ORGANISING | Audit Meetings of Estimate Committee Audit Monitoring Committee Local Fund Accounts Committee Procurement of Stationery and Office Equipments Audit Charge Suit Meetings of PAC Verification and Approval of Pensionary benefits of employees of Auditee- Institutions Charge / Surcharge Charitable Endowments Other Assignments entrusted by the Government |
| | STAFFING | Appointment of KSAD employees Transfer and posting Promotion and All Establishment matters Pension matters related to KSAD staff Maintenance of Pension books of KSAD staff Leave sanction and recording Maintenance of service books of staff Preparation of all bills for establishment Sanctioning and payments of Loans and Advances of KSAD Staff Maintenance of statutory records Making Statutory payments to the competent authority Work relating to confidential reports Departmental Promotion Committee (DPC) Salary processing and payments Disciplinary Action |
| | DIRECTING | Audit Plan Circulars/ Orders |
| | CONTROLLING & COORDINATING | Vigilance Inspection of Sub Officers Audit objections of Accountant General Action on Newspaper Reports Scrutiny of Tour Programmes of Sub Offices Review of Progress of Audit Monthly Business Statement of Sub Offices and Directorate Rules Quality Control |
| | REPORTING | Consolidated Audit Report (CAR) Administration Report RTI Act Information Management and Website Systems of Information Exchange |
| | BUDGETING | Budget Control of Expenditure Reconciliation of Departmental Figures Appropriation of Budget Grant and Contingency Fund |

2.4. Functions and Responsibilities of Officers in Sub Offices

The functional responsibilities of various categories of officers are given below:

| Designation | Location | Functional Responsibilities |
|--|--------------------------|--|
| Joint Director/ Senior Deputy Director | District Offices (14) | <ul style="list-style-type: none"> a) All duties and responsibilities as Head of office. b) Preparation of Audit Plan and monthly tour programmes and forward to Head Office. c) Conducting of audit, approval, issue and follow up of audit reports of District Panchayats, Block Panchayats, Municipalities and all other institutions under the audit purview of District audit office except grama panchayat. d) Propose audit paras for the Consolidated Audit Report to the Director. e) Surprise camp inspection. f) Function as the Drawing and disbursing officer. g) Approval of Pay fixation, Certification of last pay and qualifying service of LSGI employees excepting grama panchayat employees, pension and pay fixation approval of employees of other institutions like library councils and cultural institutions whose audit comes under the purview of District Audit offices. In the case of Municipalities, in addition to the above, recommendations of the pensionary benefits of the regular employees of the institution to the Director, and verification of pension of contingent employees. h) Custodian of all registers, service books, all stocks and stores and department vehicle. i) Prepare confidential report of Gazetted Officers and review the confidential report of non gazetted officers. j) Represent the District Audit Office in the Local Fund Accounts Committee meetings and Audit Monitoring Committee meetings. k) Conduct all litigation in which the Joint Director/Senior Deputy Director is a petitioner/respondent and all other cases which the Director has authorised the JD/SDD to represent him. l) Perform the duties of Public Information Officer. m) Attend all other duties delegated to the Head of Office. |
| Joint director | Universities | <ul style="list-style-type: none"> a) All duties and responsibilities as Head of office. b) Preparation of Audit Plan and monthly tour programmes and forward it to the Head Office. c) Conduct of audit, approval, issue and follow up of audit reports of Universities d) Propose audit paras for the Consolidated Audit Report to the Director. e) Surprise camp inspection. f) Function as the Drawing and Disbursing Officer. g) Approval of fixation of pay, certification of last pay, recommendation of pensionary benefits of employees of Universities. h) Custodian of all registers, service books, all stocks and stores. i) Prepare confidential report of Gazetted Officers and non Gazetted Officers. |

| Designation | Location | Functional Responsibilities |
|------------------------|---------------------------|--|
| | | <ul style="list-style-type: none"> j) Represent the University audit in the Local Fund Accounts Committee meetings. k) Conduct all litigation in which the Joint Director is a petitioner/respondent and all other cases which the Director has authorised the JD to represent him. l) Perform the duties of Public Information Officer. |
| Joint Director | Travancore Devaswom board | <ul style="list-style-type: none"> a) All duties and responsibilities as Head of office b) Preparation of Audit Plan and monthly tour programmes and forward them to the Head Office c) Conduct audit and all audit related functions according to the directions of the Honourable High court of Kerala d) Surprise camp inspection e) Function as the Drawing and Disbursing Officer f) Fixation of pay, certification of last pay, verification of pensionary benefits of employees of TDB g) Custodian of all registers, service books, all stocks and stores. h) Prepare confidential report of Gazetted Officers and review the confidential report of Non-Gazetted Officers. i) Perform the duties of Public Information Officer. j) Conduct all litigation in which the Joint Director is a petitioner/respondent and all other cases which the Director has authorised the JD to represent him |
| Senior Deputy Director | Travancore Devaswom board | <ul style="list-style-type: none"> a) To attend hearing before the Hon'ble High Court and Hon'ble Ombudsman b) To file further remarks to Devaswom Board Audit and audit reports on behalf of TDB audit c) To sign fair copies of all Audit notes for the JD of KSAD d) To prepare the Confidential Reports of all Non-Gazetted officers working in the office and submit to the JD for review. e) To approve and issue all routine correspondences with Board addressed to officers below the rank of Secretary/Commissioner f) Perform the duty of Public Information Officer, TDB Audit |
| Senior Deputy Director | Corporation Audit | <ul style="list-style-type: none"> a) All duties and responsibilities as Head of office. b) Preparation of udit Plan and monthly tour programmes and forward them to the Head Office. c) Conduct of audit, approval, issue and follow up of audit reports of auditee institutions. d) Propose audit paras for the Consolidated Audit Report to the Director. e) Surprise camp inspection. f) Function as the Drawing and Disbursing Officer. g) Approval of fixation of pay, recommendations of the pensionary benefits of regular employees of Corporations to the Director and authorisation and verification of pensionary benefits of contingent employees. h) Custodian of all registers, service books, all stocks and stores. i) Prepare Confidential Report of Gazetted and Non-Gazetted Officers. j) Represent the Corporation audit in the Local Fund Accounts Committee meetings and Audit Monitoring Committee meetings. k) Conduct all litigation in which the Senior Deputy Director is a |

| Designation | Location | Functional Responsibilities |
|------------------------|---|---|
| | | <p>petitioner/ respondent and all other cases which the Director has authorised the SDD to represent him.</p> <p>l) Perform the duties of Public Information Officer</p> |
| Senior Deputy Director | Malabar Devaswom Board audit/ Guruvayur Devaswom Board audit/ Kerala state housing board audit / Kerala Health Research Welfare society audit/Welfare Fund Audit/Greater Cochin Development Authority Audit | <p>a) All duties and responsibilities as Head of office.</p> <p>b) Preparation of Audit Plan and monthly tour programmes and forward them to the Head Office.</p> <p>c) Conduct of audit, approval, issue and follow up of audit reports of auditee institution.</p> <p>d) Propose audit paras for the Consolidated Audit Report to the Director.</p> <p>e) Surprise camp inspection.</p> <p>f) Function as the Drawing and Disbursing Officer.</p> <p>g) Approval of fixation of pay, Certification of last pay and qualifying service of employees of auditee institution. (Not applicable to Malabar Devaswom Board. In the case of welfare fund audit only approval of fixation of pay. In the case of Guruvayur Devaswom board audit, GCDA and KSHB audit, in addition to the above approval of pension as well).</p> <p>h) Custodian of all registers, service books, all stocks and stores.</p> <p>i) Prepare Confidential Report of Gazetted and Non-Gazetted Officers. Review of confidential reports of Gazetted and Non-Gazetted Officers prepared by the Deputy Directors.</p> <p>j) Represent the office in the Local Fund Accounts Committee meetings.</p> <p>k) Conduct all litigation in which the Senior Deputy Director is a petitioner/ respondent and all other cases which the Director has authorised the SDD to represent him.</p> <p>l) Perform the duties of Public Information Officer.</p> |
| Deputy Director | District Offices (14) | <p>a) Conduct of audit, approval, issue and follow up of audit reports of Grama Panchayats.</p> <p>b) Surprise camp inspection.</p> <p>c) Submission of details to Head of office in connection with paras selected for Consolidated Audit Report.</p> <p>d) Approval of fixation of pay, certification of last pay of the employees of Grama Panchayats.</p> <p>e) Preparation of Confidential Report of Non-Gazetted Officers and submit for review to the Joint Director/Senior Deputy Director.</p> <p>f) Represent District Office in the Local Fund Accounts Committee meetings and Audit Monitoring Committee meetings as and when required by the Head of office/Director.</p> <p>g) Conduct all litigation in which the Deputy Director is a petitioner/ respondent and all other cases which the Director has authorised the DD to represent him.</p> <p>h) Perform all other duties assigned by the Head of Office.</p> |
| Deputy Director | Malabar Devaswom Audit office, Palakkad / Cochin Devaswom Audit/ Tourism audit/ Trivandrum Development Authority/ other | <p>a) All duties and responsibilities as Head of office.</p> <p>b) Preparation of Audit Plan and monthly tour programmes and forward to Head Office</p> <p>c) In the case of Cochin Devaswom audit, conduct of audit and all audit related functions according to the directions of the Honourable High Court of Kerala.</p> <p>d) In the case of other institutions conduct of audit, approval, issue and follow up of audit reports of auditee institutions.</p> |

| Designation | Location | Functional Responsibilities |
|---------------|--|---|
| | concurrent audit offices | <p>e) Propose the audit paras for the Consolidated Audit Report to the Director.(Not applicable to Cochin Devaswom Board Audit)</p> <p>f) Surprise camp inspection.</p> <p>g) Function as the Drawing and Disbursing Officer.</p> <p>h) Approval of fixation of pay, certification of last pay, verification of the pensionary benefits of employees of the above institutions. In the case of CDB, employees include the employees of the temples under the Board. In the case of State Institute of Languages audit, apart from the approval of pay fixation of the employees of SIL, pension verification of employees in the following cultural organisations (not applicable to Tourism Audit and Malabar Devaswom Board)</p> <ol style="list-style-type: none"> State Institute of Encyclopaedic Publications, Trivandrum State Children's Literature Institute, Trivandrum Kerala Sahitya Academy, Thrissur Kerala Sangeetha Nataka Academy, Thrissur Kerala Lalitha Kala Academy, Thrissur Kerala Chalachitra Academy, Trivandrum Aranmula Vasthuvidya Gurukulam <p>i) Custodian of all registers, service books, all stocks and stores.</p> <p>j) Prepare Confidential Report of Gazetted and Non-gazetted officers and submit for review to the Senior Deputy Director/Director.</p> <p>k) Represent the office in the Local Fund Accounts Committee meetings.(Not applicable to Cochin Devaswom Board)</p> <p>l) Conduct all litigation in which the Deputy Director is a petitioner/ respondent and all other cases which the Director has authorised the DD to represent him.</p> <p>m) Perform the duties of Public Information Officer.</p> |
| Audit Officer | Malabar Devaswom Audit, Thalassery /Other concurrent audit offices | <p>a) All duties and responsibilities as Head of Office.</p> <p>b) Preparation of Audit Plan and monthly tour programmes and forward them to Head Office.</p> <p>c) Conduct of audit, approval, issue and follow up of Audit Reports of auditee institution.</p> <p>d) In the case of Malabar Devaswom Board audit, conduct of audit, approval, issue, follow up (except charge/surcharge) of audit reports of C, D grade temples/institutions.</p> <p>e) Propose the audit paras for the Consolidated Audit Report to the Director.</p> <p>f) Function as the Drawing and Disbursing Officer.</p> <p>g) Approval of fixation of pay, certification of last pay/ recommendations of the pensionary benefits of the above institutions (Not applicable to Malabar Devaswom Board).In the case of State Institute of Languages, pay fixation and pension are recommended to State Institute of languages.</p> <p>h) Custodian of all registers, service books, all stocks and stores.</p> <p>i) Prepare confidential report of Non-Gazetted Officers and submit it to the Deputy Director for review.</p> <p>j) Represent the office in the Local Fund Accounts Committee meetings as and when required by the Senior Deputy Director/Director.</p> <p>k) Conduct all litigation in which the Audit Officer is a petitioner/</p> |

| Designation | Location | Functional Responsibilities |
|--|---------------------------------------|---|
| | | respondent and all other cases which the Senior Deputy Director/Director has authorised the Audit Officer to represent him. l) Perform the duties of Public Information Officer. |
| Law Officer | Head Office | a) Legal advisor of the department b) Preparation and vetting of statement of facts and counter affidavits. Advise the Director in all legal matters. |
| Audit Officer | Sub offices | a) Performing local audits b) Supervise the sections under the control of Audit Officer c) Perform the duty of batch leader in every audit batch d) Perform all other duties assigned by the Head of Office. |
| Assistant Audit officer/Senior grade auditor/Auditor | Sub offices | a) Performing local audits b) Scrutiny , issue and follow up of Audit Reports c) Deal with establishment matters, tour program, out audit program, pay fixation of employees of auditee institutions. d) Perform all other duties assigned by the Head of Office. |
| Audit officer/Assistant Audit officer/Senior Grade Auditor/Auditor | Sub offices(Concurrent audit offices) | a) Performing local audits b) Head of office of the sub office performs the duties for and on behalf of the Director, KSAD. The functions include the approval, issue and follow up action of Audit Reports of auditee institutions and manage routine works in the office c) Any other duties that may be entrusted to sub office by Government Orders |

2.5. Powers of the Director and Auditors

In order to discharge the roles and responsibilities and duties as envisaged in the Act in particular, and expected of auditors in general, the auditors shall have some explicit and implicit powers and obligations that need to be recognized by the Auditees and other stakeholders. The Act bestows on the auditors the following powers:

2.5.1. Powers of the Director

- a) General superintendence and control over all officers and staff of the KSAD.
- b) Power to conduct the audit and report on accounts of a local authority or a local fund included in the Schedule to the Act and power to conduct audit of accounts of stock and stores and verification of cash balance.
- c) Power to conduct the audit of accounts of other bodies, institutions, authorities not included in the Schedule to the Act, provided previous sanction of the government is obtained for such audits.
- d) Power to require production of accounts and other information and seek attendance of persons.
- e) Power to charge/ surcharge illegal payments and loss caused by negligence and misconduct/amount disallowed as per Section 16 of the Act.
- f) Power to condone illegal payment from local fund in certain circumstances as provided in Section 17 of the Act.
- g) Power to delegate any of his powers or functions to any officer of the KSAD.
- h) Power to dispense with detailed audit if circumstances so warrant.

- i) With the sanction of Government, Director can seek the services of any technical expert for the purpose of auditing and reporting on the accounts of stores and stocks held by local authority specified in the Schedule.
- j) Director is the custodian officer of all assets in the office

2.5.2. General Powers of Auditors

- a) Auditors shall have free access to books and records of the Auditee Entities at all reasonable times to ensure that they can discharge their duties without any hindrance. Auditors shall also be given access to cash and securities and documents of Auditee Entities to facilitate carrying out of their audit procedures.
- b) Auditors can require in writing production of vouchers, statements, returns, correspondence, notes, data or other information relating to any transaction, working and affairs of the Auditee Entity which they needed to carry out audit procedures.
- c) Issue summons to employees for production of documents for the purpose of audit and for personal appearance.
- d) Auditors shall have adequate powers to call for explanations and responses on any matter/deficiency/defect as observed by the auditors during the course of audit.
- e) Auditors shall have powers to visit any facility, office, or other centres of the Auditee Entity to physically verify the existence of its assets.
- f) In suitable cases and if so required by Government, the auditor shall issue a public notice of audit of local authority and shall consider the objections if any made in writing by any party.
- g) Disallow any item which appears to him to be contrary to law and surcharge as provided in Section 16 of the Act.

2.5.3. Auditee Institution Groups

KSAD has the mandate to audit the following institutions as included in the Schedule to the Act:

1. All Municipal Corporations
2. All Municipalities
3. All Panchayats
4. All Universities
5. Kerala State Housing Board
6. All Development Authorities
7. Temples under the management of Hindu Religious and Charitable Endowments Administration Department.
8. State Institute of languages
9. State Institute of Encyclopaedic Publications
10. Orphanages and Poor Homes
11. Kerala Sports Council and its District Units and affiliated institutions
12. Kerala State Jawahar Balabhavan and District Balabhavans
13. Wakf Board
14. Kerala Lalithakala Academy
15. Kerala Sangeetha Nataka Academy
16. Kerala Sahithya Academy
17. Kerala Kalamandalam

18. Kerala Association for Non-Formal Education and Development
19. The State Institute of Children's Literature.
20. The State Library Council, District Library Councils and Taluk Library Unions and Libraries affiliated to the State Library Council.
21. The Bharat Sevak Samaj, Kerala Pradesh
22. Bharat Scouts and Guides
23. The T.B. Association of Kerala
24. The Society for Prevention of Cruelty to Animals
25. The Travancore- Cochin Medical Council
26. The Kerala Nurses' and Midwives' Council
27. The Kerala Pharmacy Council
28. The Kerala Dental Council
29. The Kerala State Nirmithi Kendra
30. Kerala Urban Development Finance Corporation
31. The Kerala Health Research and Welfare Society
32. The Kerala Police Welfare and Amenity Fund
33. The Kerala Police Sports Fund
34. The Kerala State Military Benevolent Fund, District Benevolent Funds and the Flag Day Fund of the Rajya Sainik Board.
35. The Scientific Research Funds under the State Committee of Science and Technology.
36. The Kerala Panchayat Association Fund
37. The Kerala Head Load Workers' Welfare Fund
38. The Kerala Khadi Workers' Welfare Fund
39. The Kerala Motor Transports Workers' Welfare Fund
40. The Kerala Coir Workers' Welfare Fund
41. The Kerala Construction Workers' Welfare Fund
42. The Kerala Abkari Worker's Welfare Fund.
43. Kerala Toddy Worker's Welfare Fund
44. Labour Welfare Fund
45. Handloom Workers' Welfare Fund
46. Agricultural Workers' Welfare Fund
47. The Kerala Tailoring Workers' Welfare Fund
48. Kerala Cashew Workers' Relief and Welfare Fund.
49. Kerala Dairy Workers' Welfare Fund
50. Kerala Ration Dealers Welfare Fund
51. Kerala Lottery Sellers and Agents Welfare Fund
52. Kerala Goldsmith Welfare Fund
53. Kerala Barbers and Beauticians Welfare Fund
54. Kerala Laundry Workers Welfare Fund

In addition to the above, as per subsection 2 of section 4 and section 5 of the Act, new institutions were included in the schedule of the Act, through Gazette notification. The name of such institutions are:

1. Kerala Traders Welfare Fund
2. State Council of Educational Research and Training
3. Society for Construction, Maintenance and Administration of Multi-purpose Cultural Complex

4. Tourism Week Celebration and District Tourism Promotion Councils
5. Kerala Chalachithra Academy
6. Kerala Etta, Kattuvally and Pandanus Leaf Workers' Welfare Fund
7. All Hospital Development/Management Committees
8. Kerala Beedi and Cigarette Workers' Welfare Fund
9. Kerala State Veterinary Council
10. Kerala Book Marketing Society
11. Charitable Endowment Funds
12. Integrated Tourism Fund
13. All Cultural institutions except those included in the Schedule
14. Kerala Ground Water Authority
15. Institute of Virology and Infectious Diseases, MCH, Alappuzha
16. Kerala Panchayat Employees Provident Fund
17. Malabar Devaswom Board

The Honourable High Court of Kerala through its various orders assigned the audit of the following institutions to KSAD:

1. Travancore Devaswom Board
2. Cochin Devaswom Board
3. Deposit Accounts of the Courts subordinate to the Honourable High Court of Kerala and Amalgamated Fund

In addition to the above, as per other Enactments/Rules, following institutions are also audited by KSAD.

1. Guruvayur Devaswom
2. Koodal Manickam Devaswom
3. Kerala Municipal Employees Central Pension Fund
4. Municipal Pension Fund

2.6. Other Institutional Framework

2.6.1. Audit Monitoring Committees

The Government has vide GO. (Rt) No. 2121/2007/LSGD 04-08-2007 constituted Audit Monitoring Committees at the District and State level for timely settlement and clearance of Audit paras. The constitution and functions of these committees are:

2.6.1.1. District Level Audit Monitoring Committee

- a) There shall be a District Level Audit Monitoring Committee each for settlement of audit paragraphs of all auditing agencies in respect of Grama Panchayat / Block Panchayat and Municipalities.
- b) For Grama Panchayat, the Deputy Director of Panchayats, Assistant Director of Panchayats, Deputy Director of Kerala State Audit Department, Audit Officer from office of the Accountant General (Audit) and the District Finance Officer in charge of the Finance inspection shall be members of the committee. For Block Panchayat, instead of the Deputy Director of Panchayat and Assistant Director of Panchayat, the Assistant development commissioner (General) and Assistant Development Commissioner (PA) shall be the members. For Municipalities, the Regional Joint Director of Urban Affairs would be the member of the committee in the place of DDP, ADP and ADCs.
- c) The DDP/ ADC (General) and RJDUA respectively shall be the Conveners of the Audit Monitoring committee of Grama Panchayats, Block Panchayats and Municipalities and the Committee shall be convened once in three months at such places as decided by the DDP/ADC/RJDUA.

- d) Details of number of Audit Reports pending and details of Panchayat not submitting replies in respect of different audit, shall be prepared by representative officer of various types of audit, and copy of the same shall be given to the DDP, ADC (General) and RJDUA sufficiently in advance
- e) The Audit Monitoring Committee can summon the Secretaries and Implementing Officers of the local bodies concerned which are not responding to audit promptly in giving replies and taking remedial action and explanation can also be called for – for non-submission of replies and for not taking remedial action based on audit observations.
- f) In the Monitoring Committee Meeting, the details of pending paras along with remedial action taken for settlement of audit paras shall be discussed and suitable decisions shall be arrived at.
- g) The decisions along with suggestion / recommendations and detailed report of pending paras of the Committee shall be forwarded to the Director of Panchayats / Commissioner for Rural Development and Director of Urban Affairs.
- h) The Director of Panchayats / Commissioner for Rural Development and Director of Urban Affairs shall constitute a separate cell in the Directorate and Commissionerate under the supervision of a senior officer to deal with the work relating to Audit Report of various agencies.
- i) Wherever necessary, district level officers of various departments may be invited by the Committee to discuss Audit Reports pertaining to various departments.
- j) The cell formed as above shall, take suitable action for settlement of Audit Paras based on the report from the District Level Monitoring Committee and an Action Taken Report shall be prepared once in a quarter. The report shall include the details of pending Audit Reports and paras, action suggested by the District Level Committee, action taken by Director/ Commissioner and the details of paras and reports settled and details of action taken against the defaulting Panchayats / Municipalities and further suggestions/ recommendation for clearance of paras. The Action Taken Report shall be submitted to the convener of the State Level Steering Committee once in four months by the Director of Panchayats/ Commissioner of Rural Development/Director of urban affairs.
- k) District Collector is the chairmen of the District Level Monitoring Committee (GO (Rt) No 2254/2010/LSGD 8-07-2010)

2.6.1.2. State Level Audit Monitoring Committee

- a) There shall be a State Level Audit Monitoring Committee for settlement of Audit Reports and paras of various agencies.
- b) The Principal Secretary (LSG), Director of Panchayats, Commissioner of Rural Development, Director of Urban Affairs, Director of Kerala State Audit Department, Senior Deputy Accountant General (LBA), State Performance Audit Officer, Additional Secretary (Finance Inspection Wing) and Deputy Secretary (A) (Local Self Govt.) shall be the members.
- c) The Principal Secretary (LSG) shall be the Chairman and the State Performance Audit Officer shall be the Convener of the Committee.
- d) The Committee shall be convened once in four months based on the order of the Chairman.
- e) The Senior Deputy Accountant General (LBA), State Performance Audit Officer, Additional Secretary (Fin) and Director of Kerala State Audit Department shall give a detailed report showing number of Audit Reports and paras pending in Panchayats and Corporations and the promptness in getting replies and the attitude of Local Self Government Institution towards Audit.
- f) The State Level Committee shall discuss the Action Taken Report (ATR) submitted by the Director of Panchayats, Commissioner of Rural Development and Director of Urban Affairs

and the Report received from Senior Deputy Accountant General (Sr.DAG), State Performance Audit Officer (SPA0) and Director of Kerala State Audit Department in respect of District Panchayats and Corporations shall be scrutinized and suitable decisions would be arrived at.

- g) Wherever necessary, the Secretary and Implementing Officers of District Panchayats and Corporations may be summoned by the State Level Monitoring Committee for failure in submission of replies or for taking remedial action on audit points.

2.6.2. Legislative Committee on Local Fund Accounts

Rule 264 of the Rules and Procedure and Conduct of Business in the Kerala Legislative Assembly was amended to include a provision to constitute a Committee on Local Fund Accounts for the examination of accounts showing the appropriation of amounts granted by the Legislative Assembly for local bodies / authorities in the Assembly. The provisions of the said rules are given below:

Rule 261 G

- a) There shall be a committee on Local Fund Accounts for the examination of accounts showing the appropriation of sums granted by the Legislative Assembly for local bodies/ authorities in the Assembly as the Committee may think fit.
- b) In scrutinizing the Appropriation Accounts of local bodies and authorities and the consolidated report of the Director of KSAD, it shall be the duty of the committee to satisfy itself:
 - i. that the money shown in the accounts as having been disbursed were legally available for, and applicable to, the service or purpose for which they have been applied or charged.
 - ii. that the expenditure conforms to the authority which governs it.
- c) It shall also be the duty of the Committee –
 - i. to examine the statement of accounts showing the income and expenditure of all Municipal Corporations, Municipalities, Panchayats, Universities, Development Authorities and such other Local Authorities or a Local Fund included in the schedule under section 3 (1) of the Act.
 - ii. to examine the statement of accounts showing the income and expenditure of autonomous and semi-autonomous bodies, the audit of which are conducted by the Director, KSAD by a Statute of the Legislature;
 - iii. to consider the Audit Report of the Director, KSAD and accounts of a fund administered by a local authority which, though not part of a Government department has been established by or under law or orders of the Government or any other fund which the Government may by notification in the Gazette declare to be a Local Fund;
 - iv. to examine the Consolidated Audit Report of the accounts audited by the Director, KSAD which is laid annually before the Legislative Assembly. The committee shall perform such other functions in respect of Audit Reports of the Local Bodies audited by the Director, KSAD as may be assigned to it by the Speaker from time to time.

Rule 261 H

At the commencement of the Assembly or from time to time, as the case may be, the Speaker shall nominate a Committee on Local Fund Accounts consisting of not more than eleven Members: provided that a Minister is not to be nominated as a member of the Committee and that if a member, after his nomination to the committee, is appointed as Minister, he shall cease to be a member of the Committee from the date of such appointment.

3. Basis of Audit Authority

3.1. Regulatory Framework for Local Fund Audit

The Kerala Local Fund Audit Act, 1994 (Act) and the Kerala Local Fund Audit Rules, 1996 (Rules) provide the overall legal and regulatory framework for audit of local funds under the management or control of certain local authorities in the State of Kerala. For the purposes of the Act and the Rules, the local fund and the local authority have been defined to be:

- a) “Local Fund” means :
 - i. a fund administered by a local authority which, though not part of a Government Department, has been established by or under a law or orders of the Government, and
 - ii. any other fund which the Government may by notification in the Gazette, declare to be a local fund for the purposes of the Act
- b) “Local Authority” means:
 - i. a Municipal Corporation constituted under the Kerala Municipal Corporations Act, 1961 (30 of 1961) or a Municipality constituted under the Kerala Municipalities Act, 1960 (14 of 1961) or Township specified in section 2 of the Guruvayur Township Act, 1961 (43 of 1961) or a Panchayat constituted or deemed to have been constituted for the local administration of a Panchayat area under the Kerala Panchayats Act, 1960 (32 of 1960) or a Panchayat or a Municipality or a Metropolitan Planning Committee or a District Planning Committee constituted in the State in accordance with the provisions in part IX and Part IX A respectively of the Constitution of India.
 - ii. any other authority, body, or institution established by or under any law or orders of the Government and responsible for the administration of a local fund

KSAD derives its powers to audit of local authorities or local funds as included in the Schedule to the Act, from Section 4 and Section 5 of the Act. Specifically, with respect to audit of PRIs and ULBs, KSAD derives its powers to be the primary auditor of these local bodies from Article 243J and Article 243 Z of the Constitution of India read with the recommendations of the 11th Finance Commission and the guidelines for utilization of Local Bodies’ grants issued by the Ministry of Finance, Government of India. In this connection it is pertinent to note that the terms such as “bodies”, “authorities” have not been defined in the Act and hence need to be interpreted using authoritative pronouncements or references. The term “authority” has been interpreted by the Attorney General of India to mean a person, or body exercising power or command vested in it by virtue of the provisions of the Constitution of India or Acts passed by Legislatures. “Body” has been interpreted to mean an aggregate of persons, whether incorporated or unincorporated. It would therefore include, institutions or organisations set up as autonomous organisations under specific statutes or as a society registered under the Societies Registration Act, 1860, or the Indian Trust Act, 1882, or other statutes, voluntary organisations or non-governmental organisations, Urban or Rural self-government institutions, cooperative societies, or societies or clubs, etc.

3.2. Audit Mandate

The Audit Mandate for KSAD is derived from Section 3, Section 4, Section 5 and Section 7 of the Act read with Rules 4 to 7 of the Rules. In addition, the provisions of the circulars No. 1/2006 dated 24th April 2006 and 2/2008 dated 25th February 2008, issued by the Director, KSAD, provide necessary mandate to KSAD for the audit of local funds/authorities included in the Schedule to the Act.

3.2.1. Audit of Accounts of the Local Funds and Local Authorities included in the Schedule to the Act

Section 4 of the Act read with Rule 3 of the Rules, vests with the KSAD, { subject to the provisions of the Controller and Auditor General, (Duties, powers and Conditions of Service) Act, 1971} , the powers to **conduct the audit of accounts of a local authority or local fund included in the schedule** attached to the LFA Act. Further, the Government may, by notification in the Gazette and for reason to be specified therein, add any other authority, body, institution or local fund to the Schedule referred to above and on the publication of the notification, such authority, body, institution or local fund shall be deemed to be added to the Schedule. It is also provided that no authority, body institution or local fund included in the Schedule referred to above could be omitted therefrom except by the authority of a law made by the State Legislature.

3.2.2. Audit of Accounts of the Institutions not included in Schedule

Section 5 of the Act read with Rule 3 of the Rules, provides that the Director, KSAD may, with the previous sanction of the Government and without prejudice to the provisions of Section 4, audit the accounts of any authority, body, institution or fund not included in the schedule subject to such terms and conditions as may be agreed upon between the Director and the person responsible for the administration of such authority, body, institution or fund. The audits conducted under this section are “agreed upon” audits and procedures and therefore the scope of the audit will be determined by Engagement Letters exchanged with the client. These engagement letters should provide the scope and coverage of audit in clear terms in order to ensure a proper conduct of audit.

3.2.3. Audit of Stores and Stock and Verification of Cash Balance

Section 6 of the Act read with Rule 4 of the Rules, vests with the KSAD the powers to **audit and report on the accounts of stores and stock** kept by a local authority included in the Schedule. The Director may, with the sanction of the Government, seek the services of any, technical expert for this purpose if, in his opinion, it is necessary to do so. An officer not below the rank of a Deputy Director shall have authority to make surprise inspection of the stock and stores kept by a local authority specified in the Schedule. Further, the Director shall **have authority to verify the cash balance of the fund** at the time of audit and inspection. This audit may include the following:

- a) Physical verification of stock and cash balances
- b) Verification of stores accounts and matching them with the books of accounts.
- c) Ensuring that the expenditure on stores complies with relevant departmental/government rules and procedures.

3.2.4. Audit Report and Certification of Accounts

As per **section 13** of the Act, as soon as practicable after the completion of the audit, but not later than three months thereafter the auditor shall send to the local authority concerned a report on the accounts audited and examined by him and the copies of the report shall also be sent to such officers and such bodies as the Government may direct or as may be specified under the law governing that local authority.

As per **Section 14** of the Act, the Director or the officer delegated by him shall include in the Audit reports a statement of –

- a) every payment which appears to him to be contrary to law.
- b) cases of any deficiency or loss which appears to have been caused by the negligence or misconduct of any person.

- c) cases of misappropriation or mis-utilization of the local fund.
- d) the amount, if any, received which is required to be brought into account but has not been brought into account by any person; and
- e) any other material impropriety or irregularity which he has observed in the accounts.

Rule 19 of the Rules deals with the form and content of the audit reports and this is reproduced in the following exhibit.

“Unless otherwise provided in these rules, the audit of accounts of the local authorities/local funds shall be conducted by the auditors in such manner as may be specified by the Director. The instructions issued by the Director from time to time with regard to the form of audit report, drafting of audit paras, completion of audit report, contents of the audit report and enclosures to the audit report shall be followed unless otherwise specified in these rules or in the Act. In the case of institutions which are bound to meet the audit charges under section 19 of the Act and rule 24 of these rules, a separate para showing the computation of audit charges due may be incorporated in the audit report.

There shall be two separate parts in the audit reports.

- (1) Part showing the details of clear cases of loss on receipt side in which shall be incorporated :
 - i. Cases in which the amount, if any, received which is required to be brought into account but has not been brought into account by any person;
 - ii. The cases of misappropriation of collections made; and
 - iii. Cases of any deficiency or loss of money due to short realization/non realization of dues which appears to have been caused by the negligence or misconduct of any person.
- (2) Part showing details of clear cases of loss on payment side in which shall be incorporated.
 - i. Cases of mis-utilization of funds
 - ii. Cases of payments which appears to be contrary to law
 - iii. Cases of any deficiency/loss of any property, stock, etc.
 - iv. Cases of excess payment made; and
 - v. Cases of avoidable expenditure.

It appears from the aforesaid provisions of the Act that the mandate of KSAD is to audit the accounts as presented to them by the respective local funds/local authorities and submit only an audit report and the mandate does not extend to certification of accounts. A significant portion of the audit of KSAD is the financial and compliance transaction audit and therefore the scope of audit report should be wider than just reporting only on those items as per section 14. Certification of annual accounts involves verification and examination of books of original entry, ledgers, registers, subsidiary books of accounts, etc., to see that accounts are in accordance with the books. Inherent in the process of audit of annual accounts is the assumption that transactions appearing in the books of original accounts pertain to the organization and represent legitimate charge, and the books themselves record fully and faithfully all transactions pertaining to the organisation for the period and nothing is left out. This can be ensured only by a detailed audit of the transactions and accounts using the process and audit procedures described in this Manual. In this connection it is relevant to note that as per the extant CAG guidelines and the circular No 2/2008 issued by the Director, KSAD, in the case of audit of PRIs/ULBs, auditor is required to issue an Auditors Certificate, the first part of which would provide the scope of audit and second part would give the auditors’ opinion on accounts. This opinion may be (i) qualified (ii) unqualified (iii) Adverse or (iv) Disclaimer, opinions, as the case may be. This certification process may be extended to all the entities audited by KSAD.

4. Audit of Accounts-Concepts & Types

4.1. Concepts and Definition

Audit is a systematic and independent examination of books of accounts, statutory records, documents and vouchers of an entity to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the entity. The broad aim of audit of Local Bodies/Institutions is to safeguard their financial interest by sound and economic financial management practices and to promote public accountability. The executives of the Local Bodies/Institutions 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 weakness, deficiencies and circumstances leading to infructuous expenditure.

In the context of Section 4 and Section 5 of the Act, in performance of duties and exercise of powers by the Director of the KSAD the term **Audit** may be interpreted to mean examination of books of accounts, transactions and records. The essential features of the audit of accounts may therefore be understood to be:

- a) to make critical review of the system of maintaining accounts books, accounting and internal control;
- b) to make such tests and enquiries as the auditors consider necessary to form an opinion as to the reliability of the records as a basis for preparation of accounts;
- c) to compare figures of different accounts schedules with those of the connected records in order to see whether they are in accordance with the transactions depicted therein;
- d) to make a review to ensure propriety, regularity and financial control;
- e) to make a critical review for the scheme/programme/activities economy, efficiency and effectiveness; and
- f) to make a critical review of the accounts in order that a report may be made stating whether, in the opinion of the auditors, the accounts are presented and the items are described in such a way that they properly present the receipts and payments of the Auditee Institutions.

For local fund audits, audits should be seen as a composite concept and look into accounting and arithmetical accuracy of books and financial statements, adherence to rules and regulations, propriety and the end result in the form of efficiency and effectiveness of the programs and schemes and even organizations. In this connection it is relevant to note that according to CAG's Auditing Standard 4.9: **“the term 'Audit' includes financial audit, regularity audit and performance audit”**.

In pursuance of various provisions of the Act and its Rules and responsibility bestowed on the KSAD for local fund audits, the Director KSAD is empowered to decide nature, scope, extent and quantum of audit to be conducted by him or on his behalf for each audit entity. In this connection it is further relevant to note that the completeness and accuracy of the accounts are examined by the auditors and it has to be seen that there is proper voucher or proof of payment. In addition, audit against provision of funds is done to ascertain whether the amounts shown in the accounts as having been disbursed, were legally available for and applicable to the service or purpose to which they have been applied or charged. It should also be seen in audit that the expenditure conforms to the authority which governs it (regularity audit).

The interpretation of Audit for the purpose of section 4 and section 5 of the Act should also be understood to include examination of the propriety of executive action and look beyond the formality

of the expenditure to its wisdom, faithfulness and economy and to bring to the notice of the Legislature/Appropriate Authority, cases of waste, losses, extravagant and nugatory expenditure (Propriety audit). Propriety requires the transactions and more particularly the expenditure, to conform to certain general principles. These principles are:

- a) that the expenditure is not prima facie more than the occasion demands and that every official exercises appropriate prudence and vigilance in respect of expenditure as the situation/occasion warrants.
- b) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;
- c) that the funds are not utilized for the benefit of a particular person or group of persons and
- d) that the expenditure, apart from the agreed remuneration or reward, shall not directly or indirectly benefit the management personnel, employees and others.

Thus, Propriety Audit is concerned with scrutiny of executive actions and decisions having a bearing on the financial and non-financial aspects of the local authority/fund, with special regard to public interest, accountability, commonly accepted customs and standards of conduct.

Further, for the purposes of local fund audits, the term audit of accounts may mean to include Efficiency-Cum-Performance audit which is a comprehensive appraisal of the progress and efficiency of the execution of development programmes. In this audit, an attempt is made to assess and appraise to what extent, social; and economic objectives sought to be achieved have been achieved and at what cost; and to examine how far the agency or department is adequately discharging its financial responsibilities and to ascertain whether the schemes are being executed and their operations conducted economically.

According to Audit Standard SA 200, Basic Principles Governing an Audit, issued by the ISSAI, Audit is an independent examination of financial information of any entity, whether profit oriented or not, irrespective of its size or legal form when such examination is conducted with a view to express an opinion thereon. The term “financial information” encompasses financial statements. As per Audit Standard SA 200 A, Objectives and Scope of the Audit of Financial Statements, issued by the ISSAI, the objective of an audit of financial statements; is to enable an auditor to express an opinion on such financial statements and help in determination of the true and fair view of the financial position and operating results of an enterprise. The term “financial statements” is construed to refer to general purpose financial statements, which according to para 3.3 of the Preface to the Statement of Accounting Standards issued by the ISSAI includes (i) Balance Sheet (ii) Statement of Profit and Loss and other statements and explanatory notes which form part thereof. For the purpose of expressing an opinion, the auditor/s are expected to assess the accuracy, reliability and sufficiency of the information contained in the underlying accounting records (books of accounts) and other records and sources of data by:

- a) evaluating accounting systems and internal controls on which they rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures;
- b) carrying out such other enquiries, tests, examinations, verification procedures of accounting transactions and account balances as the auditors consider appropriate under the circumstances.
- c) assessing the selection and consistent application of accounting policies, the manner in which information has been classified and the adequacy of disclosure.

The Audit Standards issued by CAG of India or the INTOSAI do not contain any specific definition or explanation of “audit” or “audit of accounts”; these standards categorize audits into three types and provide the general guidelines for each type of audit along with objectives of such audits.

4.2. *Types of Audit*

Para 22 of the ISSAI 100, Fundamental Principles of Public-Sector Auditing and the General Audit Standards issued by CAG of India categorize audits into three essential types, namely:

- a) **Financial Audit:** the objective and the focus are to determine whether the financial statements are properly prepared, are complete in all respects and are presented with adequate disclosures and in general are in accordance with the applicable financial reporting and regulatory framework. The audit assurance or expression of an opinion is whether the financial information is free from material misstatement due to error or fraud.
- b) **Compliance Audit:** the objective and focus are to determine whether the activities of the audit entity, its financial transactions and information materially comply with the applicable laws, rules and regulations made thereunder and various orders and instructions issued by competent authority.
- c) **Performance Audit:** the focus of the audit is on the extent to which an activity, programme or organisation operates economically, efficiently and effectively and whether there is room for improvement. The objective of the audit is to audit performance against set outputs and outcomes and criteria and provide key recommendations for improvement.

By virtue of various provisions of the Act and Rules, the Director KSAD has the powers to decide the type of audit and the manner in which it has to be conducted. A narrative on (i) Financial Audit (ii) Compliance Audit and (iii) Performance Audit as extracted from the relevant rules and standards of CAG and ISSAI is given below to facilitate necessary discussion and decision by KSAD for planning its audits of various institutions as per Schedule to the Act.

4.2.1. *Financial Audit*

The primary purpose of financial audit is to verify whether the books of accounts are properly prepared and maintained and are complete in all respects and accounts are presented in proper formats and with adequate disclosures. The Financial audit is concerned with expression of an opinion on the financial statements together with their notes and schedules. It involves:

- a) inspection, verification and examination of books of accounts and financial records and expression of opinions on financial statements prepared in accordance with applicable accounting and financial reporting framework.
- b) audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations which affect the accuracy and completeness of accounting records; and
- c) testing the design and effectiveness of internal controls and internal audit functions that assist in safeguarding assets and resources and assure the accuracy and completeness of accounting records.

Therefore, in conducting a Financial Audit, the auditors examine and verify:

- a) books of accounts and the financial statements for their compliance with the applicable laws, rules and regulations and accounting principles, policies and acceptable standards including conformity with the form of accounts prescribed by appropriate authorities.
- b) completeness of the books of accounts and the financial statements; which also includes a critical review of the amounts that are not adjusted to their final classification;

- c) accounting transactions and account balances, accuracy of the books of accounts and the financial statements including consistency between the related statements;
- d) the amount of actual expenditure with reference to its budgets and application to the service or purpose in accordance with the scope and intent of the grant/scheme.
- e) significant variations between the budgets as authorized and actual expenditure and explanations for such variations
- f) accounting and reporting of receipts and payments, their cross verification and reconciliation with the accounts and other records
- g) timeliness of the books of accounts and the financial statements;
- h) adequacy of disclosures including appropriate and necessary explanations for any entry or amount that is prima facie unusual

In regularity (financial) audit and in other types of audit when applicable, auditors should analyse the financial statements to establish whether prescribed accounting procedures for financial reporting and disclosure are complied with. 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. The auditors should thoroughly analyse the financial statements and ascertain whether:

- a) financial statements are prepared in accordance with prescribed accounting procedures;
- b) financial statements are prepared 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.

4.2.1.1. Objectives of Financial Audit

The primary objective of Financial Audit is to express an opinion on the financial statements in the Audit Report or by means of an exclusive Audit Certificate if it is so provided in the relevant Audit Standards such as those applicable for Local Authorities. Given the audit mandate (arising from legislations, regulation and government policy requirements), the broad objectives may therefore be set as:

- a) to obtain reasonable assurance whether the financial statements as a whole are free from material misstatement, due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- b) to report on the financial statements, and communicate the result of the audit in accordance with the auditor's findings.
- c) the detailed transaction audit should essentially seek to address the issues of risks to regularity, propriety and financial control.

For audit of receipts & payments accounts/income and expenditure accounts, CAG, **suggests additional audit objectives as below:**

- a) **Completeness:** 'Completeness' means that all transactions relevant to the year of account have been recorded. This implies that no transaction has been overlooked. This assertion directly tests for potential understatement of figures in accounts.

- b) **Occurrence:** ‘Occurrence’ means that all recorded transactions occurred and were relevant to the year of account. This assertion directly tests for potential overstatement of figures in the accounts.
- c) **Measurement:** ‘Measurement’ means that the recorded transactions have been correctly valued, properly calculated, or measured in accordance with established accounting policies, on an acceptable and consistent basis. This involves much more than clerical accuracy as it requires the auditor to check the conformity with established accounting policies and standards and the consistency in the measurement.
- d) **Disclosure:** ‘Disclosure’ means that the recorded transactions have been properly classified and disclosed where appropriate. This implies that the receipts and expenditure were booked to the proper account head and the disclosures in the notes and foot notes in the accounts are appropriate and adequate.
- e) **Regularity:** ‘Regularity’ is a unique requirement for Government Accounts. This requires that the recorded transactions are in accordance with the primary and secondary legislation and other specific authorities required by them.

For audit of balance sheet items, CAG’s audit objectives are as detailed below:

- a) **Completeness:** ‘Completeness’ means that all assets and liabilities have been recorded in the accounts and nothing has been omitted. This objective directly tests for potential understatement of assets and liabilities. For example, if the accounts omit some investments or liabilities, the ‘completeness’ objective is not satisfied.
- b) **Existence:** ‘Existence’ means that all recorded assets and liabilities exist. This objective directly tests for potential overstatement of assets and liabilities. For example, if the accounts show some amount as cash balance, which does not exist, the ‘existence’ objective is not satisfied.
- c) **Valuation:** ‘Valuation’ means that the values given to the assets and liabilities are accurate and have been arrived at in accordance with the established accounting policies on an acceptable and consistent basis. This goes beyond mere arithmetical accuracy, and requires conformity with accounting policies and standards and their consistent application.
- d) **Ownership:** ‘Ownership’ means that the assets are owned by the entity, the liabilities are properly those of the entity and both arise solely from regular activities. The balance sheet represents an accumulation of the entity’s rights and obligations. ‘Ownership’ assertion requires that the assets and liabilities reported actually represent those rights and obligations. For example, if an item is shown in the accounts as amount receivable, the entity should have the legal right to sue and collect the amount.
- e) **Disclosure:** ‘Disclosure’ means that the assets and liabilities have been properly disclosed in accordance with the applicable reporting framework. This implies that the assets and liabilities are booked to the proper account head and the disclosures in the notes and foot notes in the accounts are appropriate and adequate. For instance, if obligations under guarantees given by the entity are not shown in the accounts, the requirement of ‘disclosure’ is not satisfied.

4.2.1.2. Certification of Accounts

Section 4 and Section 5 of the Act do not mandate the KSAD to certify the financial statements. However, as the objective of conducting the Financial Audit is to express an opinion on Financial Statements, certification of financial statements becomes necessary. It is also mandatory under the Audit Standards issued by CAG of India, to issue Audit Certification with or without accompanying certification of their financial statements in respect of audit of Panchayati Raj Institutions and Urban

Local Bodies. However, the best practices for certification suggest, that the auditors should certify the financial statements on which they are expressing an opinion. As per the CAG standards and guidance, normally financial audit will result in issuing an Audit Certificate and in those audits, financial Audit Reports and Audit Certificate are synonymous.

4.2.2. Compliance Audit

The CAG's Regulations on Audit and Accounts, 2007 define compliance audit as:

‘an assessment as to whether the provisions of the Constitution of India, applicable laws, rules and regulations made there under and various orders and instructions issued by the competent authority are being complied with’.

This audit by its very nature promotes accountability, good governance and transparency as it is concerned with reporting deviations, identifying weaknesses and assessing propriety. The purpose of Compliance Audit is to examine the transactions relating to expenditure, receipts, assets and liabilities of local authorities/funds and other institutions for compliance with:

- a) the relevant provisions of the laws, rules and regulations, Codes and Manuals and Orders and instructions issued by the Government/Competent Authority or with the powers formally delegated by a superior authority;;
- b) the transactions of Local Bodies as evidenced by the documents audited, are in accordance with the prescribed Codes, Rules, Manuals, Instructions, etc.; and
- c) ensuring that rules and regulations are observed not merely in the letter but also in the spirit. For example, sanctions and orders for the grant of special pay or other allowances or concessions should be questioned in audit if they are in conflict with the broad spirit or main principles of the relevant service rules.

4.2.2.1. Objectives of Compliance Audit

The overall Compliance Audit Objectives can be summarized as below:

- a) To assess whether the subject matter adheres to the formal criteria arising out of the laws, regulations and agreements applicable to the auditable entity;
- b) To assess whether the general principles of sound public sector financial management and ethical conduct have been adhered to; and
- c) The report on the findings and conclusions to the responsible party, those charged with governance, legislature and/or other parties as appropriate.

In addition to the above, Auditors will have to list out any specific objectives based on their scope of audit; illustrative and not comprehensive, instances of scope and detailed audit objectives of compliance audits are given below:

| Compliance audit scope | Detailed audit objectives |
|-------------------------------|---|
| Contracting and procurement | <ol style="list-style-type: none"> a) Verify whether procurement is carried out as per extant rules and in accordance with delegated financial powers. b) Verify whether financial propriety is ensured during the different stages of tendering, evaluation and award of contract. |
| Tax receipts | <ol style="list-style-type: none"> a) Verify whether assessments are made in accordance with the relevant tax laws and rules thereunder. b) Verify whether the assessed demands are collected and properly accounted for. |

| | |
|---------------------|--|
| Establishment audit | a) Verify whether payments in respect of salaries and other entitlements are in accordance with the relevant rules and instructions. |
| Audit of sanctions | a) Verify whether the sanction is within the general powers or specific powers delegated to the sanctioning authority. b) Verify whether the criteria for sanction such as - availability of funds, determination of physical targets, objects of expenditure and accounting procedure- have been adhered to. |

4.2.3. Financial and compliance Audit

While a Compliance Audit may be taken up individually, it is generally combined with the Financial Audit and thus the annual audit as envisaged in Section 4 and Section 5 of the Act may be a Financial and Compliance Audit. As per 'Compliance Audit Guideline- General Introduction (ISSAI 4000), when compliance Audit is performed together with the Audit of financial Audit, the Compliance Audit Guide lines are supplement to the INTOSAI Financial Audit Guide lines (ISSAI 1000-2999). ISSAI's Compliance Audit Guidelines have the following two main perspectives.

1. ISSAI 4100 deals with Compliance Audit performed separately from the Audit of financial statements, for example, as a separate Audit task or related to Performance Audit.
2. ISSAI 4200 deals with Compliance Audit related to the Audit of financial statements.

These two ISSAIs are written as consistent standalone documents. Therefore, in conducting this audit, the auditors need to verify the following (in addition to those stated under Financial Audit):

4.2.3.1. Verification of Expenditure

- a) Appropriation of expenditure which is the availability of funds in the budget, including supplementary grant(s) and re-appropriation and confirmation that the expenditure is within the scope and intent of the grant/scheme.
- b) Authorization of the expenditure by the competent authority.
- c) Compliance with the requirement of the applicable laws, rules, regulations, orders and instructions in actual disbursement;
- d) Evidence by way of vouchers, bills, acknowledgement by payee and other supporting documents.
- e) Verification of expenditure in the books of accounts of the Auditee Entity and its cross-verification with the records of the treasury, bank, etc.

4.2.3.2. Verification of Receipts

Verification of receipts shall be with reference to existence of necessary systems and procedures as required by relevant laws and rules, and the efficacy of those systems and procedures to achieve the following:

- a) Correct assessment of taxes, refunds if any, abatements if any, and proper record of potential tax assesses and detection and prevention of tax evasion, including maintenance of records for arrears and their recovery, if any.
- b) Proper record of potential revenue resources and detection and prevention of revenue losses through default, mistakes, fraud etc.
- c) Proper maintenance of DCBs and other records and follow up and recovery of claims with due diligence; no claim should be dropped without proper justification on record.

- d) Levy of penalties and initiation of regulatory action in all cases of default and/or evasion.
- e) Measures to strengthen or improve revenue administration.

4.2.3.3. *Verification of stores and stock*

Verification of stores and stock shall be with reference to existence of necessary systems and procedures to comply with relevant rules and regulations and their efficacy to achieve the following:

1. Assessment of requirement of stores, including determination of limits for reserve stock.
2. Authorization of procurement of stores by competent authority in accordance with prevailing delegation of powers and rules.
3. Procurement of stores in accordance with the prevailing rules and prescribed systems and procedures.
4. Receipt, inspection, custody, issue and accounting of stores including appropriate segregation of duties of personnel and reconciliation of store accounts with books of accounts;
5. Physical verification of stores and reconciliation and resolution of discrepancies between physical balances and balances as per the books of accounts.
6. Identification of obsolete stores and their disposal/write off and inter office/unit transfer of surplus stores.

4.2.3.4. *Audit Report*

When Compliance Audit is done in conjunction with Financial Audit, there need not be a separate certification/audit report other than the one recited in para 3.2.4. However, if Compliance Audit is done separately, then the audit should be followed by issuance of an appropriate Audit Report. The Audit Report should state the following amongst others:

- a) Significant breach or irregularities detected with quantification of expenditure
- b) Expenditure if in the professional opinion of the auditor/s was wasteful, extravagant or unavoidable despite it complying with applicable rules and regulations.

4.2.4. **Performance Audit**

The purpose of Performance Audit is to examine the extent to which an Auditee Entity operates economically, efficiently and effectively of its schemes or programmes. It aims to assess the following:

Economy:

This represents minimizing the cost of resources used by acquiring them in due time, appropriate quantity and quality and at the best price. Auditors need to assess whether in the given context, resources have been acquired, held and used economically and acquired in due time, in appropriate quantity and quality at the best price.

Efficiency:

This represents the relationship between resources employed and outputs delivered in terms of quantity, quality and timing. Efficiency exists where the use of financial, human, physical and information resources is such that output is maximized for any given set of resource inputs, or input is minimized for any given quantity and quality of output. Auditors should examine whether the resources have been put to optimal or satisfactory use or whether the same or similar results in terms of quality and turn-around time could have been achieved with fewer resources.

Effectiveness:

This represents meeting the objectives set and achieving the intended results. Effectiveness is essentially a goal-attainment concept. It addresses the issue of whether the programme/activity has achieved its objectives. When focusing on effectiveness, it is important to distinguish between the immediate outputs or products and the ultimate impacts or outcomes. Outcomes are important to the effectiveness of programmes/ activities but may be more difficult to measure and assess than the inputs and outputs. Outcomes will often be influenced by external factors and may require long term rather than short-term assessment.

Auditing the objective of efficiency embraces aspects such as whether:

- a) human, financial and other resources are efficiently used;
- b) public sector programmes, entities and activities are efficiently managed, regulated, organized and executed;
- c) services are delivered in a timely manner; and
- d) the objectives of public sector programmes are met cost-effectively

In auditing effectiveness, Performance Audit, for instance may:

- a) assess whether the objectives of and the means provided (legal, financial, etc.,) for a new or ongoing public sector programmes are proper, consistent, suitable or relevant to the policy;
- b) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;
- c) identify factors inhibiting satisfactory performance or goal-fulfilment;
- d) assess whether the programmes complements, duplicate, overlap or counteract other related programmes;
- e) assess the adequacy of the management control system for measuring, monitoring and reporting on a programme's effectiveness; and identify ways of making programmes work more effectively.

4.2.4.1. Audit Objectives for Performance Audit

The basic objective of performance auditing is to constructively promote economical, effective and efficient governance and contribute to accountability and transparency. Performance Audit promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance. Performance Audit objectives may vary widely and include assessments of program effectiveness, economy, and efficiency; internal control; compliance and prospective analyses. Audit objectives that focus on program effectiveness typically measure the extent to which a program is achieving its goals and objectives, while audit objectives that focus on economy and efficiency address the costs and resources used to achieve program results. In any case, the basic objectives of the Performance Audit is to focus on improving the accountability and administration by reporting:

- a) The existence and effectiveness of administrative machinery to inform the government whether programme objectives and targets have been determined with a view to fulfilling policy objectives.
- b) Whether and to what extent the objectives of the programmes/schemes etc. have been achieved.
- c) The economy, efficiency and effectiveness of the means used and results obtained in implementing schemes, programmes of the government.
- d) The impact of the programmes/schemes/activities
- e) General compliance to applicable laws, rules and regulations.

The CAG has laid down certain guidelines for Performance Audit which need to be followed by all auditors. These are listed below.

| Guidelines for Performance Auditors |
|---|
| <ol style="list-style-type: none"> 1. Information on the programme/subject of audit as given below: <ol style="list-style-type: none"> a. Programme inputs/outputs b. Programme process and resource flow chart with explanatory notes c. Execution structure and institutional design d. Expected cost benefit/input output as per the programme design e. Programme beneficiaries f. Performance measures if any set in the programme g. Expected programme objectives and impact. 2. Scope of the performance audit in terms of period of operations to be audited, segment or activities or entities to be audited etc. 3. Criteria to assess if the programme objectives fulfil the policy objectives 4. Basis for comparison of the intended impact with the actual impact 5. Programme evaluation techniques to be used in the PA 6. Impact evaluation, if possible on the basis of available evidence – i.e. whether the observed impacts are attributed to the programme or there are other reasons 7. Audit evidence including their type 8. Expected value addition to the programme through PA 9. Expert or consultancy services or outsourcing if required 10. Evaluation of Internal Control System 11. Risk Analyses and Sampling Techniques 12. Recommendations development process and test of recommendations on the internal control parameters 13. Report writing procedures 14. Series of actions expected at each stage for entity involvement 15. Entry and Exit conferences and minutes thereof. |

4.2.4.2. Performance Audit Criteria

Audit criteria within the context of Performance Audit are audit specific, reasonable standards of performance against which the economy, efficiency and effectiveness of operations are evaluated and assessed. Criteria are the benchmarks used to evaluate the audit subject matter. Criteria may represent the laws, regulations, contracts, grant agreements, standards, specific requirements, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations included in the report. During planning, auditors should identify the potential criteria needed to evaluate matters subjected to audit. Auditors should identify and use criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter. The criteria can be qualitative or quantitative and should define what the audited entity will be assessed against. The criteria may be general or specific, focusing on what *should be* according to laws, regulations or objectives; what *is expected*, according to sound principles, scientific knowledge and best practice; or what could be (given better conditions).

4.2.4.3. *Fundamental Principles of Performance Audit*

As derived from the CAG's standards and guidance, the following are the fundamental principles of Performance Audit.

- a) Performance audit is an assessment of efficiency and effectiveness of the programmes, with due regard to economy;
- b) Addresses the issues of inputs, processes, outputs (products) and outcomes (impact);
- c) Apart from the question whether the things are being done the right way, it also addresses the question of whether the right things are being done. In other words, it also focuses on what is not being done rather than what is being done;
- d) Performance Audit also addresses the issues of equity and ethics, which impacts one or more of the core concerns of economy, efficiency and effectiveness and include, apart from others, integrity in preparation of performance reports;
- e) Distinction between regularity and performance audit should always be kept in mind;
- f) Performance Audit is undertaken with the objective of improving performance of public sector programmes and, therefore, an assessment of the expected impact-qualitative and quantitative-on the programme must be made before undertaking the audit;
- g) The subjects selected for performance audit could be a programme, segments of a programme - including the processes, procedures and systems, an entity itself or parts of an entity, etc.;
- h) The subjects of Performance Audit could be financial, non-financial or public interest and governance issues;
- i) The subjects selected for performance audit should include cutting edge issues that form the core of governance and sunrise issues in the light of policy shifts;
- j) Performance Audit can be carried out posterior or concurrently;
- k) Performance Audit may use many techniques used in programme evaluation;
- l) While the Performance Audit may and should assess the implementation of the policy through one or more programmes, the scope of audit should be limited to assessing the impact of the implementation of policy and the policy per se should not be questioned;
- m) Performance Audit conducted in time, when there is scope for remedial measures is encouraged; and
- n) Performance audit being knowledge-based exercise, in which conclusions emerge from interpretations, calls for special skills, knowledge and competence of the audit personnel.

4.2.4.4. *List of Issues for Performance Audit*

Illustrative issues for Performance Audit are given below:

| | |
|------------|---|
| Mandate | Has the approval of the competent authority been obtained (<i>e.g.</i> , legislature) for the programme/scheme/activity. |
| Objectives | <ol style="list-style-type: none"> a) Have clear objectives been developed for the programme/ scheme? b) Have the programme objectives been appropriately determined to fulfil the policy objectives? c) Are the objectives specific enough to enable outcome measurement? d) Have specific targets been set to accomplish the programme objectives within the scheduled timeframe? |
| Need: | <ol style="list-style-type: none"> a) Has the entity identified and evaluated the nature and extent of the need for the programme outputs? b) Does the programme continue to make sense in the light of the needs that it was originally set up to meet? |

| | |
|------------------------------|--|
| Implementation | <ul style="list-style-type: none"> a) Has management given proper consideration to alternative means of achieving the programme objectives? b) Are the design of the programme and its components, and the level of effort expended, logical in the light of the programme's objectives? c) Is the implementation timely? |
| Direction: | <ul style="list-style-type: none"> a) Does the entity have measurable and understandable objectives, plans, targets for levels of service and organizational arrangements? b) Do all employees/programme implementers understand what they are meant to be doing? |
| Economy and Efficiency: | <ul style="list-style-type: none"> a) Has management used resources economically and efficiently? b) What is the relationship between costs, inputs and outputs? Do systems procedures and practices promote accountability of programme managers towards economic and efficient use of resources? |
| Finances | <ul style="list-style-type: none"> a) Does the entity monitor, report and control its financial performance and position? b) Are resources (budgets) commensurate with the targets and how realistic are the budgetary assumptions? c) Are the financial and physical performance reports interlinked to enable an appreciation of the cost of delivery against the estimated cost as well as value for money? |
| Effectiveness | <ul style="list-style-type: none"> a) To what extent has the agency achieved intended objectives without any significant unintended adverse impacts? b) To what extent have significant intended or unintended, adverse or beneficial consequences occurred? |
| Acceptance | Is the programme outcome meeting the identified needs of its beneficiaries and stakeholders? |
| Accountability relationships | <ul style="list-style-type: none"> a) Is action taken on the basis of the reports? b) Does the programme/scheme framework provide for clear accountability relationships? c) Does the programme management/delivery frame work ensure good value for money? d) Are the controls reliable? e) Are there transparent systems and procedures as well as the delivery mechanisms in programme/scheme implementation? |
| Review | Has the entity established an effective internal audit unit, undertaken appropriate evaluation of programmes (including an analysis of unintended impacts) and established procedures for assuring that it is managing with economy, efficiency and effectiveness? |
| Equity | <ul style="list-style-type: none"> a) Are outputs/services made available to intended groups without discrimination? b) Does everyone have access to the benefits due to them? c) Has management acted with fairness and impartiality? |
| Ethics | <ul style="list-style-type: none"> a) Has the entity established procedures to ensure that public servants utilize public funds honestly? b) Are the highest standards of integrity and devotion to duty ensured through adequate management systems, including a system of review of propriety in programme management? c) Are public servants motivated to optimize the outputs and subsequent outcomes of the programme for the beneficiaries? |

| | |
|--------------|---|
| Transparency | Are the systems and procedures used in the management of public programmes transparent and do they promote the concept of accountability and good governance? |
|--------------|---|

4.2.5. Manner of Audit

Section 7 of the Act describes the manner of audit and this is extracted below:

The auditor shall conduct the audit annually and at such intervals as may be decided by the Director or may conduct concurrent audit of such of those local authorities as are found necessary under the provision of any law governing them or as may be decided by the Director in consultation with the Government.

4.2.5.1. Concurrent Audit

Section 2 b of the Act defines concurrent audit as “continuous audit of accounts of a local authority by auditors specially appointed by the Government by virtue of the powers conferred on them by the relevant enactments”. According to Rule 7 of the Rules, the system of concurrent audit shall be followed in the case of the local authorities/local funds where such system of audit was in vogue at the commencement of Act. In all other cases, the accounts shall be audited annually in arrears during the local audit. Concurrent audit for the purposes of this Act has been defined to mean and include a continuous audit of accounts.

Concurrent audit is a transaction audit. It is generally understood to be a systematic and timely examination of financial transactions concurrent with their occurrence or is carried out as near to it as possible. The objectives of concurrent audit are to:

- a) carry out audit on an ongoing basis with a view to identify areas of weaknesses and deficiencies as quickly as possible and detect mistakes, errors and frauds as close to the occurrence of the transaction as possible.
- b) shorten the interval between the occurrence of a transaction and its examination by an independent person not involved in the transaction.
- c) checking for accuracy, authenticity and compliance with laid down policies and procedures; spot rectification of errors and mistakes in accounting.
- d) preclude the possibility of serious errors and fraudulent manipulations by performing substantive checking of transactions in key areas and rectification of deficiencies in the earliest possible period.
- e) identify key areas of weakness and take corrective action as soon as possible.

The emphasis of concurrent audit is detailed verification and not a test check of transactions. Therefore, vouching of 100% of receipts and payments vouchers is one of its essential scopes and objectives and such verification should be done as quickly as possible after the occurrence of the transaction.

The decision to introduce concurrent audit system should generally be based on the following:

- a) The statutory provision in the Act
- b) If there are no statutory provisions, then the risk profile of the auditee entity or audit area should determine its introduction; generally the higher the risk in an Auditee Entity, the

higher the preference for concurrent audit. The risk profile may manifest in any of the following ways:

- i. Weak internal controls in the local authority/local funds or other bodies, institutions subject to audit by KSAD.
 - ii. Low quality book keeping and accounting of transactions; no uniform or standardized policies and procedures for accounting
 - iii. Lack of accuracy or unreliable financial statements and other financial reports of the Auditee Entity.
 - iv. Weak capacities in the local funds/authorities requiring continuous handholding support in financial management and accounting systems
 - v. Lack of timely and periodical closure of books of accounts
 - vi. Several public complaints and grievances requiring continuous audit intervention.
- c) The justification of concurrent audit in terms of its cost and economies and advantages that it is expected to bring to the Auditee Entity and the Government.

Concurrent audit should be carried out as soon as possible after the occurrence of the transaction; at least it should be planned to be conducted on “monthly basis”. In carrying out the concurrent audit of funds/institutions, the auditors’ role is generally restricted to the following:

- a) A concurrent auditor is expected to verify and recommend a correction for a deficiency noted and not challenge the decisions taken by the Auditee Entity.
- b) Not to challenge an existing policy but only verify its compliance. The power of amending a policy, a procedure or delegation always rests with the competent authority.
- c) A concurrent auditor is also not expected to rectify/correct the transactions; the rectification/correction/removal of deficiencies are the responsibilities of the concerned officers/staff of the Auditee Entity.
- d) A concurrent auditor shall also not be involved in day to day functions of the Auditee Entity.

Concurrent audit of transactions should necessarily be followed by an audit of Annual Financial Statements carried either by the same team of Concurrent Auditors or different teams from the concerned audit office.

4.2.5.1.1. Audit Report

To be effective, concurrent audit should adhere to strict timelines both in terms of conduct of audit, submission of reports and action taken on audit observations. An “Audit Report” should follow every audit and should detail transaction wise deficiencies observed; the report should address the following:

- a) Revenue leakages to the auditee entity and to the government
- b) Expenditure inefficiencies
- c) Lack of compliance with rules and regulations
- d) Quality of book keeping and accounting and deficiencies noted
- e) Deficiencies in internal checks and controls
- f) Transaction wise deficiencies noticed.
- g) Action taken on previous reports

The following timelines are suggested for concurrent audit of local bodies and other institutions that are subject to KSAD audit.

| Activity | Timelines |
|--|-------------------------------------|
| Conduct of Concurrent Audit | Monthly |
| Submission of Audit Notes by auditors to Audit Office | 5 th of Next Month |
| Review by Audit office and issuance of notes to Auditee Entity | 10 th of Next Month |
| Compliance/Management Response of Auditee Entity | 15 th of Next Month |
| Consolidation and submission of notes and submission of report by the Audit Office to the Director, KSAD | Quarterly, by end of every quarter. |

4.2.5.2. Detailed Audit

Section 2 c of the Act defines the detailed audit as audit of accounts of the entire transactions for the whole year or for the period specified by the Director. Sub-rule 7(2) of the Rules stipulate that the audit of a local fund/local authority shall be a detailed audit unless otherwise decided by the Director. Sub-rule 7(1) of the Rules requires that accounts of all local funds/ authorities where concurrent audit is not introduced, to be audited annually in arrears during local audit. Sub-rule 2(c) of the Rules defines the local audit to be “audit conducted at the office of any institutions in the Schedule as per the approved programme of auditors”.

The Director, KSAD has powers to dispense detailed audits when the circumstances so warrant on any account or clause of transactions and apply such limited checks in relation to such accounts or clause of transactions as he may deem fit.

The focus of the detailed audit could either be **financial and compliance or Performance** audit. Accordingly, the narratives included in paras 4.2.1 to 4.2.4 shall be applied to such audits. Where Concurrent Audit is introduced, audit of financial statements and certification thereon, will still be required as narrated in paras 4.2.1 to 4.2.4.

4.3. Basic Principles of Audit

Audit is not a privilege, but a responsibility. It is, therefore, governed by some fundamental principles which guide and govern the Auditors’ professional responsibilities in discharging their role as expected in the regulatory framework of audit. Audit Standards prescribe the principles and practices that the Auditors are expected to follow. This is in addition to the staff rules and code of conduct, if any, of the KSAD that apply to all the Auditors in the conduct of audit. There are five fundamental principles that apply universally and these are:

- a) **Integrity:** Auditors are expected to be straightforward and honest in all professional and business relationships. Integrity suggests honesty and also fair dealing and truthfulness.
- b) **Objectivity:** Auditors are expected not to allow bias, conflicts of interest or undue influence to override their professional judgements.
- c) **Professional competence and due care:** Auditors are expected to be competent and skilled to discharge their duties to the expectation of all stakeholders; they should update and maintain their skills and levels of knowledge to ensure they provide best of service to their clients. They are expected to act with diligence and in accordance with the professional and technical standards that are mandated by the Act and Rules and the Orders thereunder.

- d) **Confidentiality:** Auditors are expected to keep the information acquired in the course of their duties confidential and they are not to disclose it to others without authority or a legal or a regulatory need for such disclosure. This information must not be used for their personal advantage.
- e) **Professional behavior:** Auditors should comply with relevant laws and regulations and must avoid any action which discredits the profession.

ISSAI 100, Fundamental Principles of Public Sector Auditing issued by the ISSAI describes the basic postulates that the Auditors' need to be aware of. Though these are not strictly applicable to the KSAD Auditors, it is recommended that they subject themselves for these principles to ensure credibility of their duties.

4.4. Fundamental Principles of Public-Sector Auditing

4.4.1. Mandate

1. An SAI will exercise its public-sector audit function within a specific constitutional arrangement and by virtue of its office and mandate, which ensure sufficient independence and power of discretion in performing its duties. The mandate of an SAI may define its general responsibilities in the field of public-sector auditing and provide further prescriptions concerning the audits and other engagements to be performed.
2. SAIs may be mandated to perform many types of engagements on any subject of relevance to the responsibilities of management and those charged with governance and the appropriate use of public funds and assets. The extent or form of these engagements and the reporting thereon will vary according to the legislated mandate of the SAI concerned.
3. In certain countries, the SAI is a court, composed of judges, with authority over State accountants and other public officials who must render account to it. There exists an important relationship between this jurisdictional authority and the characteristics of public-sector auditing. The jurisdictional function requires the SAI to ensure that whoever is charged with dealing with public funds is held accountable and, in this regard, is subject to its jurisdiction.
4. An SAI may make strategic decisions in order to respond to the requirements in its mandate and other legislative requirements. Such decisions may include which auditing standards are applicable, which engagements will be conducted and how they will be prioritised.

4.4.2. Public-sector auditing and its objectives

1. The public-sector audit environment is that in which governments and other public-sector entities exercise responsibility for the use of resources derived from taxation and other sources in the delivery of services to citizens and other recipients. These entities are accountable for their management and performance, and for the use of resources, both to those that provide the resources and to those, including citizens, who depend on the services delivered using those resources. Public-sector auditing helps to create suitable conditions and reinforce the expectation that public-sector entities and public servants will perform their functions effectively, efficiently, ethically and in accordance with the applicable laws and regulations.
2. In general, public-sector auditing can be described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria. Public-sector auditing is essential in that it provides legislative and oversight bodies, those charged with governance and the general public with information and independent and objective assessments concerning the stewardship and performance of government policies, programmes or operations.

3. SAIs serve this aim as important pillars of their national democratic systems and governance mechanisms and play an important role in enhancing public-sector administration by emphasising the principles of transparency, accountability, governance and performance. ISSAI 20 – Principles of Transparency and Accountability contain guidance in this regard.
4. All public-sector audits start from objectives, which may differ depending on the type of audit being conducted. However, all public-sector auditing contributes to good governance by:
 - providing the intended users with independent, objective and reliable information, conclusions or opinions based on sufficient and appropriate evidence relating to public entities;
 - enhancing accountability and transparency, encouraging continuous improvement and sustained confidence in the appropriate use of public funds and assets and the performance of public administration;
 - reinforcing the effectiveness of those bodies within the constitutional arrangement that exercise general monitoring and corrective functions over government, and those responsible for the management of publicly-funded activities;
 - Creating incentives for change by providing knowledge, comprehensive analysis and well-founded recommendations for improvement.
5. In general, public-sector audits can be categorised into one or more of three main types: audits of financial statements, audits of compliance with authorities and performance audits. The objectives of any given audit will determine which standards apply.

4.4.3. Types of public-sector audit

1. *(See Para 4.2 of this manual)*
2. SAIs may carry out audits or other engagements on any subject of relevance to the responsibilities of management and those charged with governance and the appropriate use of public resources. These engagements may include reporting on the quantitative outputs and outcomes of the entity's service delivery activities, sustainability reports, future resource requirements, adherence to internal control standards, real-time audits of projects or other matters. SAIs may also conduct combined audits incorporating financial, performance and/or compliance aspects.

4.4.4. Elements of Public-Sector Auditing

1. Public-sector auditing is indispensable for the public administration, as the management of public resources is a matter of trust. Responsibility for the management of public resources in line with intended purposes is entrusted to an entity or person who acts on behalf of the public. Public-sector auditing enhances the confidence of the intended users by providing information and independent and objective assessments concerning deviations from accepted standards or principles of good governance. All public-sector audits have the same basic elements: the auditor, the responsible party, intended users (the three parties to the audit), criteria for assessing the subject matter and the resulting subject matter information.
2. The three parties: Public-sector audits involve at least three separate parties: the auditor, a responsible party and intended users. The relationship between the parties should be viewed within the context of the specific constitutional arrangements for each type of audit.
 - **The auditor:** In public-sector auditing the role of auditor is fulfilled by the Head of the SAI and by persons to whom the task of conducting the audits is delegated. The overall responsibility for public-sector auditing remains as defined by the SAI's mandate.

- **The responsible party:** In public-sector auditing the relevant responsibilities are determined by constitutional or legislative arrangement. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations, and may be individuals or organisations.
- **Intended users:** The individuals, organisations or classes thereof for whom the auditor prepares the audit report. The intended users may be legislative or oversight bodies, those charged with governance or the general public.

4.4.5. Subject matter, criteria and subject matter information

1. Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. It can take many forms and have different characteristics depending on the audit objective. An appropriate subject matter is identifiable and capable of consistent evaluation or measurement against the criteria, such that it can be subjected to procedures for gathering sufficient and appropriate audit evidence to support the audit opinion or conclusion.
2. The criteria are the benchmarks used to evaluate the subject matter. Each audit should have criteria suitable to the circumstances of that audit. In determining the suitability of criteria the auditor considers their relevance and understandability for the intended users, as well as their completeness, reliability and objectivity (neutrality, general acceptance and comparability with the criteria used in similar audits). The criteria used may depend on a range of factors, including the objectives and the type of audit. Criteria can be specific or more general, and may be drawn from various sources, including laws, regulations, standards, sound principles and best practices. They should be made available to the intended users to enable them to understand how the subject matter has been evaluated or measured.
3. Subject matter information refers to the outcome of evaluating or measuring the subject matter against the criteria. It can take many forms and have different characteristics depending on the audit objective and audit scope.

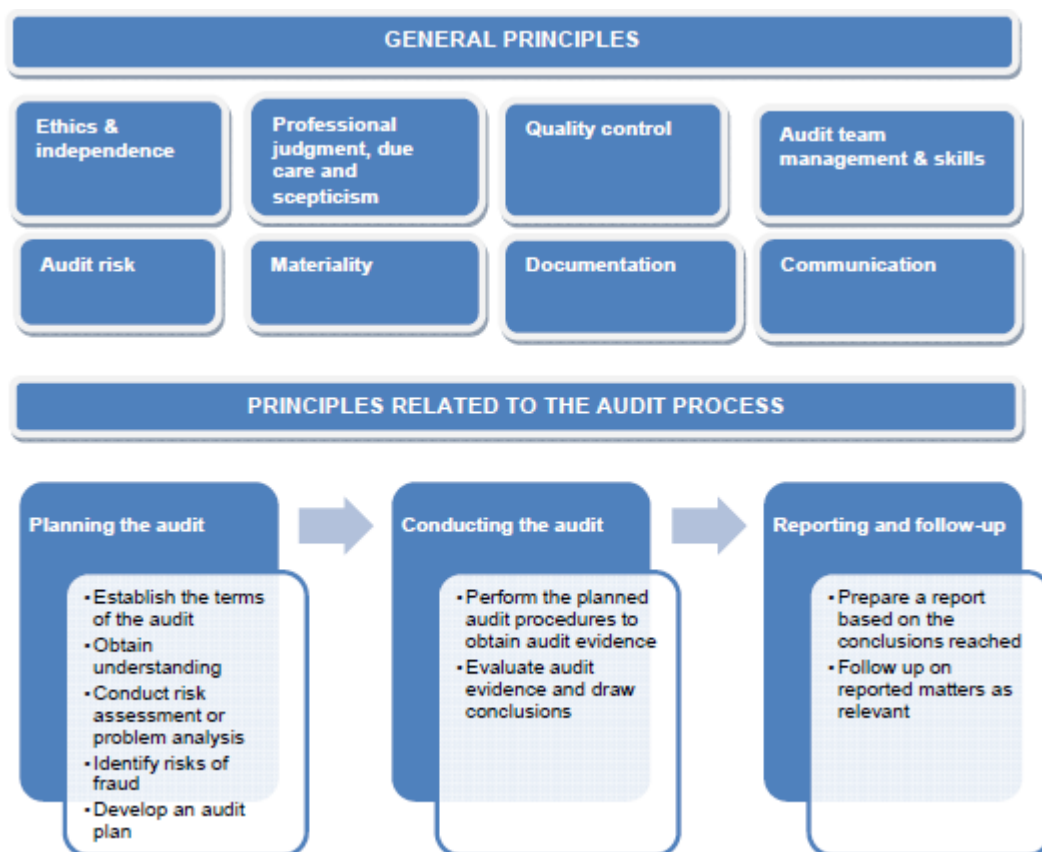
4.4.6. Confidence and assurance in public-sector auditing

The need for confidence and assurance

The intended users will wish to be confident about the reliability and relevance of the information which they use as the basis for taking decisions. Audits therefore provide information based on sufficient and appropriate evidence, and auditors should perform procedures to reduce or manage the risk of reaching inappropriate conclusions. The level of assurance that can be provided to the intended user should be communicated in a transparent way. Due to inherent limitations, however, audits can never provide absolute assurance.

4.4.7. Principles of Public-Sector Auditing

The principles detailed below are fundamental to the conduct of an audit. Auditing is a cumulative and iterative process. However, for the purposes of presentation the fundamental principles are grouped by principles related to the SAI's organisational requirements, general principles that the auditor should consider prior to commencement and at more than one point during the audit and principles related to specific steps in the audit process.



4.4.8. Areas covered by the principles for public-sector auditing

4.4.8.1. Organisational requirements

SAIs should establish and maintain appropriate procedures for ethics and quality control. Each SAI should establish and maintain procedures for ethics and quality control on an organisational level that will provide it with reasonable assurance that the SAI and its personnel are complying with professional standards and the applicable ethical, legal and regulatory requirements. ISSAI 30 – Code of Ethics and ISSAI 40 – Quality Control for SAIs contain guidance in this regard. The existence of these procedures at SAI level is a prerequisite for applying or developing national standards based on the Fundamental Auditing Principles.

4.4.8.2. General principles Ethics and independence

Auditors should comply with the relevant ethical requirements and be independent. Ethical principles should be embodied in an auditor's professional behaviour. The SAIs should have policies addressing ethical requirements and emphasising the need for compliance by each auditor. Auditors should remain independent so that their reports will be impartial and be seen as such by the intended users. Auditors can find guidance on independence in the ISSAI 10 – Mexico Declaration on SAI Independence. Guidance on the key ethical principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour are defined in ISSAI 30– Code of Ethics.

4.4.8.3. Professional judgement, due care and scepticism

Auditors should maintain appropriate professional behaviour by applying professional scepticism, professional judgment and due care throughout the audit.

The auditor's attitude should be characterised by professional scepticism and professional judgement, which are to be applied when forming decisions about the appropriate course of action. Auditors should exercise due care to ensure that their professional behaviour is appropriate.

Professional scepticism means maintaining professional distance and an alert and questioning attitude when assessing the sufficiency and appropriateness of evidence obtained throughout the audit. It also entails remaining open-minded and receptive to all views and arguments. Professional judgement implies the application of collective knowledge, skills and experience to the audit process. Due care means that the auditor should plan and conduct audits in a diligent manner. Auditors should avoid any conduct that might discredit their work.

4.4.8.4. Quality control

Auditors should perform the audit in accordance with professional standards on quality control

An SAI's quality control policies and procedures should comply with professional standards, the aim being to ensure that audits are conducted at a consistently high level. Quality control procedures should cover matters such as the direction, review and supervision of the audit process and the need for consultation in order to reach decisions on difficult or contentious matters. Auditors can find additional guidance in ISSAI 40 – Quality Control for SAIs.

4.4.8.5. Audit team management and skills

Auditors should possess or have access to the necessary skills

The individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being conducted, familiarity with the applicable standards and legislation, an understanding of the entity's operations and the ability and experience to exercise professional judgement. Common to all audits is the need to recruit personnel with suitable qualifications, offer staff development and training, prepare manuals and other written guidance and instructions concerning the conduct of audits, and assign sufficient audit resources. Auditors should maintain their professional competence through ongoing professional development.

Where relevant or necessary, and in line with the SAI's mandate and the applicable legislation, the auditor may use the work of internal auditors, other auditors or experts. The auditor's procedures should provide a sufficient basis for using the work of others, and in all cases the auditor should obtain evidence of other auditors' or experts' competence and independence and the quality of the work performed. However, the SAI has sole responsibility for any audit opinion or report it might produce on the subject matter; that responsibility is not reduced by its use of work done by other parties.

The objectives of internal audit are different from those of external audit. However, both internal and external audit promote good governance through contributions to transparency and accountability for the use of public resources, as well as economy, efficiency and effectiveness in public administration. This offers opportunities for coordination and cooperation and the possibility of eliminating duplication of effort.

Some SAIs use the work of other auditors at state, provincial, regional, district or local level, or of public accounting firms that have completed audit work related to the audit objective. Arrangements should be made to ensure that any such work was carried out in accordance with public-sector auditing standards.

Audits may require specialised techniques, methods or skills from disciplines not available within the SAI. In such cases experts may be used to provide knowledge or carry out specific tasks or for other purposes.

4.4.8.6. Audit risk

Auditors should manage the risks of providing a report that is inappropriate in the circumstances of the audit

The audit risk is the risk that the audit report may be inappropriate. The auditor performs procedures to reduce or manage the risk of reaching inappropriate conclusions, recognising that the limitations inherent to all audits mean that an audit can never provide absolute certainty of the condition of the subject matter.

When the objective is to provide reasonable assurance, the auditor should reduce audit risk to an acceptably low level given the circumstances of the audit. The audit may also aim to provide limited assurance, in which case the acceptable risk that criteria are not complied with is greater than in a reasonable assurance audit. A limited assurance audit provides a level of assurance that, in the auditor's professional judgment, will be meaningful to the intended users.

4.4.8.7. Materiality

Auditors should consider materiality throughout the audit process

Materiality is relevant in all audits. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs. Materiality considerations affect decisions concerning the nature, timing and extent of audit procedures and the evaluation of audit results. Considerations may include stakeholder concerns, public interest, regulatory requirements and consequences for society.

4.4.8.8. Documentation

Auditors should prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained and conclusions reached

Audit documentation should include an audit strategy and audit plan. It should record the procedures performed and evidence obtained and support the communicated results of the audit. Documentation should be sufficiently detailed to enable an inexperienced auditor, with no prior knowledge of the audit, to understand the nature, timing, scope and results of the procedures performed, the evidence obtained in support of the audit conclusions and recommendations, the reasoning behind all significant matters that required the exercise of professional judgement, and the related conclusions.

4.4.8.9. Communication

Auditors should establish effective communication throughout the audit process

It is essential that the audited entity be kept informed of all matters relating to the audit. This is key to developing a constructive working relationship. Communication should include obtaining information relevant to the audit and providing management and those charged with governance with timely observations and findings throughout the engagement. The auditor may also have a responsibility to communicate audit-related matters to other stakeholders, such as legislative and oversight bodies.

Principles related to the audit process

4.4.8.10. Planning an audit

1. Auditors should ensure that the terms of the audit have been clearly established

Audits may be required by statute, requested by a legislative or oversight body, initiated by the SAI or carried out by simple agreement with the audited entity. In all cases the auditor, the audited entity's management, those charged with governance and others as applicable should reach a common formal understanding of the terms of the audit and their respective roles and responsibilities. Important information may include the subject, scope and objectives of the audit, access to data, the report that will result from the audit, the audit process, contact persons, and the roles and responsibilities of the different parties to the engagement.

2. Auditors should obtain an understanding of the nature of the entity/programme to be audited

This includes understanding the relevant objectives, operations, regulatory environment, internal controls, financial and other systems and business processes, and researching the potential sources of audit evidence. Knowledge can be obtained from regular interaction with management, those charged with governance and other relevant stakeholders. This may mean consulting experts and examining documents (including earlier studies and other sources) in order to gain a broad understanding of the subject matter to be audited and its context.

3. Auditors should conduct a risk assessment or problem analysis and revise this as necessary in response to the audit findings

The nature of the risks identified will vary according to the audit objective. The auditor should consider and assess the risk of different types of deficiencies, deviations or misstatements that may occur in relation to the subject matter. Both general and specific risks should be considered. This can be achieved through procedures that serve to obtain an understanding of the entity or programme and its environment, including the relevant internal controls. The auditor should assess the management's response to identified risks, including its implementation and design of internal controls to address them. In a problem analysis the auditor should consider actual indications of problems or deviations from what should be or is expected. This process involves examining various problem indicators in order to define the audit objectives. The identification of risks and their impact on the audit should be considered throughout the audit process.

4. Auditors should identify and assess the risks of fraud relevant to the audit objectives

Auditors should make enquiries and perform procedures to identify and respond to the risks of fraud relevant to the audit objectives. They should maintain an attitude of professional scepticism and be alert to the possibility of fraud throughout the audit process.

5. Auditors should plan their work to ensure that the audit is conducted in an effective and efficient manner

Planning for a specific audit includes strategic and operational aspects.

Strategically, planning should define the audit scope, objectives and approach. The objectives refer to what the audit is intended to accomplish. The scope relates to the subject matter and the criteria which the auditors will use to assess and report on the subject matter, and is directly related to the objectives. The approach will describe the nature and extent of the procedures to be used for gathering audit evidence. The audit should be planned to reduce audit risk to an acceptably low level.

Operationally, planning entails setting a timetable for the audit and defining the nature, timing and extent of the audit procedures. During planning, auditors should assign the members of their team as appropriate and identify other resources that may be required, such as subject experts.

Audit planning should be responsive to significant changes in circumstances and conditions. It is an iterative process that takes place throughout the audit.

4.4.8.11. Conducting an audit

1. Auditors should perform audit procedures that provide sufficient appropriate audit evidence to support the audit report

The auditor's decisions on the nature, timing and extent of audit procedures will impact on the evidence to be obtained. The choice of procedures will depend on the risk assessment or problem analysis.

Audit evidence is any information used by the auditor to determine whether the subject matter complies with the applicable criteria. Evidence may take many forms, such as electronic and paper records of transactions, written and electronic communication with outsiders, observations by the auditor, and oral or written testimony by the audited entity. Methods of obtaining audit evidence can include inspection, observation, inquiry, confirmation, recalculation, reperformance, analytical procedures and/or other research techniques.

Evidence should be both sufficient (quantity) to persuade a knowledgeable person that the findings are reasonable, and appropriate (quality) – i.e. relevant, valid and reliable. The auditor's assessment of the evidence should be objective, fair and balanced. Preliminary findings should be communicated to and discussed with the audited entity to confirm their validity.

The auditor must respect all requirements regarding confidentiality.

2. Auditors should evaluate the audit evidence and draw conclusions

After completing the audit procedures, the auditor will review the audit documentation in order to determine whether the subject matter has been sufficiently and appropriately audited. Before drawing conclusions, the auditor reconsiders the initial assessment of risk and materiality in the light of the evidence collected and determines whether additional audit procedures need to be performed.

The auditor should evaluate the audit evidence with a view to obtaining audit findings. When evaluating the audit evidence and assessing materiality of findings the auditor should take both quantitative and qualitative factors into consideration. Based on the findings, the auditor should exercise professional judgement to reach a conclusion on the subject matter or subject matter information.

Reporting and follow-up

3. Auditors should prepare a report based on the conclusions reached

The audit process involves preparing a report to communicate the results of the audit to stakeholders, others responsible for governance and the general public. The purpose is also to facilitate follow-up and corrective action. In some SAIs, such as courts of audit with jurisdictional authority, this may include issuing legally binding reports or judicial decisions.

Reports should be easy to understand, free from vagueness or ambiguity and complete. They should be objective and fair, only including information which is supported by sufficient and appropriate audit evidence and ensuring that findings are put into perspective and context.

The form and content of a report will depend on the nature of the audit, the intended users, the applicable standards and legal requirements. The SAI's mandate and other relevant laws or regulations may specify the layout or wording of reports, which can appear in short form or long form.

Long-form reports generally describe in detail the audit scope, audit findings and conclusions, including potential consequences and constructive recommendations to enable remedial action.

Short-form reports are more condensed and generally in a more standardised format.

Opinion

When an audit opinion is used to convey the level of assurance, the opinion should be in a standardised format. The opinion may be unmodified or modified. An unmodified opinion is used when either limited or reasonable assurance has been obtained. A modified opinion may be:

- Qualified (except for) – where the auditor disagrees with, or is unable to obtain sufficient and appropriate audit evidence about, certain items in the subject matter which are, or could be, material but not pervasive;
- Adverse – where the auditor, having obtained sufficient and appropriate audit evidence, concludes that deviations or misstatements, whether individually or in the aggregate, are both material and pervasive;
- Disclaimed – where the auditor is unable to obtain sufficient and appropriate audit evidence due to an uncertainty or scope limitation which is both material and pervasive.

Where the opinion is modified the reasons should be put in perspective by clearly explaining, with reference to the applicable criteria, the nature and extent of the modification. Depending on the type of audit, recommendations for corrective action and any contributing internal control deficiencies may also be included in the report.

Follow-up

SAIs have a role in monitoring action taken by the responsible party in response to the matters raised in an audit report. Follow-up focuses on whether the audited entity has adequately addressed the matters raised, including any wider implications. Insufficient or unsatisfactory action by the audited entity may call for a further report by the SAI.

4.5. Level of Assurance provided by Auditors

Auditors provide only a “Reasonable Assurance” that the financial statements are free from any material misstatements caused either due to errors, mistakes or fraud or other irregularities. The framework for assurance engagements published by the ICAI and the CAG of India’s audit guidelines suggest expression of a reasonable assurance and not absolute assurance as absolute assurances are rarely attainable or cost beneficial for the following reasons:

- a) Inherent limitations of internal controls in an entity do not guarantee the completeness or accuracy of accounting records.
- b) There can be no absolute proof against human error or fraud
- c) The audit evidence collected by auditors is mostly persuasive and not conclusive
- d) A lot of professional judgement is used in gathering and evaluating audit evidence and
- e) The use of test checking/selective testing.

However, what is important for auditors is the concept of “materiality” and the guidelines of CAG of India for materiality are particularly relevant for the audit of local funds and local authorities.

4.6. Audit Standards and their Applicability

Audit Standards are statements of guidance to auditors in practice providing the extent of audit steps and procedures that should be applied in audit. Adherence to audit standards lends credibility to the audit and provides necessary reassurance to the users of financial statements and the audit reports. Audit Standards aim to improve the audit processes.

The INTOSAI has issued several audit standards for government/public sector audits which are recommendatory for Supreme Audit Institutions (SAI). These reflect “best practices” for public sector audits. The Audit Standards issued by CAG of India adopt the INTOSAI standards with due consideration to the Constitution of India and relevant Indian Laws and Regulations. CAG audit standards do not apply to KSAD except to the extent of such of those standards issued for audit of Panchayat Raj Institutions and other local bodies and made applicable to all local fund auditors by the CAG directions.

Though the audit standards are not strictly applicable for local fund audits of KSAD, it is recommended that KSAD and its auditors may follow as many audit standards as they can in conducting their audit of local funds and local authorities as they provide “best practices”. The following tables provide a brief overview of these standards for general application by KSAD auditors.

INTOSAI FRAMEWORK OF PROFESSIONAL PRONOUNCEMENTS

| | | | | | |
|---|---|---|--|--|--------------------|
| INTOSAI Principles (INTOSAI – P) | | | | | INTOSAI Principles |
| INTOSAI funding principles | | INTOSAI – P 1-9 | | | |
| INTOSAI care principles | | INTOSAI – P 10-99 | | | |
| International Standards of Supreme Audit Organizations (ISSAIs) | | | | | INTOSAI Standards |
| Fundamental Principles of public sector auditing | | ISSAI | | | |
| SAI Organisational requirement | | ISSAI 130-199 | | | |
| Functional Audit | Performance audit | Compliance audit | Other engagements | | |
| FA Principles ISSAI 200-299 FA Standards ISSAI 2000-2899 | PA Principles ISSAI 300-399 PA Standards ISSAI 3000-3899 | CA Principles ISSAI 400-499 CA Standards ISSAI 3000-4899 | Reserved for future development based on ISSN 100 ISSAI 600-699 ISSAI 6000-6899 | | |
| Guidance (GUID) | | | | | INTOSAI Guidance |
| SAI Organisational guidance | | GUID 1900 -1999 | | | |
| Supplementary financial audit guidance GUID 2900-2999 | Supplementary performance audit guidance GUID 3900-3999 | Supplementary compliance audit guidance GUID 4900-4999 | Reserved for future development based on ISSN 100; GUID 6500-6999 | | |
| Subject matter specific guidance | | GUID 5000 -5999 | | | |
| Other guidance | | GUID 9000 -9999 | | | |
| Competency Standards (COMP) | | | | | |
| Reserved for future development | | | | | |
| (Fossiby) COMP 700-799; and COMP 7000-7499 | | | | | |
| Competency Guidance (COMP) | | | | | |
| Reserved for future development based on ISSAI | | | | | |
| Supplementary competency guidance COMP 7500 7999 | | | | | |

| INTOSSAI - Framework | | |
|-----------------------------|---|---|
| CATEGORY NUMBER | CATEGORY | CLASSIFICATION CRITERIA |
| INTOSAI P1-9 | INTOSAI founding principles | Founding historical principles specifying the role and functions that SAIs should aspire to. These principles may be informative to Governments and Parliaments as well as SAIs and the wider public and may be used as reference in establishing national mandates for SAIs. |
| INTOSAI P-10 99 | INTOSAI Core principles | Core principles that support the founding principles for an SAI, clarifying issues in relation to the SAIs role in society as well as high level aspirations for the proper functioning and professional conduct of an SAI |
| ISSAI 100-129 | Fundamental principles of public auditing | Defines basic set of concepts and principles that defines public sector auditing and the different types of engagements supported by the ISSAIs. |
| ISSAI 130-199 | SAI organizational requirements (SAI level) | Requirements for organizational functions of an SAI that are designed to enhance the performance of quality audits. |
| ISSAI 200-299 | Financial audit principles | These define the elements and principles of financial auditing with reference to the fundamental principles of public sector auditing |
| ISSAI 300-399 | Performance audit Principles | These define the elements and principles of performance auditing with reference to the fundamental principles of public sector auditing |
| ISSAi 400 -499 | Compliance audit principles | These define the elements and principles compliance auditing with reference to the fundamental principles of public sector auditing |
| ISSAI 2000-2999 | Financial audit standards | Standards for financial auditing In conformity with the financial audit principles |
| ISSAI 3000-3999 | Financial audit standards | Standards for performance auditing In conformity with the performance audit principles |
| ISSAI 4000-4999 | Compliance audit standards | Standards for compliance auditing In conformity with the compliance audit principles |
| ISSAI – 1900-1999 | SAI organizational guidance | Guidance that supports the SAI in enhancing organizational performance in practice related to the organizational requirements and ISSAI implementation |

| | | |
|---|---|--|
| GUID 2900 – 2999 | Supplementary financial audit guidance | Guidance that support the auditor in the financial audit process on how to apply the ISSAIs in practice |
| GUID 3900 – 3999 | Supplementary performance audit guidance | Guidance that supports the auditor in the performance audit process on how to apply the ISSAIs in practice |
| GUID 4900- 4999 | Supplementary compliance audit guidance | Guidance that supports the auditor in the compliance audit process on how to apply the ISSA is in practice |
| GUID 5000- 5999 | Subject matter specific guidance | Guidance that supports the auditor in understanding a specific subject matter and the application of the relevant ISSAIs |
| Reserved for future development based in ISSA 100 | | |
| ISSAI 600-699 | Principles for other engagements | These define the elements and principles of other engagements with reference to the fundamental principles of public sector auditing |
| COMP 700-799 | Competency principles | Principles laying down the competencies and professional studies, knowledge, ethics, values and attitudes required by the public sector auditor to undertaken audit in line with the ISSAIs |
| ISSAI 6000- 6499 | Standards for other engagements | Standard for other engagements in conformity with the fundamental principles of public sector auditing. This may include other INTOSAI |
| COMP 7000- 7499 | Competency standards | Standards that set out the competencies and professional sto, knowledge, ethics, values and attitude and attitudes required by the public sector auditor to undertaken audit in line with the ISSAIs |
| GUID 6500 – 6999 | Supplementary guidance on other engagements | Guidance that supports the auditor in other engagements on how to apply the ISSAIs in Practice |
| GUID 7500 – 7999 | Supplementary competency guidance | Guidance to an SAI in implementing mechanisms and programmed for competency development in line with ISSAIs |

Table 1: Field Audit Standards issued by CAG which may be followed by KSAD

| Audit Standard Title | Description of Standard Requirement |
|--|--|
| Audit Planning | <ul style="list-style-type: none"> 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 |
| Audit Supervision | <ul style="list-style-type: none"> 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 <p>Review brings more than one level of experience and judgement to the audit task and should ensure that:</p> <ul style="list-style-type: none"> 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 satisfactorily resolved. |
| Study and Evaluation of Internal Control | <p>The study and evaluation of internal control should be carried out according to the type of audit undertaken.</p> <ul style="list-style-type: none"> a. 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. b. The extent of the study and evaluation of internal control depends on the objectives of the audit and on the degree of reliance intended. c. 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. |

| | |
|---|---|
| Compliance with Applicable Laws and Regulations | <p>The following paragraphs explain compliance as an auditing standard.</p> <ol style="list-style-type: none"> Reviewing compliance with laws and regulations is especially important when auditing government programs 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 organizations, programs, services, activities, and functions are created by laws and are subject to more specific rules and regulations. 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. 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. 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. 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. 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. |
| Audit Evidence | <ol style="list-style-type: none"> 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. 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. 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. 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. Adequate documentation is important for several reasons. It will: <ol style="list-style-type: none"> Confirm and support the auditor's opinions and reports; Increase the efficiency and effectiveness of the audit; Serve as a source of information for preparing reports or answering any enquiries from the audited entity or from any other party; Serve as evidence of the auditor's compliance with Auditing Standards; |

| | |
|----------------------------------|---|
| | <ul style="list-style-type: none"> v. Facilitate planning and supervision; vi. Help the auditor's professional development; vii. Help to ensure that delegated work has been satisfactorily performed; and viii. Provide evidence of work done for future reference. <p>f. 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 inexperienced auditor having no previous connection with the audit subsequently to ascertain from them what work was performed to support the conclusions.</p> |
| Analysis of Financial Statements | <p>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.</p> <ul style="list-style-type: none"> a. 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. b. The auditor should therefore thoroughly analyse the financial statements and ascertain whether: <ul style="list-style-type: none"> i. Financial statements are prepared in accordance with acceptable accounting standards; ii. Financial statements are presented with due consideration to the circumstances of the audited entity; iii. Sufficient disclosures are presented about various elements of financial statements; and iv. The various elements of financial statements are properly evaluated, measured and presented. c. 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. d. Where the SAI is required to report on the execution of budgetary laws, the audit should include: <ul style="list-style-type: none"> i. for revenue accounts, ascertaining whether forecasts are those of the initial budget, and whether the audits of taxes, rates and duties recorded, and imputed receipts, can be carried out by comparison with the annual financial statements of the audited activity; ii. for expenditure accounts, verifying credits to assist budgets, adjustment laws and, for carryovers, the previous year's financial statements. e. Where the SAI 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. |

5. Internal Controls

The CAG's Regulations on Audit and Accounts, 2007 explain that the auditor should examine and evaluate the reliability of internal controls. This is done by first obtaining an understanding of the internal controls relevant to the audit objectives and then testing those controls on which they expect to rely for their design and operating effectiveness. The assurance derived from the assessment of internal controls will assist the auditors to determine the confidence level and hence, the extent of audit procedures to perform either on the whole population of data or samples chosen using an appropriate sampling approach. Local Bodies/Institutions are expected to establish systems of control designed to assure the accuracy and completeness of financial statements, the legality and regularity of underlying transactions and the economy, efficiency and effectiveness of operations. Generally speaking, if the auditor is satisfied about the adequacy of these controls, substantive checking of financial statements, transactions or the performance of the organization can be reduced accordingly.

The Audit Standard SA 400 issued by the ISSAI and the Field Audit Standards issued by the CAG of India, both require the auditors' understanding and evaluation of internal control system at Auditee Entities. The auditors are expected to document in the Audit Working Papers the understanding obtained of the entity's accounting and internal control systems.

5.1. Understanding Control Environment

Understanding internal controls is normally an integral part of understanding the Auditee Entity and the relevant subject matter. The control environment comprises the conditions under which the Auditee Entity's accounting process and internal controls are designed, implemented and function. Based on the understanding, the audit team should seek to arrive at a conclusion as to whether the control environment is generally conducive to reliable accounting systems and effective internal control and determines if specific components increase or decrease the effectiveness of some or all application systems and controls. If, based on understanding of the control environment, the audit team has fundamental doubt about the effectiveness of the accounting system or controls, this should be reported to the entity and kept in mind while carrying financial audit.

Audit should understand the control procedures established by the entity to:

- a) ensure regularity;
- a) ensure compliance with the legal and regulatory framework within which the entity conducts its operations;
- b) prevent and detect fraud by management, employees or third parties.
- c) ensure that:
 - proper financial procedures are followed;
 - public funds are properly utilized and safeguarded;
 - assets are similarly controlled and safeguarded;
 - funds are applied only to the extent and for the purposes authorized by the Legislature and/or Competent Authority;

5.1.1. Accounting system

The auditors' understanding of the Accounting System should focus on the following:

- a) Types and classes of transactions in the Auditee's operations
- b) The method of initiating and recording the transactions in the books of accounts

- c) Significant accounting records and books that the Auditee Entity should maintain, supporting documents required in the support of transactions; nature and types of accounts in the financial statements and their classification and grouping.
- d) The accounting and financial reporting process followed by the Auditee.

5.1.2. Internal Controls

“Internal controls” is a system that covers the policies, processes, procedures, tasks, behaviours and other aspects of an entity that taken together:

- a) Facilitate an effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving its objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed.
- b) Ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the entity.
- c) Ensure compliance with applicable laws, rules and regulations, and also internal policies with respect to the conduct of operations of the entity.

Internal Controls are one of the principal tools for managing risk inherent in any operations. It is a system designed, implemented and operated by the management of the Entity and the Auditor’s responsibility is only to evaluate and comment.

5.1.2.1. Internal Control – COSO Framework

According to COSO¹ framework 2013, an internal control is:

- a) Geared to the achievement of objectives in one or more categories—operations, reporting, and compliance
- b) A process consisting of ongoing tasks and activities—a means to an end, not an end in itself
- c) Affected by people—not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to affect internal control
- d) Able to provide reasonable assurance—but not absolute assurance, to an entity’s senior management and stakeholders.
- e) Adaptable to the entity structure—flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process

The COSO framework has 5 components and 17 principles of Internal Controls. These are universally relevant and apply to all institutions, whether government or private.

¹ Committee of Sponsoring Organizations (COSO) of the Treadway Commission

| Component | Principles |
|-------------------------------|--|
| Control Environment | <ol style="list-style-type: none"> 1. Demonstrate commitment to integrity and ethical values 2. Ensure that management (board) exercises oversight responsibility 3. Establish structures, reporting lines, authorities and responsibilities 4. Demonstrate commitment to a competent work force 5. Hold people accountable |
| Risk Assessment | <ol style="list-style-type: none"> 1. Specify appropriate objectives 2. Identify and analyze risks 3. Evaluate fraud risks 4. Identify and analyze changes that could significantly affect internal controls |
| Control Activities | <ol style="list-style-type: none"> 1. Select and develop control activities that mitigate risks 2. Select and develop technology controls 3. Deploy control activities through policies and procedures |
| Information and Communication | <ol style="list-style-type: none"> 1. Use relevant, quality information to support the internal control function 2. Communicate internal control information internally 3. Communicate internal control information externally |
| Monitoring | <ol style="list-style-type: none"> 1. Perform ongoing or periodic evaluations of internal controls (or a combination of the two) 2. Communicate internal control deficiencies |

5.1.3. Internal Controls for Accounting Systems

Internal controls specific to the Accounting systems are expected to achieve the following:

- a) All transactions are properly authorized and approved by competent authority supported by a suitable delegations of powers.
- b) All transactions are properly recognized at their correct value, in appropriate accounts and in the year they belong to in accordance with applicable Accounting Standards and financial reporting framework.
- c) Assets and records are safeguarded from unauthorized access/use or disposition.

Of the five components as listed in the COSO framework, Control Activities need to be understood in more detail from the perspective of performing audit tests (control tests and substantive tests). Control Activities are those policies and procedures, tasks to address specific risks. Generally, these are of two types: (a) preventive and (b) detective. To be effective, Control Activities must be appropriate and operate consistently according to plan throughout the period and be cost effective, comprehensive, and reasonable and directly relate to the control objectives.

Controls can be designed and operated at two levels: (i) at the Institution Level (ii) at the transaction/process level. These are illustrated below:

| Institutional Controls | Transaction/Process Level Controls |
|---|---|
| <ol style="list-style-type: none"> 1. Policies, SoPs, Rules, Regulations 2. Budgets 3. Organisation Charts, Levels of Authority, Delegation of Powers 4. Risk Management Process 5. Financial Reporting 6. Monitoring Control | <ol style="list-style-type: none"> 1. Authorisations/Approvals/Verifications 2. Segregation of duties 3. Reconciliations/Reviews 4. Physical counts |

Control Activities at the transaction/process level are generally designed to be the following.

| Control Type | Control Description |
|---------------------|--|
| Preventive Controls | <p>Authorizations: These are authority levels, spending limits, passwords etc. Authorization is the principal means of ensuring that only valid transactions and events are initiated as intended by the Executive Authority of the local fund/local authority/government. Authorization procedures, should include the specific conditions and terms under which authorizations are to be made. Conforming to the terms of an authorization means that employees act in accordance with directives and within the limitations established by management or legislation</p> |
| | <p>Approvals: to ensure all the transactions requiring necessary approval for validating and verifying the activity/transaction.</p> |
| | <p>Segregation of duties (authorizing, processing, recording and reviewing): To reduce the risk of error, waste, or wrongful acts and the risk of not detecting such problems, no single individual or team should control all key stages of a transaction or event. Rather, duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include authorizing and recording transactions, processing, and reviewing transactions. Rotation of employees may help ensure that one person does not deal with all the key aspects of transactions or events for an undue length of time. Also, encouraging or requiring annual holidays may help reduce risk by bringing about a temporary rotation of duties.</p> |
| | <p>Physical controls for security of assets/records: Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records. Access to resources and records is limited to authorized individuals who are accountable for the custody and/or use of the resources. Accountability for custody is evidenced by the existence of receipts, inventories, or other records assigning custody and recording the transfer of custody. Restricting access to resources reduces the risk of unauthorized use or loss to the entity and helps achieve management directives. The degree of restriction depends on the vulnerability of the resource and the perceived risk of loss or improper use, and should be periodically assessed. When determining an asset's vulnerability, its cost, portability and exchangeability should be considered.</p> |
| Detective Controls | <p>Verifications (preventive or detective) Transactions and significant events are verified before and after processing; for example, when goods are delivered, the number of goods supplied is verified with the number of goods ordered. Afterwards, the number of goods invoiced is verified with the number of goods received. The inventory is verified as well by performing stock-takes.</p> |
| | <p>Reconciliations: Records are reconciled with the appropriate documents on a regular basis, e.g. the accounting records relating to bank accounts are reconciled with the corresponding bank statements.</p> |
| | <p>Reviews of operating performance: Operating performance is reviewed against a set of standards on a regular basis, assessing effectiveness and efficiency. If performance reviews determine that actual accomplishments do not meet established objectives or standards, the processes and activities established to achieve the objectives should be reviewed to determine if improvements are needed.</p> |
| | <p>Reviews of operations, processes and activities: Operations, processes and activities should be periodically reviewed to ensure that they are in compliance with current regulations, policies, procedures, or other requirements.</p> |
| | <p>Physical counts/verifications of assets/inventories</p> <p>Internal Audit as per a set policy for given objectives.</p> |

5.1.3.1. Important Control to be considered by Auditors

In particular, the system of internal control over the following aspects would need to be noted by the auditor:

- a) Sanctions to expenditure and watch over progress vis-à-vis budget of the Local Authority/Institution.
- b) Realization of receipts and avoidance of loss due to negligence, delayed action, etc.
- c) Accounting of cash receipts and payments.
- d) Purchase, accounting, issue, utilization and physical existence of stores and stock.
- e) Execution of construction programmes.
- f) Creation of assets, their maintenance and verification of their existence etc.
- g) Disbursement of grants, subsidy, scholarships, etc., and their utilization by the recipients.
- h) Utilization of Government assistance for specific purposes.

5.1.4. Inherent Limitations of Internal Controls

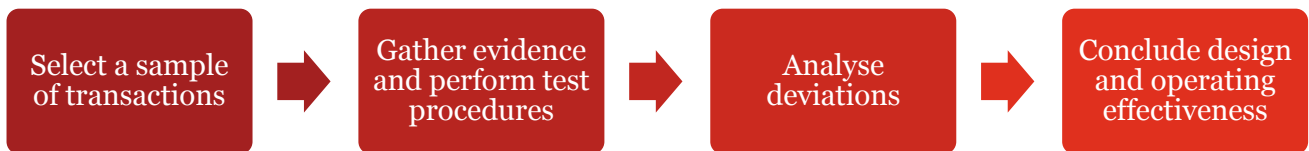
- a) An effective internal control system, no matter how well conceived and operated, can provide only reasonable — not absolute — assurance to management about the achievement of an entity's objectives or its survival.
- b) Internal control cannot change an inherently poor manager into a good one. Moreover, shifts in government policy or programs, demographic or economic conditions are typically beyond management's control and may require managers to re-design controls or adjust the level of acceptable risk.
- c) An effective system of internal control reduces the probability of not achieving the objectives. However, there will always be the risk that internal control will be poorly designed or will fail to operate as intended.
- d) The Internal Control System may be subject to flaws in design, errors of judgment or interpretation, misunderstanding, carelessness, fatigue, distraction, collusion, abuse or override.
- e) In designing controls, benefits must outweigh costs, otherwise the purpose may be lost.
- f) Internal controls cannot eliminate risks, but can only manage them.
- g) In determining whether a particular control should be established, the likelihood of the risk occurring and the potential effect on the entity are considered along with the related costs of establishing a new control.
- h) Organizational changes and management attitude can have a profound impact on the effectiveness of internal control and the personnel operating the system.
- i) Thus, management needs to continually review and update controls, communicate changes to personnel, and set an example by adhering to those controls

5.2. Testing of Internal Controls

Audit generally begins with **Test of Internal Controls** (also called as Tests of Compliance) to collect audit evidence for the following:

- a) Whether the controls are suitably designed to prevent, detect or correct material misstatements (control design)
- b) whether such controls are effective and operate throughout the period (control effectiveness)

The process of testing is illustrated by the following exhibit:



The following procedures are employed to gather evidence and test the controls:

- a) **Inquiries** – interviewing staff responsible for the control activity, asking questions and documenting the replies. Inquiry is usually required when seeking to understand whether a manual control that involves judgment has been properly applied. For example, inquiry of a member of process/entity management who approves reconciliations or transactions can help determine whether the individual understands what should be identified for follow-up and whether the approval process has been done diligently. Interviews or questionnaires can be used for inquiries. Inquiry alone ordinarily will not provide sufficient audit evidence to detect the presence of a control or to support a conclusion about its operating effectiveness. Auditors should consider performing tests in addition to the use of inquiry to obtain sufficient and appropriate audit evidence.
- b) **Observation** – observing the staff perform a task or an activity, for e.g. how a voucher is prepared and approved or how a payment is made and receipt obtained and recorded; where the Auditee Entity operates in a computer environment, this also includes physical examination of access controls to see if unauthorized staff seek entry into computer rooms, systems, applications and also unauthorized access of passwords for making accounting or other entries in the system. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.
- c) **Examination/Inspection** – Inspection consists of examining records or documents whether in paper form, electronic form, or other media. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness. For example, verifying whether a transaction has been properly authorized or tracing the purchase of a capital asset from the purchase order to the inclusion on the financial statements, ensuring that required process is followed (in terms of Purchase Requisition, Bids, Purchase Order, Purchase Voucher, etc.), required approvals, categorization of asset, and amortization policies applied.
- d) **Recalculation/Re-performance** – Recalculation consists of checking the arithmetical accuracy of documents or records. Re-performance is the independent execution of procedures or controls that were originally performed as part of the organisation's internal control. Re-performance techniques are often the most time consuming to undertake. To tests some controls like for e.g. bank reconciliation, auditor will have to re-perform the control to ensure he/she gets the same result using similar/same steps and documents. If such re-performance is successful he/she would be to confirm that the control is operating effectively

A basic procedure used by auditors for testing controls is “**Walkthroughs**” – A walkthrough is a method of confirming an understanding of a process flow by tracing an individual transaction from beginning to end. For example, we follow a monetary transaction from origination through the

organisation's information system until it is reflected in the financial reports. A walkthrough can be used to confirm understanding of the design of controls. Much of the walkthroughs will be examination of documents but may also include:

- a) Making inquiries of the person that performs the procedure or control
- b) Observing the performance of the procedure or control
- c) Reviewing documents that are used in, and that result from, the application of the procedure or control
- d) Comparing supporting documents (i.e. sales invoices, contracts and bills of lading) to the accounting records

Testing Control Effectiveness – this refers to applying the procedures to ensure controls are really operating as intended; it is important to note, that a control may have been designed well (for e.g. a Payment Voucher (PV) may have to be prepared by “x”, checked by “z” and approved by “a” before it can be posted to the books), but if the “z” and “a” do not perform the activity as intended, then the activity/transaction itself could become susceptible with control not being effective.

- a) applying the same procedures as above, auditors will test and understand that the person/s performing the control (i) has/have the necessary power to do it (ii) possess/possesses necessary competence to does/do it and (iii) actually do it. For example, a person authorized to review and post a Payment Voucher (PV), should actually possess competence to understand what is being reviewed and why and actually review the PV with supporting documents and then authorize the PV. This will suggest that the control is in fact operating effectively.
- b) In case of testing of automated control in an IT environment, the ability to rely on the proper and consistent operation of automated controls usually depends on the effective operation of related IT general controls. There are a number of factors to consider before we determine the nature, timing and extent of testing for automated application controls and ITGCs, as follows:
 - The quality and effectiveness of the IT control environment and Entity Level Controls over IT.
 - This knowledge gained from past audits and any significant known or anticipated changes to people, processes, systems, technologies, operations or business conditions that could impact audit. High-level controls executed by IT management in the normal course of business to monitor controls.

There are a variety of techniques for testing whether an automated control operates effectively. They include:

- c) Controls obtaining evidence that the automated control is operating effectively through sufficient inquiry, observation, examination, and/or re-performance procedures during walkthrough of the related transaction process.
- d) A method of confirming our understanding of the process flow and design of controls by tracing individual transactions, both recurring and unusual, from initiation through recording and processing by the entity's information system until they are reported in the entity's financial statements.
- e) Running sample transactions through the application program or routine and comparing the output to expectations.
- f) Replicating the output by running our own independent analysis, queries or programs on the actual source data.
- g) Evaluating the logic of the application program/routine by:
 - Inspecting application system configurations
 - Inspecting vendor system documentation
 - Interviewing program developers (note that inquiry is not enough by itself)

- h) Testing the logic indirectly by performing substantive testing of the output to source documents or by reconciling it to independent, reliable sources (e.g., testing the accuracy of depreciation computed by system by comparing the manually computed depreciation to test various scenarios of depreciation computation, say, depreciation amount for part period or depreciation amount in the event of sale of asset, etc.)

Understanding and Reviewing Deviations: The deviations that the auditors notice while testing the design and operating effectiveness of controls may arise for several factors such as, (i) change of personnel (which is generally the most common) performing the control (ii) change of systems (for example moving from a manual or excel to another IT application) (iii) changes in volumes of transactions resulting in human error (for example, during the year end there will be need to complete a lot of activities and close the books). These deviations have to be discussed with the Executive Authority of the Local Fund/Authority while planning for Test of Details (also known as Substantive Procedures) that will provide further evidence on transactions/activities. The auditors will have to also look at the materiality in further pursuing the deviations or ignoring them altogether.

5.3. Documenting Audit Observations

Audit of controls using aforesaid procedures will have to be properly documented in the audit work papers to ensure the evidence on which the opinion of auditors is based upon is properly captured:

- Transactions selected for walkthrough tests
- Officers/Persons with whom the auditor/s have confirmed their understanding of controls and processes
- Description of procedures that were actually performed to test the controls
- Segregation of duties within the process/transaction flow to confirm if there is appropriate SOD in place.
- Results of the test procedures

Walkthrough tests may be documented in the following format.

| S. No | Control Ref # | Control Description | Walk-through Procedure Performed | Evidence Examined | M / A * | P / D * | Weakness Identified (Y/N) |
|-------|---------------|---------------------|----------------------------------|-------------------|---------|---------|---------------------------|
| | | | | | | | |

*M=Manual; A=Automated; P=Preventive; D= Detective

5.4. Illustrative Internal Control Checklists

The Auditors will have to develop as part of their understanding of the Audit Entity, an internal control checklist/questionnaire that is appropriate to that entity. This is generally once a year exercise usually done as part of Audit Planning and reviewed yearly to make necessary changes/amendments. As an illustrative exercise, sample internal control checklists are given for Local Bodies (PRI/ULB) at Appendix 2 and for Universities at Appendix 3.

6. Audit Sampling and Test Checking

6.1. Why Sampling

“**Audit Sampling**” means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate the audit evidence about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population.²

The level of assurance given by the auditors is always “reasonable” assurance and the certification of financial statements provide opinion on the “true and fair” view and not “true and correct” view. Even the CAG resists from “true and correct” certifications in its Audit Standards. It is not practical nor desirable or feasible to examine always the 100% of all transactions/underlying data in providing audit opinions. Therefore, auditors will have to draw samples from a larger population, audit the items selected by the sample and extrapolate the results to the larger population. The sample selected should be a “representative sample” and a representative sample is one in which the characteristics for the audit interest are **approximately** the same as the population. The sampling sizes are defined by the auditors to achieve a particular audit objective.

Test Checking is the checking of a selected sample of transactions/class of transactions/account balances from a given population. The extent of test checking and the size of the sample generally depend upon the audit objectives and the effectiveness of internal controls and the satisfaction obtained by the auditors on such controls.

Population is the entire set of data from which the auditor should extract a sample in order to reach a conclusion. The individual items in a population are known as “sampling units”.

Sample Size is the number of units that the auditor would like to select and test in the course of audit. However as it should be representative of the population, it should be chosen with diligence and care so that the sampling risk is negligible in the audit process.

Sampling Risk is the risk that the auditor reaches an incorrect conclusion about the population as a whole based on the sampled items tested during the course of the audit. This could happen in the following ways:

- a) The population is judged to fail the test- for e.g. when determining the internal controls for purchases risks, auditor may determine that the controls are not effective, when in effect they are.
- b) The population is judged to pass the test – for e.g. the auditor may conclude that the value of the population (i.e. total procurement) is not misstated when in fact it is.

As auditor’s credibility could suffer in both the above cases it is essential that the sampling approach should be a proven one and auditor’s judgement to use any of the approaches must be fully professional and not subject to any bias. Sampling risks could be minimized by following some established rules and non-sampling risks could be reduced by following carefully designed audit procedures and proper training in audit.

² Audit Standard SA 530, issued by the Institute of Chartered Accountants of India

6.2. Sampling Approaches

Sampling may be (i) Non Statistical, where the auditors use their professional judgement to select sample items and sample size and (ii) Statistical as described below. Use of either of the methods is left to the best judgement of the auditors given their audit objectives and quality of internal controls on a population of data.

6.2.1. Non Statistical Sampling

Non-statistical sampling is based on the auditor's judgment. It is appropriate when looking for the existence of a problem or when the auditor does not need to draw conclusions about the entire population. Generally, auditors use one of the following approaches:

| Sampling Method | Description |
|----------------------------|--|
| Directed Sample Selection | <ol style="list-style-type: none"> 1. Sample Items selected based on pure professional judgement of auditors 2. Generally of large value transactions 3. Sample Items are those that could most likely to be misstated/misrepresented. 4. Items could have some selected population characteristics. |
| Block Sample Selection | Selection is done in sequence forming block of items- involves selection of contiguous items. |
| Haphazard Sample Selection | Selection without any regard for size, source or characteristics and without any structured technique. However in choosing a sample based on this method, auditors should be careful to avoid any bias. |

Where non-statistical sampling approach is used, the results of testing a sample should not be extrapolated over the population as the sample may not fully be representative of the population. To illustrate: if samples are obtained using this non-statistical sampling and if there is 20% error rate, the report may only say that 20% of the total sample (and not total population) were defective and explain the nature of defects.

6.2.2. Statistical Sampling

Statistical Sampling could be (i) Simple Statistical Sampling (ii) Systematic (iii) Stratified or (iv) more complex probability based sampling method. The following table illustrates some of the statistical approaches to sampling:

| Sampling Approach | Description |
|------------------------|--|
| Simple Random Sampling | <ol style="list-style-type: none"> a) Auditor can use random number tables or could use MS excel to generate random numbers for a given population. b) All Population characteristics have an equal chance of being represented in the sample. |
| Systematic Sampling | <ol style="list-style-type: none"> a) Selecting items using a constant interval between two selections, the first item will be chosen randomly from the given population. b) Auditor should calculate an interval for the sample. Interval = Population size/Number of sample items desired. c) Based on the Interval, selects the items from a given population. |

| | |
|---|---|
| <p>Example for Systematic Sampling, say for receipt vouchers, verification</p> <p>a) The vouchers numbers of the population for e.g. lie between 1021 to 10051 (i.e. 9030)</p> <p>b) Auditor wants a sample of 60 items</p> <p>c) Interval = $(10051-1021)/60 = 150.5$, say 151</p> <p>d) Auditor selects a random voucher between 1st item to 151 items, say 47th item</p> <p>e) First items for sample would be: $1021+47 = 1068$ receipt voucher and thereafter sample items would be , voucher no. 1219 ($1068+151$), voucher no. 1370 ($1219+151$), etc.</p> | |
| Stratified Sampling | <p>a) The audit population is divided into homogenous and mutually exclusive groups and samples are drawn from such groups.</p> <p>b) Stratification may be based on value of vouchers or volume of vouchers. For e.g. in the PV audit illustration given above, all PVs with a value greater than Rupees 500,000 can form one group and less than that value into a different group. Sample can be drawn from each group.</p> |
| Probability Based Sampling | <p>a) Probability of a value or characteristic is used in this approach.</p> <p>b) Population may be stratified for any particular sub function/feature/characteristic.</p> <p>c) Tolerance rates of errors fixed, both for Tolerance for Population and Tolerance for Sample.</p> <p>d) Occurrence rate and Exception rates are fixed for the sample for extrapolation.</p> <p>e) Samples are determined using probability approaches.</p> |

6.3. Sample Size

Sample size refers to number of items/transactions that the auditor is willing to test to arrive at an opinion. The size is based on the sampling risk that the auditors are willing to absorb i.e. lower the risk appetite, higher the size. In general, the sample size in statistical sampling depends on four factors:

- The population size — the entire set of data from which a sample is selected about which the auditor wishes to draw conclusions.
- The variability in the population — the extent to which the characteristics of items in the population differ from each other. Variability is measured by the expected deviation rate (for attributes sampling) and standard deviation (for variables sampling). The more variability in the population, the larger the required sample size. Variability can be reduced by stratifying the population i.e. dividing up a population to create relatively homogeneous groups.
- The desired confidence level — the degree to which a sample drawn at random can be expected to fall within a specified range. It is also referred to as the level of assurance. The lower the assurance required, the smaller the required sample size.
- The tolerable and expected deviation rates (for attribute sampling) — the tolerable deviation rate is the maximum rate of deviations from the control that the auditor is checking, that s/he will be willing to accept without altering the planned assessed level of control risk. The lower the tolerable deviation rate, the higher the sample. The expected deviation rate is the estimated error rate in the population. This can be determined based on a pilot sample or prior experience. It should be less than the tolerable deviation rate; or the desired precision (for variables sampling) — the tolerable error that can be accepted to conclude that the audit objective has been achieved. The smaller the tolerable error, the larger the required sample. The auditor has no control over the population size or variability but can alter the confidence level or the tolerable and expected deviation rates/precision level to determine the sample size.

The sample size for non-statistical sampling is based on the number of items the auditor believes he/she needs to check to enable him/her reach a conclusion on the audit objective. In providing guidance on the determination of sample sizes based on judgment Sawyer et al (Sawyer's Internal Auditing, 2003, p445) said: "... we should not place undue reliance on a sample of under 30 items. Only at 30 may the sample begin to adopt the characteristics of the population. In many situations, a statistical sample of 30 or 40 items will give sufficient assurance that the system is working with reasonableness. Auditors should be aware, however, that they are counting on the system to detect errors rather than on their small sample."

The auditor may also decide not to sample if: The population is small;

- a) He/she is unwilling to accept the sampling risk; or
- b) He/she is searching for rare occurrences or known problem areas

Sample Size Selection Methodology for Test of Controls:-

The sample size selected for testing should be based on the significance of the control in question and the level of assurance desired. The fewer items tested, the greater the risk of an incorrect conclusion. Thus, for highly critical controls, or when a single manual control provides the sole support for a financial statement assertion regarding a significant account, increasing the sample size to the high end of the range provided in the table below should be considered. This decision should be made after considering other evidence available (e.g., results of self-assessment or evidence from other monitoring controls).

The combination of evidence should provide a high level of assurance the control is operating effectively. When no exceptions are found, these sample sizes will provide a high level of assurance that the control is operating effectively. For example, (using the concepts of statistical sampling theory) if 25 instances of a control (occurring multiple times a day) are tested and no exceptions are found, there is a 90 percent confidence level that the actual exception rate is no more than 9 percent. If 60 instances are tested with no exceptions, there is a 95 percent confidence level that the actual exception rate is no more than 5 percent.

| Frequency of Manual Control's Performance | Typical Number / Range of Times to Test Controls | Factors to Consider When Deciding the Extent of Testing |
|--|---|--|
| Annually | 1 | <ul style="list-style-type: none"> • Complexity of the control • Significance of judgement in the control operation • Level of competence necessary to perform the control • Frequency of operation of the control • Impact of changes in volume or personnel performing the control • Importance of the control • Addresses multiple assertions • Period-end detective control • Only control that covers a particular assertion |
| Quarterly | 2 | |
| Monthly | 2 to 5 | |
| Weekly | 5 to 15 | |
| Daily | 20 to 40 | |
| As & When / Multiple Times a Day | 25 to 60 | |

7. *Audit Materiality*³

Audit materiality is a concept relating to the significance of an amount, transaction, or discrepancy when seen or judged individually or in aggregate. Auditors express opinion on the financial statements as to whether they are prepared, in all **material** respects, in accordance with the General Accepted Accounting Policies. Similarly, they express an opinion if the financial statements are free from material misstatements. The assessment of what is material is a matter of professional judgment. However, the Audit Standard SA 320 issued by the ISSAI and guidance contained in the CAG manuals provide material to establish the concept of materiality.

SA 320 issued by the ISSAI defines materiality as "Information is material if its misstatement (i.e. omission or erroneous statement) could influence the economic decision of users taken on the basis of the financial information. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

ISA 320, Materiality in Planning and Performing an Audit, issued by the International Standards on Audit (ISA) delineates materiality as "Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements".

7.1. *Setting Materiality for audits*

Audit Materiality is relevant at two stage of audit namely:

- a) at the time of audit planning, when the type and extent of audit procedures to be performed are determined ("planning materiality"); this is calculated as the highest "tolerable error" for the financial statements as a whole and/or tolerable errors for individual accounts/class of transactions based on which audit procedures and checks are planned to ensure that the financial statements do not contain errors greater than the value of the "tolerable error".
- b) at the time of reporting when the deficiencies and misstatements are evaluated and auditors decide to report only material errors/misstatements ("reporting materiality"); at this stage auditors will have to consider all errors and findings and their impact on the total financial statements/financial information.

Generally, the planning materiality levels are kept lower than the reporting materiality levels in order to keep the audit risk low.

Materiality is an extremely relative term and though there are acceptable benchmarks provided by CAG and others, setting the quantum of materiality should best be left to the professional judgement of auditors. The prime consideration for materiality is the value of error (quantitative) and nature of error (qualitative). It can therefore be of the following types:

- a) **Materiality by value:** this represents the total tolerable error of misstatement, beyond which the auditors will have to qualify the opinion and also issue either a (i) qualified (ii) adverse or (iii) disclaimer certificate. The threshold for such tolerance levels depends upon the sensitivity of an account and also the basis of an error. In order to set such materiality, auditors will have to judge the potential error/s from the perspective of the users of the

³ Materiality considerations are required to ensure that items of little importance do not require auditor's investigation.

financial information and government. In general, the following norms as suggested by CAG can be applied

- **For Cash Basis of Accounting⁴**

| Classification of Account | Materiality Base | Materiality as % |
|---------------------------|----------------------------|------------------|
| Very Sensitive | Gross Receipts/Expenditure | 1/2% |
| Sensitive | Gross Receipts/Expenditure | 1/2% to 2% |
| Not Sensitive | Gross Receipts/Expenditure | 2% |

- **For Accrual Basis of Accounting**

| Basis for Materiality | Sensitivity of Accounts | | |
|--------------------------|-------------------------|-----------|---------------|
| | Very Sensitive | Sensitive | Not Sensitive |
| Normal Net Surplus | 5% | 5% - 10% | 10% |
| Gross Income/Expenditure | 1/2% | 1/2% - 2% | 2% |
| Turnover | 1/2% | 1/2% - 2% | 2% |
| Total Assets | 1/2% | 1/2% - 1% | 1% |
| Net Assets | 1% | 1% - 2% | 2% |

Materiality should be considered both at individual transaction level/class of transactions and also at the account balance level. In addition to the above quantitative norms, materiality may also be influenced by non-quantitative factors such as legal and regulatory requirements, qualitative misstatements etc. The CAG guidance on materiality, classifies such qualitative materiality into (i) Materiality by Nature and (ii) Materiality by Context.

- b) Materiality by Nature:** represents those errors in the financial statements/information that users of the financial statements and/or government expect to be stated with high degree of accuracy. These may include items such as (i) budget variations (ii) misclassification of expenditure, (iii) nature of cash balances, (iv) accounting policy and methods not complying with Accounting Standards relevant for the Auditee Entity etc.
- c) Materiality by Context:** this represents contextual errors such as one error in any part of financial statement or information implicating another balance or transaction; for example, if errors discovered in audit are material misstatement of expenditure, these may affect the budgets of the entity or a savings in expenditure may result in excess budget when the errors are corrected.

⁴ CAG guidelines

7.2. Types of Errors

Errors that the auditors will have to identify in settling the materiality and subsequent audits are generally based on the audit objectives. The following table provides a general indication for guidance.

| Possible Error | Objective/Tests to reveal the errors |
|---|---|
| Omission from accounts | Tests designed for completeness objective |
| Transactions not relevant for the accounting period | Tests designed for occurrence objective |
| Misstatement of figures | Tests designed for measurement objective |
| Transactions do not comply with policies and guidelines | Tests designed for regularity objective |
| Expenditure not disclosed | Tests designed for disclosure objective |

7.3. Issues with Materiality

What is “material” to one Entity may not be “material” to another; even amongst auditors the materiality may be interpreted and calculated differently. It may vary by the type of transaction/class of transaction or the same type of transaction with a different context. For example, in audit of public works work done or amount paid to a contractor of a small value may be seen differently when auditing a Welfare Board and auditing a Primary Health Centre. Similarly, small value stores taken individually may not be material but taken as a group may be material. Therefore auditors will have to exercise their professional judgement with diligence and care in setting materiality levels.

7.4. Audit Risk and Materiality

Audit Risk means that the conclusions reached by auditors are wrong and material errors remain undetected. Therefore, auditors will have to keep the Audit Risk very low, otherwise the very purpose of the audit is lost. Audit Risk cannot be eliminated and even considering auditing 100% of transactions is not the right solution as it is not practical or feasible. The level of assurance and materiality are related and are the determinants of the sample size for audit. Materiality and Audit Risk are inversely related with Audit Risk getting higher when materiality levels are lower.

What level of Audit Risk can auditors accept is a moot question and there are no universal answers for this. CAG guidance and manuals suggest that normally a 95% assurance is considered appropriate which means the Audit Risk would be approximately 5%.

Mathematically, Audit Risk (AR) = IR*CR*DR; where

- IR = Inherent Risk i.e. risk that is inherent in any operation and which arises on account of weak internal controls, complex nature of operations, poor quality of supervision
- CR = Control Risk, is the risk that controls established to manage inherent risk do not detect/prevent misstatements.
- DR = Detection Risk, is the risk audit plan and procedures do not detect the errors, mistakes etc.

7.4.1. Audit Risk Model

The following illustration gives an understanding of how detection risk and confidence levels can be calculated:

Assume that auditors can only take a 5% risk and the Auditee Control Environment presents the following:

- Weak internal controls and ill-defined procedures where the auditor's judgement caps the IR at 60% (otherwords, only 40% assurance is possible in the prevailing circumstances).
- Auditors, testing of controls (past experience) shows that auditors can only take 40% assurance from controls, in other words, the control risk is 60%.

Then Detection Risk = $0.05 / 0.6 * 0.6 = 14\%$ which means prevailing environment only gives a 86% confidence level for auditors. Therefore the auditors test procedures and sample sizes will have to be planned accordingly.

8. Audit Evidence

Audits provide assurances. Assurances have to be based on evidence collected through performance of appropriate compliance and substantive audit procedures (tests). Audit evidence refers to the data, information and documents relied upon to arrive at the audit findings and conclusions. The CAG's Regulations on Audit and Accounts, 2007, stipulate that the auditors have to obtain competent, relevant and reasonable evidence to support their judgement as well as conclusions on audit. While reporting the results of audit, the auditors may include such audit evidence in support of audit findings and conclusions as considered necessary. However, the audit evidence retained as working papers and not included explicitly in the final report of audit, viz. audit notes, inspection reports, audit reports, etc. may be shared with the auditable entity at various stages of audit. Further, para 8.1 of Chapter III of Auditing Standards for PRIs & ULBs, issued by CAG, states that "Sufficient, competent, relevant and reliable evidence should be obtained to support the auditor's judgment and conclusions regarding the body, programme and function under audit".

The Audit Standard SA 200, issued by the ISSAI states that "The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusion therefrom on which to base his opinion on the financial information".

- a) Compliance procedures (also known as test of controls) are designed to test transactions to obtain reasonable assurance that the internal controls are effective;
- b) Substantive procedures (also known as test of details) are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by Accounting System. Substantive procedures could be (i) test of details of transactions and balances and (ii) analysis of ratios and trends.

Thus, the Auditing Standards issued by CAG and ISSAI both converge on the same concept of sufficient and appropriate audit evidence to be collected by auditors. As per para 8 of the Chapter III of the CAG field standards that deal with Audit Evidence, the following paragraphs explain audit evidence as an auditing standard.

- a) 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.
- b) Auditors should have a sound understanding of techniques and procedures such as inspection, observation, enquiry and confirmation, to collect audit evidence. The audit authority should ensure that the techniques employed are sufficient to reasonably detect all quantitatively material errors and irregularities.
- c) 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.
- d) 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 inexperienced auditor having no

previous connection with the audit to ascertain from them the evidence that supports the auditor's significant findings and conclusions.

- e) List of audit evidences collected should be submitted along with the Draft Audit Report.

8.1. Sufficiency and Appropriateness

Sufficiency of evidence, refers to quantum of evidence gathered and appropriateness of evidence refers to quality of evidence and its relevance and reliability.

How much is “sufficient” and what is “appropriate”, is best left to the professional judgement of the auditors as there are no quantitative or qualitative standards to determine them. The following factors influence the auditors in their judgements on audit evidence:

- a) The degree of risk of misstatement which may often be influenced by (i) nature of transactions/operations/activities (ii) design effectiveness of internal controls put in place (iii) the value of the transaction/s and the total size of the operations of the auditee (iv) external influences on management of the auditee entity and the financial position of the entity.
- b) The materiality of the item
- c) The results of the audit procedures (including the analytical procedures) performed and availability of different types of evidence in support of transactions/activities.
- d) The experience of previous audits and their findings.

Evidence has to be factual, adequate, and convincing; the auditors may obtain evidence on a selective basis by way of judgmental or statistical sampling procedures.

Relevant information supports engagement observations and recommendations and is consistent with the objectives for the engagement. Relevant information should have a logical, sensible relationship with the associated audit finding. Useful information helps the organization meet its goals.

8.2. Reliability of Audit Evidence

The reliability of audit evidence is based on its nature and source. Reliability can be generalized as below:

- a) Documentary evidence is more reliable than oral evidence; evidence provided by original documents, duly attested photocopies are more reliable than that provided by photocopies or facsimiles
- b) Evidence directly collected by the auditors is more reliable, for example, evidence collected directly from the auditor's own physical observations, or from independent sources outside the organization or part of the organization being audited
- c) External confirmations for evidence is more reliable than internal evidences; however evidence gathered internally may be reliable when the related controls imposed by the organization are satisfactory and effective.
- d) Visual evidence (photos etc) is more reliable to establish the existence of assets than their ownership or value which should be the part of audit paragraph.
- e) Audit evidence which is corroborated by multiple sources is more reliable.

8.3. Audit Evidence and Assertions

Generally the Auditee Entity makes several assertions in their financial statements and information which are tested by the auditors by performing suitable tests and collecting evidences. Audit evidence intends to provide reasonable assurance to auditors on the following assertions:

8.3.1. Test of Controls

| Assertion | Assurance provided by evidence |
|---------------|---|
| Existence | That the controls exist |
| Effectiveness | That the controls are operating effectively |
| Continuity | That the controls are operated throughout the period for intended reliance. |

8.3.2. Test of Details

| Assertion | Assurance provided by evidence |
|------------------------|---|
| Existence | That an asset or liability exists on a given date/at given point of time |
| Rights and Obligations | That the Auditee entity has adequate rights or incurred a liability obligation on a given date/at a given point of time |
| Occurrence | That the activity/transaction has really occurred and it pertains to the auditee and for the relevant period. |
| Completeness | That all assets, liabilities or revenue or expenditure are fully recorded and complete and there are no unrecorded assets/liabilities. |
| Valuation | That the asset/liability is carried at appropriate value |
| Measurement | That the transaction is recorded at its correct and proper value. |
| Disclosure | That the revenue/expenditure/asset/liability is classified and disclosed in accordance with applicable accounting policies and standards. |

8.4. Procedures to collect Audit Evidence

The evidence gathering and evaluation is a simultaneous, systematic process and involves:

- Gathering evidence by performing appropriate audit procedures
- Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality)
- Re-assessing risk and gathering further evidence as necessary

The audit evidence collected should be authenticated by the Head of Office

The methods used for performing audit procedures are: (i) Inspection (ii) Observation (iii) Inquiry (iv) Confirmation (v) Computation/Re-performance and (vi) Analytical Review. These are illustrated below:

| Method | Description |
|-------------------------|--|
| Document Scrutiny | This is the predominant mode of obtaining audit evidence and involves scrutiny of a wide variety of documents – Minutes of Meetings, Records, Government Orders, Accounting Records, Registers, Ledgers, Reports etc. |
| Inspection/Verification | Examining/Verifying records, documents, assets etc. Inspection produces evidence that is: <ul style="list-style-type: none"> documentary evidence from third parties documentary evidence originating from third parties and held by Auditee documentary evidence originating from Auditee and held by third parties documentary evidence originating and held by Auditee of physical assets/inventory for their existence followed by other checks to confirm their ownership. |

| | |
|-----------------------------------|---|
| Physical Inspections/ Site Visits | This involves inspection of physical assets (eg a road, bridge, stores and stock etc). Generally such inspection is conducted jointly with departmental personnel to ensure acceptability to the audit findings. Where the auditable entity does not co-operate with physical inspection, the fact of such non-cooperation may be appropriately documented and reported to the top management of the auditable entity, but the physical inspection may continue nevertheless by the audit team on its own. Photographs taken during physical inspection/site visits are an acceptable form of evidence, provided the location and date of photograph are amply clear. |
| Observation | Watching a process as it takes place; or of people, of actions, to obtain evidence. Observation involves looking at the process or procedure being performed. In performing finance and compliance audit and this may include looking at how transactions are processed in real time by staff of the auditable entity. |
| Inquiry and Confirmation | Confirmation is a type of inquiry and involves obtaining, independently of the auditable entity, a reply from a third party with regard to some particular information – for example, confirmation of balances from the banks. Seek information from third parties, experts etc, internal or external in the form oral or written enquiries and obtain necessary evidence to corroborate data/information contained in the entity's financial and accounting systems. |
| Questionnaires | This involves seeking information from relevant persons within the auditable entity through issue of a formal questionnaire to elicit further information and gather relevant audit evidence |
| Surveys | This involves interaction with persons outside the auditable entity to get the information from the affected parties or the beneficiaries of programmes/ schemes, as the case may be. This would involve careful selection of the survey sample, formulation of an appropriate survey questionnaire, collation and analysis of the survey responses. Evidence gathered from surveys would be corroborative in nature to support evidence gathered by conventional techniques. |
| Computation and Re-performance | Checking arithmetical accuracy of records and also performing calculations and computations on the data thrown up by the system. Re performance involves independently carrying out the same procedures which have already been performed by the auditable entity. This can be carried out either manually or by computer assisted audit techniques. Where highly technical matters are involved experts may be involved for re-performance. |
| Analytical Procedures | These are the analysis of significant ratios and study of resulting information or fluctuations which appear inconsistent or which deviate from prescribed or predicted ratios/indicators. |

Section 6 of the Act requires Audit of Stores and Stock at all Auditee Entities. Audit includes physical verification/count of stock. Some additional considerations for obtaining evidence in connection of stores and stock are given below:

- a) Auditors need to be physically present at the location/s where the physical count of stock will take place unless the attendance is considered impractical or impossible due to nature of inventory or location of the stores. Physical presence benefits the auditors to inspect the condition of the stores and stock and observe if management procedures for physical count are being followed and results are properly tabulated and accounted.
- b) Where physical presence is not possible, auditors should employ alternative procedures such as examining the Material Received Note/Material Issued Note for movement of inventory into and out of stores and verify if inventory represented is included/excluded in the stock. This verification at the closing date or nearer to closing date is essential.
- c) Auditors should review management procedures for physical count such as usage of stock sheets, tagging, counting procedures etc.
- d) Auditors should also review the procedures for identification of obsolete and damaged stores, slow moving items, work in progress, etc.
- e) Auditors should also review procedures for cut-off date purchase/sale transactions to ensure they are correctly represented in the stock.
- f) Where physical count is done at a date other than period end date, auditors should ensure that the movement of stock from the period end date to the physical count date is properly dealt with in the books of accounts and stock records.

8.5. *Evaluation of Evidence*

Audit evidence, collected through above mentioned audit procedures, is to be evaluated against the relevant, already identified criteria. This involves consideration of evidence collected vis-à-vis the subject matter information as well as the written responses obtained from responsible officers of the auditable entity against the applicable criteria. The evaluation process enables auditors to assess whether the subject matter information is, in all material aspects, compliant with the identified criteria. Audit conclusions should be arrived at after evaluating the audit evidence using the best professional judgement of the auditors. The audit conclusions should clearly bring out the nature and extent of non-compliance/variance with a set parameters/other errors relating to the transactions, cause of such errors/non-compliance/variances, its materiality and also their effect on the auditee entity. The audit conclusions should also indicate whether non-compliance is a solitary one-off case, or wide spread systemic issue in the auditable entity.

9. Audit Planning

Audit plans are critical to ensure that the audit is performed in an effective manner. The CAG's Auditing Standards require that each audit has to be planned that ensures that audits are carried out in an economic and efficient and in a timely manner. The Audit Standard 300 issued by the ISSAI, deals with planning of an audit of financial statements (financial and compliance audit) which sets the objective of performing the audit in an effective manner.

Planning is about establishing and documenting the overall audit approach, audit objectives, scope, and audit programmes covering audit procedures to be performed.

Audit plans facilitate:

- a) Devoting appropriate attention to key audit areas and significant risks.
- b) Identification of potential problems and their resolution.
- c) Assignment of audit work to audit staff and supervision over the audit.
- d) Documenting the audit procedures and required audit evidence to ensure audit is systematically conducted.
- e) Directing and coordinating the work done by experts and other auditors.

Audit plans should cover amongst other things the following:

- a) Business understanding of the entity, its accounting systems, policies and internal control procedures.
- b) Degree of reliance to be placed on internal controls
- c) Nature, timing and extent of the audit procedures to be performed
- d) Yearly and month wise audit allocation programmes; and;
- e) Coordinating the work to be performed.

Audit plans should be properly documented as part of Audit Documentation and should be archived in the permanent/temporary audit files as the case may be.

9.1. Audit Plan for the entire KSAD

Understanding the Audit Universe and prioritization of audits to be taken up is essential, which is in itself a complex task, given the various regulatory requirements and timelines and limited audit resources. Given the institutional design of the KSAD, this requires a mix of top-down and bottom-up approach where the audit planning begins in the audit offices responsible for conducting the audits. It is essential that an overall annual/quarterly/monthly audit plan and program is developed for the audit department as a whole which will facilitate the audits to be conducted and audit resources to be allocated. This should be done as described below:

- a) Early in February every year and in accordance with the instructions issued by the Directorate, the audit offices and concurrent audit offices will prepare an annual audit programme to carry out audit of all audit universe entities falling within their respective jurisdiction. This programme will amongst other details, have the following essential information:
 - Number of Institutions to be covered –month-wise
 - Number of Man days provided for each institution
 - Manpower Available
 - Total days available in a year for audit
 - Current or arrears audit

- b) This audit programme should be sent to Directorate for **consolidation and approval by the Director**. This single consolidated plan will lay down the overall audit programme for all auditors across the State and the number of institutions to be covered under audit for that year. The approved plan should be sent to all the heads of audit offices for implementation.
- c) The annual audit programme should be split into quarterly programmes for various audit teams for easy implementation and follow-up. In addition, a month wise audit programme should be prepared for each audit office and the designated audit teams to be deputed to the field for carrying out the scheduled audits. This month-wise programme should be in accordance with the annual and quarterly plan. In case of shortage of audit resources, the audits of those institutions which are mandatory as per the provisions of the respective parent acts and regulations should be first taken up before non-mandatory audits are planned.

9.2. Audit Plan for Specific Institutional Audits

In planning an audit of specific audit entities, the auditors should:

- a) Identify important aspects of the environment in which the audited entity operates;
- b) Develop an understanding of the accountability relationship;
- c) Consider the form, content and uses of audit opinions, conclusions or report;
- d) Specify the audit objective 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) Review the internal audit of the audited entity and its work programme.
- g) Determine the materiality of matters to be considered.
- h) Assess the extent of reliance that might be placed on other audits, for example, internal audit;
- i) Determine the most efficient and effective audit approach;
- j) Provide 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.

Audit Planning should be in terms of significant and non-significant audit areas to ensure the audit resources are efficiently used and relevant account areas are audited and evidence collected for expression of opinions. Significance and Non Significance depends upon (i) the risk perception of auditors about the audit areas (ii) account areas that can significantly impact an entity's financial statements. In order to do this, auditors can use books of accounts and trial balance, prints of ledger accounts, lead schedules to financial statements etc. Account areas can be interpreted to mean classes of revenue, expenditure, assets and liabilities which are grouped based on similar characteristics and obligations imposed and rights acquired by the entity. Understanding of account areas enables an informed risk assessment and audit planning. Understanding of account areas requires a clear understanding of:

- a) the nature and type of transactions included in each audit area
- b) the accounting policy, process and controls in that areas
- c) the sensitivity of that area

However, common to all entities will be audit of the following areas as these carry same degree of risks in all entities.

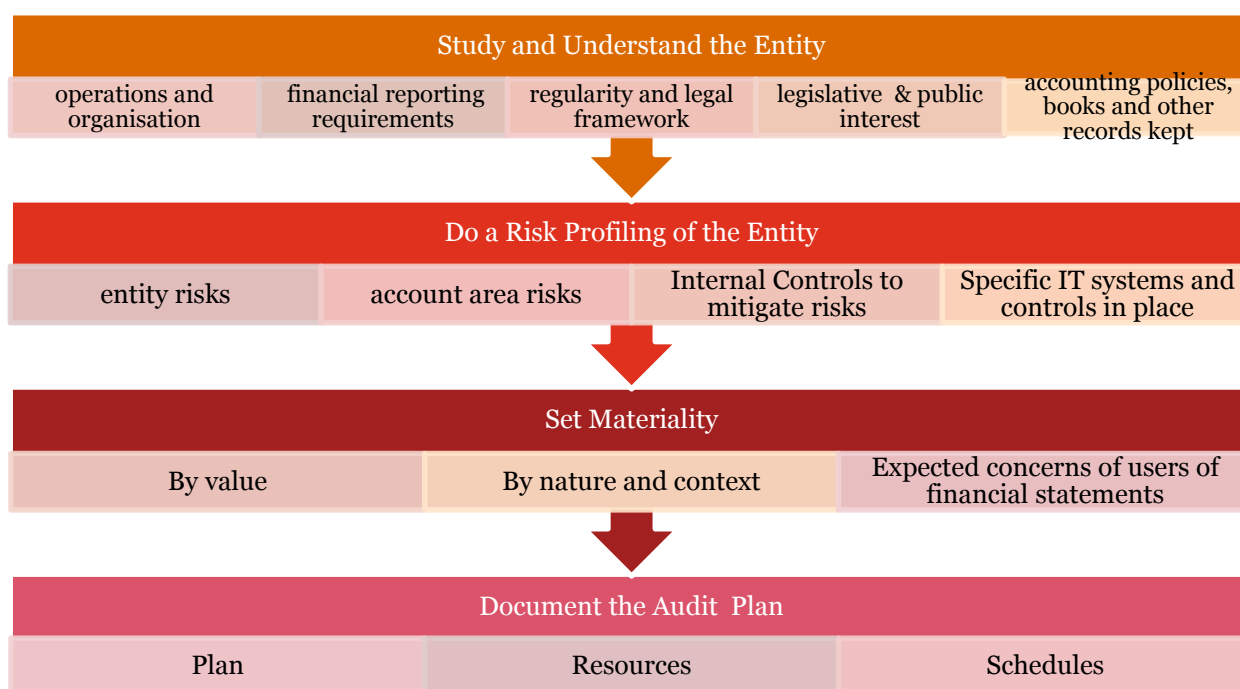
- a) Budget controls and budget execution
- b) Procurement expenditure including utilization of grants for specified expenditure.
- c) Establishment expenditure (payroll, pensions, claims etc.)
- d) Revenue collections and banking arrangements
- e) Fixed assets

9.2.1. Process of Audit Planning

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

- Collect information about the audited entity and its organisation in order to assess risk and to determine materiality;
- Define the objective and scope of audit;
- Undertake preliminary analysis to determine the approach to be adopted and the nature and extent of enquires to be made later;
- Highlight special problems foreseen when planning the audit;
- Identify staff requirements and a team for the audit, and
- Familiarize the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary.

The audit plan can be essentially divided into 4 steps (i) understanding of entity (ii) risk assessment (iii) setting audit materiality and (iv) plan finalization and documenting the audit plan. The process is shown in the following exhibit.



9.2.2. Understanding the Entity to be audited

The Audit Standard SA 310 issued by the ISSAI and the CAG's auditing standards require the audit teams to develop a thorough understanding of the Auditee Entity and familiarize with the following:

- The legal and regulatory framework of the entity
- The operations and organization of the entity in terms of their goals and objectives, activities/services performed, dependence on government for budget transfers/grants, grants/funds received and spent, revenue and expenditure streams and flows, other funds and sources etc.
- The applicable financial reporting framework and financial statements generated by the entity, and in particular (i) changes to accounting systems and policies, if any, (ii) chart of accounts, new heads created during the year, (iii) format of financial statements and changes, if any, during the year, etc.

- d) The accounting policies, books of accounts required to be maintained and actually maintained. Accounting treatment for revenues, expenditure, grant received, assets and liabilities created. In particular, the budgets and budget controls, procedures followed for procurement and public works and sources of revenue and windows of revenue leakages, if any.
- e) The auditor shall understand the accounting policies, account balances, classes of transactions and disclosures expected in the financial statements and shall evaluate whether such policies are appropriate for the entity considering its nature and regulatory framework.
- f) The auditors should get an understanding of the Information System being used by the Auditee Entity to the extent it is relevant for financial reporting and communication; this generally includes:
 - i. The procedures in IT and Manual environments by which transactions are initiated, recorded, processed or corrected as may be necessary and transferred to the General Ledger for reporting
 - ii. The related accounting records, supporting documents that are used to initiate, record, process and reporting transactions
 - iii. Controls surrounding the journal entries
 - iv. The year-end financial reporting process to prepare the financial statements including notes to accounts and disclosures.
- g) Identify legislative interest and public interest in the Entity and its financial statements, in particular the level of assembly questions, complaints from public directly or to the public representatives and scrutiny of financial statements by government and/or legislature.
- h) Manual or computerized accounting processes and the degree of computer involvement;
- i) Assess the overall internal control environment and in particular the controls to prevent irregularity, illegality and fraud.

9.2.2.1. Set Audit Objectives, Scope and Methodology

Audit planning also involves setting audit objectives, scope and methodology for each audit.

- a) Audit objectives are broad questions that the auditors seek an answer for through collection and analysis of evidence and draw a conclusion on the audit engagement.
- b) Set clear and measurable Audit Criteria for the given audit objectives- audit criteria are reasonable and attainable standards of performance as laid down in the rules/regulations of the entity or best practices that the auditee entity is expected to follow.
- c) Define and document the scope of audit
- d) Define and document the methodology for audit

9.2.3. Risk Profiling of the Entity

Risk can be business risks (entity risks and processes risks) or audit risks; business risks hinder the entity's goals and objectives and affect its operations; audit risks is the risk of reaching incorrect conclusion/observation when auditing an activity/process/function. Risk assessment as a component of internal control is primarily a management responsibility. Management of the Auditee Entity must be aware of the risks which may impact on its ability to achieve its operational objectives,

affect their reputation and even their funding availability so that these can be addressed. Auditors shall only evaluate the risks along with related controls to treat those risks as assessed by the Management in its process of providing assurances on the governance, controls and accountabilities. In terms of Auditee Entity's abilities to set up risk management process, they can be divided into the following categories:

| Risk Maturity | Description of the Level |
|----------------------|---|
| Risk Naïve | No formal approach developed for risk management by the entity |
| Risk Aware | Scattered silo based approach to risk management. Risks identified within functions and not across processes. Also risks not communicated across the departments. |
| Risk Defined | Strategy and policy in place and communicated. Risk appetite defined. Risk Appetite is level of risk the Entity as a whole is willing to accept |
| Risk Managed | Enterprisewise approach to risk management developed and communicated. Risk Register is in place. |
| Risk Enabled | Risk management and internal control fully embedded into operations. Organization in readiness to convert market uncertainties into opportunities. |

Barring a few entities, it can be generalized all most all local funds/authorities which are subject to the audit by the KSAD will fall into the first category which is "Risk Naïve". Therefore, audit planning in such organizations and risk assessment by auditors assumes more significance. In assessing the risk the following risk indicators may be used as a general guidance.

| Generalised Risk Indicators in Entities |
|--|
| <ol style="list-style-type: none"> 1. Past audit experiences, audit observations of the previous audits and pending audit paras yet to be complied with and the entity's track record in producing records for audit. 2. Complexity of the regulatory framework and external influences on the management of the entity. 3. Nature of operations, complexity and size and ability of the management in terms of competence and size. Staffing in accounts departments and their competence. 4. Nature of transactions and susceptibility for fraud and mismanagement; similarly susceptibility of assets to material frauds and misrepresentation. 5. Existence and effectiveness of internal controls. 6. Financial problems being faced by the entity. 7. Nature and complexity of accounting process and use of IT in accounting; mix of IT and manual controls in place; accounting policies and changes to accounting policies. 8. Changes in management and accounting staff. 9. Public interest and visibility of the entity; public complaints about the entity and their redressal. 10. Incentives and motivations for fraud and misstatements in financial statements. 11. Litigations in courts 12. Expenditure trends in the last 3 years 13. Persistent and unexplained budget problems and excess spending 14. Unadjusted account bills. 15. Transfers to Personal Ledger Accounts. 16. Large purchases. |

Auditors should assess the risk at (i) Entity Level (ii) Transaction Level. The following table illustrates the risk factors at these levels relevant for local funds/authorities subject to audit by KSAD.

| Entity Level Risks | Transaction Level Risks |
|---|--|
| <ol style="list-style-type: none"> 1. Management commitment for internal controls and accurate record keeping and error free financial reporting. 2. Risk is lower if there exists competent and experienced Staff with adequate commitment and training. 3. Risk is lower where there is adequate supervision on the staff, operations and transactions. 4. Risk is lower if the accounting system (manual or computerized) is reliable and tested; generally speaking manual systems carry high risk. 5. Modification to accounting systems and changes to accounting policies increase the risk. 6. Any performance targets (for schemes/programmes) put pressure and can result in higher risk in those areas as the management tries to achieve those targets. | <ol style="list-style-type: none"> 1. Complex regulation or an accounting policy can result in higher risk in an account area or in a transaction. 2. Works carried through contractors/third parties with no day to day control can result in higher account area/transaction level risks. 3. Transactions recorded against goods and services may have lower risk than transactions recorded against specific claims. 4. Transactions not in the normal course of business and/or exceptional transactions may carry higher risk. 5. Accounting estimates carry higher risk 6. Multiple sources of funds (e.g. budget from central government and state government) can increase the risks of misstatement/error. 7. Reconciliations not timely done can increase the risk of misstatement/fraud. |

9.2.3.1. Auditors' Responsibility towards Risks

As per the Audit Standard 315 issued by the ISSAI and the CAG's General and Field Audit Standards, the auditors' responsibility is to identify and assess the risks of material misstatement, whether due to error or fraud, at the financial statement and assertion levels, thorough understanding of the entity and its control environment which provides a basis for designing and implementing auditor's responses in terms of conducting various test procedures and forming and expressing an opinion. Where the Auditee Entity has a formal risk assessment process in place, Auditors are required to obtain an understanding of it for:

- a) Identifying and managing risks relevant for financial reporting
- b) Estimating the significance of the risks
- c) Assessing the likelihood of their occurrence
- d) Deciding about actions to address those risks.

If the Auditee Entity does not have a formal risk assessment process as above, then the auditors are expected to discuss with the Management whether business risks relevant for financial reporting have been identified and they are being addressed. Auditors shall evaluate if absence of a documented process is appropriate or not. The decision as to "appropriateness" is a matter of professional judgement.

Auditors are expected to carry out the following risk assessment procedures in discharging this responsibility:

- a) Inquiries with the management of the Auditee Entity who may have information that is likely to assist the auditors in identifying risks of material misstatement due to error or fraud. These could be summarized as:
 - i. Inquires with/of employees involved in initiating, processing, or recording complex transactions may help in evaluation of appropriateness of the policies and procedures.
 - ii. Inquiries with senior management (i.e. those charged with governance) will help the auditors in understanding the environment in which financial statements are prepared.
 - iii. Inquiries with senior management or appropriate external stakeholders may help auditors in collecting information about compliance with regulations, knowledge of fraud or suspected fraud etc.,
- b) Carry out Analytical Procedures that establish data relationships, dependencies and trends and ratios provide a broad indication if a material misstatement exists. Such information may help auditors in designing the test procedures for carrying out the substantive tests.
- c) Observe and Inspect the control procedures and activities
 - i. Observation of processes/procedures as they are performed
 - ii. Examination of documents, records and operating manuals if any
 - iii. Examination of past audit reports, management reports, etc.
 - iv. Inspection/verification of Entity's assets, premises and facilities
- d) Information obtained from prior audits to the extent it continues to be relevant, for e.g. uncorrected errors, unrecovered dues, and significant changes in the accounting and financial policies if any, etc.

9.2.3.2. *Relevant controls for Audits*

While enterprisewide risks and controls are essential for the auditors to gain an understanding to assess their impact on the financial statements and reporting, controls that are particularly relevant for auditors are those related to transactions, account balances and disclosures in the financial statements. Auditors are expected to identify and assess the risks of material misstatement at:

- a) The financial statement level and
- b) The assertion level for transactions, account balances and disclosures.

Risks at the financial statement level are those that have a pervasive effect on the statements as a whole and therefore will potentially affect many transactions. These risks may not be identifiable with single or class of transactions or an account balance or particular group/set of balances. In general the source of such risks are the following:

- a) A weak control environment suggests management's inability or incompetence to identify risks and set up appropriate controls – this overall weakness may be present in several local funds/authorities requiring auditors' appropriate interventions.
- b) Concerns about the integrity of the management may be so high that auditors may have to conclude that risk of misrepresentation may be so high that audit cannot be concluded or if done only an adverse certificate or a disclaimer could be issued.

- c) The reliability and accuracy of accounting records may be so poor that auditors may fail to collect appropriate audit evidence to support their opinions and resultantly auditor may have to issue an adverse opinion or a disclaimer.

At the transaction levels, controls are tested to ensure there are no misstatements relating to the following assertions.

| Assertions about Transactions | Assertions about Account Balances | Assertions about Presentation and Disclosure |
|--|---|--|
| 1. Occurrence 2. Completeness 3. Accuracy 4. Cut-off 5. Classification | 1. Existence 2. Rights and Obligations 3. Completeness 4. Valuation and Allocation | 1. Occurrence and Rights & obligations 2. Completeness 3. Classifications 4. Accuracy and Valuation |

The following text is provided as guidance to understand the control procedures/control activities for testing the aforesaid assertions and the financial statements.

| General Control Procedures/Activities relevant for auditors |
|---|
| 1. Checking the arithmetical accuracy of the records 2. Approvals and Authorizations – of documents, records and financial statements 3. Reviewing the reconciliations 4. Maintaining and reviewing control accounts in the GL and their related subsidiary ledgers 5. Comparing internally generated data with external confirmations 6. Comparing the results of physical counts/verifications with corresponding balances in books of accounts. 7. Access controls (restricting access) to assets, records and information 8. Comparing the actuals with budgets 9. Establishing and monitoring controls over IT systems used for accounting and financial reporting 10. Performance Reviews, these are mostly the analytical procedures and comparison of data elements and relationships to derive and interpret the results 11. Physical controls over assets and records 12. Segregation of duties such that incompatible functions are handled by different staff. Segregation of duties is one of the most important control for fraud prevention. |

9.2.4. Set Materiality

The next step in audit planning is understanding and setting the planning and reporting materiality and providing necessary directions on audit universe, audit population and sampling including selection of samples for carrying out detailed audit procedures as explained in detail in Chapter 6 and Chapter 7.

9.2.5. Documenting the Audit Plan

Auditors will have to comprehensively document the aforesaid items for every audit engagement as part of Audit Work Paper documentation. However, once a detailed understanding and risk assessment are done, then auditors will only have to review these for subsequent year's audits and understand and document the changes that may have occurred/implemented to ensure that the audit team's understanding is appropriate in the circumstances. The audit planning done using the process explained above, should be documented in the format of a Planning Memorandum; an illustrative content of a planning memorandum is given below for general guidance. This needs to be customized for every auditee entity based on its specific requirements:

- a) A brief outline of the Auditee's activities and financial circumstances, cross referenced to more detailed information if appropriate;
- b) The effect of the regularity framework on the audit; cross-referenced to a summary of primary and secondary legislation under which the Auditee Entity operates.
- c) Details of any significant facts, events or changes which have taken, or may take place; their likely effect on the Auditee's operations or environment and on the audit;
- d) A description of the scope of the audit and the authority under which it is conducted, the type of account, the form of opinion required and any other reporting requirements. This should highlight any additional work required;
- e) The accounting principles / framework under which the financial statements are prepared and their acceptability (for example government accounting rules; accounting standards);
- f) A brief assessment of the Auditee's financial situation; sources of revenue and funds; grants and their utilization and specific risks with respect to financial position.
- g) Planning materiality, cross referenced to documentation setting out the reasons and basis on which it was calculated;
- h) A summary of specific risks identified, any major problems likely to be met;
- i) A brief assessment of the general control environment and mitigating controls, and whether they are to be relied on.
- j) A brief overview of the audit approach to be adopted, that is to say the degree of compliance and substantive procedures (including analytical procedures);
- k) Comment on the Auditee's ability to continue as a going concern;
- l) A summary of the key team members and the total planned days / hours and costs, if required under the extant instructions.
- m) Respective responsibilities of the auditor and the Auditee Entity; and
- n) Liaison schedule with Auditee Entity.

10. Conducting Audit – Field Work

Audit field work commences with issuing a communication to the Auditee Entity and holding an Entry Conference followed by auditors conducting various tests of controls and tests of details and collecting evidences and forming conclusions and ends with auditors' holding an Exit Conference and submitting formal audit report/s and certificates.

10.1. Communication and Entry Conference

Section 11 (3) of the Act requires the auditor to give a notice in writing to the Executive Authority of the institutions concerned at least two weeks before the date on which he proposes to commence the audit provided that the auditor may, for special reasons to be recorded in writing, give shorter notice than two weeks or commence a special or detailed audit without notice, on the order of the Director. Rule 5 of the Rules requires such notice to be given in Form I or I (A) as the case may be, at least 14 days in advance. These forms are not reproduced here and necessary reference may be taken to the Act and Rules by the auditors.

This letter serves as letter of understanding for all statutory audits (Sec 3 and Sec 4 of the Act) and as an Engagement Letter for non-statutory audits under Section 5 of the Act. Therefore, additional information in terms of details of the audit team, responsibilities of the auditors and the Auditee Entity, the time lines for the audit, etc., may also be given in that notice to make it more comprehensive. However, it may be emphasized here that auditor's communication with auditee is continuous from commencement till the closure of the audit.

Section 11 (1) (a) of the Act, requires the auditors to requisition the information needed for audit in writing; Rule 8 of the Rules\ require such requisition to be in Form No. II which shall be sent to the Executive Authority of the local authority/local fund in duplicate. An acknowledgement shall be obtained from the concerned officer of the local authority on the duplicate copy of the Form No. II. This form is also not reproduced here and necessary reference may be taken to the Act and Rules by the auditors.

Entry Conference with Auditee Entity should be held on the date communicated (as above). It serves multiple purposes as detailed herein:

- a) Introduction of team members, team leader and to explain the scope of audit and methodology that will be followed.
- b) Identification of records and information that will be needed for the audit and process of submitting the records to the auditors, office space, access cards, etc., including giving them necessary access to the computer systems and applications, creating temporary passwords for auditors, providing them laptops or desktop machines to conduct their work and setting up necessary interface with the Auditee's systems.
- c) Explaining the process of raising audit queries during the course of audit, method of responses from the Auditee, etc.
- d) Raising and discussing issues of areas of concern including discussions on risks and controls.
- e) Discussion of the audit plan, objectives, scope and approach and timelines for completion and reporting.
- f) Identification of nodal officers from both sides to ensure smooth flow of communication between the auditors and the Auditee Entity.

The proceedings of the Entry Conference should be properly documented as this serves as an important Audit Work Paper. The minutes signed by the KSAD Audit Team Leader and the Head of the Auditee Entities should be filed in the current file of the Audit Work Papers. Immediately following this meeting, the auditors will submit a list of records and information required to commence the audit work. The audit areas will be divided amongst the audit team members for commencing the testing procedures as per the Audit Plan.

10.2. Testing Opening Balances

Testing opening balances is an important activity for auditors. The objective for testing the opening balances is to ensure that:

- a) The closing balances of the preceding period (year) have been correctly brought forward.
- b) The opening balances do not contain any material misstatements that will affect current period.
- c) Appropriate accounting policies are consistently applied.

In case of KSAD audits, as the audit evidence would have been previously obtained, there may not be any need to obtain fresh evidences for these opening balances. However, in case of initial (first time) audit engagements, audit evidence will have to be obtained and tested for verification of opening balances. In obtaining the audit evidence and applying the audit tests the following guidance may be relevant:

a) Where the previous year's financial statements were audited

- If the previous financial statements were audited, then studying the audited financial statements along with audit file documentation that may have been maintained by the Auditee Entity can provide sufficient evidence on the opening balances of assets and liabilities; generally, the current auditors are entitled to rely on past audits for assurance on opening balances, but the current auditors will have to check for arithmetical accuracy and correctness of carrying over of those balances in the current period accounts.

b) Where the previous year's financial statements were not audited

- For current assets and liabilities, some audit evidence can be obtained on opening balances also when auditing the current period balances; for example checking of collections from debtors or payment to creditors may provide as to the existence, completeness and rights/obligations as on the opening date.
- For fixed assets, Investments and Debt Obligations auditors normally examine the underlying records for the current year which also provide evidence as to their existence, completeness and rights as on the opening date; where additional evidence is required, it has to be obtained by the auditors. Where required third party confirmations should be obtained to ensure that those balances are correct.
- Where opening balances were carried forward incorrectly, the auditors will have to ask the Auditee to rectify the errors where auditors conclude that opening balances contain material misstatements affecting the current year's financial statements too, then a qualified opinion/disclaimer should be issued.

10.3. Analytical Procedures

Analytical procedures are the analysis of significant trends, ratios and data relationships and study of resulting information or fluctuations which appear inconsistent or which deviate from prescribed norms or predicted ratios. Auditors normally employ analytical procedures at the audit planning stage or at the overall review stage. It may also be necessary to employ these procedures during the course of audit if the available audit evidence requires such procedures. The choice and extent of analytical procedures is a matter of professional judgment and the size and complexity of the Auditee Entity. However, these may include any or all of the following:

- a) Simple period to period comparisons (either absolute or simple averages) of either the actual financial information or the budgets.
- b) Performing a ratio analysis, generally done either during the course of audit or at the overall review stage.
- c) Complex analysis of standard deviations, variance co-efficient, portfolio at risk etc., (however, these are seldom applied in audit of small entities);
- d) Consideration of relationships between the data – for example, payroll costs to number of employees; number of tax payers to total taxes collected etc.

The purpose of Analytical Procedures is to:

- a) Help the auditors in planning their other audit procedures and their timing;
- b) Substitute the test of details (substantive procedures) when they can be more effective in reaching an audit opinion/conclusion;
- c) Facilitate an overall review of the financial statements at the time of closing the audit and arriving at an overall conclusion and expression of an opinion.

The extent of reliance that can be placed on Analytical Procedures depends on several factors, some of which are:

- a) If internal controls are found to be weak, auditors should not rely too much on analytical procedures and instead should perform more substantive procedures to test the transactions.
- b) When the audit risk and materiality are high, reliance on analytical procedures should be low
- c) When the accounting records and the Management Information System (MIS) considered unreliable, tests of detail should be preferred to analytical procedures.
- d) Availability and nature of information and degree to which it can be disintegrated, its relevance, reliability and accuracy are also important considerations for the analytical procedures.
- e) Source of the information, comparability of the information across periods and data elements.

When unusual observations are noticed/found, auditors will have to investigate the respective items for potential misstatements in the Financial Statements and reporting.

10.4. Audit Testing

Audit Testing means designing and performing audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. The Audit Plan document as discussed above, will set out the type and extent of Tests of Control and Test of Details (Substantive Procedures) which, subject to satisfactory results, the auditors of the KSAD think will provide necessary and reasonable evidence to support the auditors' opinion and issue of relevant certification.

10.4.1. Test of Controls

In order to place reliance on internal controls of the Auditee Entity, the auditors will have to perform Test of Controls (also known as Compliance Tests) for necessary assurance on their design and operating effectiveness. The tests that are expected to be conducted by auditors are discussed in detail in **Chapter 5- Internal Controls**. The results of this testing could be:

- a) A conclusion that controls are effective and in which case, auditors can perform a minimum number of Test of Details (also known as Substantive Procedures) in order to get reasonable assurance on the financial statements and information.
- b) A conclusion that controls are ineffective and in which case auditors should not rely on them and instead perform Test of Details either on a larger sample size or carry out a 100% testing of accounts.

Auditors should evaluate the results from their Test of Controls as follows:

- a) When enquiry and confirmation or observation are the procedures adopted, the results may either succeed or fail. Accordingly auditors can conclude on the effectiveness of controls.
- b) When sampling is adopted to select transactions for testing, and the level of error found to be less than maximum acceptable level, then auditors can go by their planned level of assurance and perform only minimum level of substantive procedures.
- c) When the level of error found to be not acceptable, then it may mean (i) auditors use a larger sample size to re-list the controls or (ii) performing more substantive procedures to get all the assurance required by them for their opinion.
- d) When there are control failures, it could also mean risks of regularity and propriety of expenditure requiring necessary investigation into such failures and reporting thereon.
- e) The control weaknesses/failures should be reported to the Auditee for necessary action.

10.4.2. Test of Details (Substantive Procedures)

The Audit Standard SA 330 issued by the ICAI and the Field Audit Standards of the CAG, require auditors design and perform substantive testing procedures irrespective of the assessed risks of material misstatement. The Standards require these procedures as (i) the auditors' assessment of risks is judgmental and therefore may not identify all risks (ii) internal controls have inherent limitations and (iii) management override of internal controls.

Where the auditors plan to test their audit objectives using Substantive Procedures, then they should

- a) Identify the relevant population and:
- b) Apply an appropriate sampling technique to select items from the population and examine supporting evidence for those items; or
- c) Examine supporting evidence for the entire population

The timing, nature and extent of the Test of Details depend on:

- a) The audit objectives – auditors will have to document (as part of audit plan) the objectives for each audit area/unit and also objectives for performing a particular procedure. Audit objectives will also have to be related to one of the five assertions (Refer **Chapter 8 – Audit Evidence for these assertions**) that the auditors are expected to test.
- b) The results of the Test of Controls – satisfactory or unsatisfactory; if the results are satisfactory, then there will be less substantive tests to be performed. Conversely, there will more substantive tests if the results are unsatisfactory.
- c) The nature and significance of business and audit risk that the auditors are addressing – significant risks require considerable tests to gather audit evidence that has higher reliability; significant audit risks are required to reduce the audit risk to an acceptably low level.
- d) The extent of the automation employed by the Auditee; generally, the greater the manual environment (of a process), the higher the degree of substantive procedures.

Substantive Procedures are carried at the assertion level and the type of procedures to be performed are detailed in **Chapter 8 – Audit Evidence**. These include application of any or all of the following procedures:

- a) **Document Scrutiny:** This is the predominant mode of obtaining audit evidence and involves scrutiny of a wide variety of documents – Minutes of Meetings, Records, Government Orders, Accounting Records, Registers, Ledgers, Reports, etc.
- b) **Examination/Verification** of registers, records, ledger documents, vouchers, bills, receipts, confirmations and other relevant written records with respect to the transactions. This produces evidence that are:
 - documentary evidence from third parties
 - documentary evidence originating from third parties and held by Auditee
 - documentary evidence originating from Auditee and held by third parties
 - documentary evidence originating and held by Auditee
- c) **Physical Verification:** This involves inspection of physical assets (eg. a road, bridge, stores and stock, etc.). Generally such inspection is conducted jointly with departmental personnel to ensure acceptability to the audit findings. Where the auditable entity does not co-operate with physical inspection, the fact of such non-cooperation may be appropriately documented and reported to the top management of the Auditable Entity, but the physical inspection may continue nevertheless by the audit team on its own. Photographs taken during physical inspection/site visits are an acceptable form of evidence, provided the location and date of photograph are amply clear.
- d) **Observing** a process or procedure being performed by the Auditee Staff. Observation involves looking at the process or procedure being performed. In performing finance and compliance audit, this may include looking at how transactions are processed in real time by staff of the Auditee Entity.
- e) **Formal written enquiries** to third parties and confirmations to corroborate the information in the accounting records of the Auditee. Confirmation is a type of inquiry and involves obtaining, independently of the Auditee Entity, a reply from a third party with regard to some particular information – for example confirmation of balances from the banks. Seek information from third parties, experts etc., internal or external in the form oral or written enquiries and obtain necessary evidence to corroborate data/information contained in the entity's financial and accounting systems.

- f) **Checking the arithmetical accuracy** of source documents and/or performing independent calculations by auditors – Re-performance. Checking arithmetical accuracy of records and also performing calculations and computations on the data thrown up by the system. Re performance involves independently carrying out the same procedures which have already been performed by the Auditee Entity. This can be carried out either manually or by computer assisted audit techniques. Where highly technical matters are involved experts may be involved for re-performance.

In addition, Substantive Procedures for Financial Statement closing process are:

- a) Reconciling/Matching the Financial Statements with the underlying General Ledger and other accounting records.
- b) Examining the material journal entries and other adjustment entries made at the timing of the closing of books and preparing the Financial Statements.

Whether to use whole population or a sample for test of details is a matter of professional judgement and will be based on (i) acceptable/tolerable levels of error for risks identified and (ii) feasibility or cost-effectiveness of testing the whole population. Where the auditors decide to use sampling techniques, they may follow the guidance given in **Chapter 6- Audit Sampling and Test Checking**.

In determining the nature and type of audit tests to be performed, the auditors usually consider the relationship between Audit Evidence and Tests to be performed as illustrated by the following table:

| Type of Audit Evidence | Audit Procedures | | |
|-------------------------------|------------------|-----------------|-----------------------|
| | Test of Controls | Test of Details | Analytical Procedures |
| Inquiries | X | X | X |
| Observation | X | | |
| Documentation and Examination | X | X | |
| Performance | X | X | |
| Physical Verification | | X | |
| Confirmations | | X | |
| Analytical Procedures | | | X |

In performing the audit tests as above, auditors may use any or all of the following tools:

- a) Vouching — testing recorded amounts by examining supporting documents to determine whether they represent an actual transaction
- b) Tracing — following a document through its processing cycles to the accounting records to determine whether all transactions have been recorded
- c) Re-computation — verifying the arithmetical accuracy of figures. The value of this procedure is limited as the reliability of the evidence obtained depends on the validity of the underlying input.
- d) Scanning — searching for obvious exceptions in a large quantity of data

10.4.3. Testing Accounting Estimates

During the course of audit, auditors will have to test not only actual values for transactions recorded but also estimates used by the management wherever required and wherever allowed; for e.g. verification of depreciation. Generally, in cash basis accounting, estimates do not arise and it is only

when the Auditee follows the accrual basis of accounting, estimates become more relevant. Auditors will have to gather evidence to ensure that estimates are reasonable and are appropriately disclosed by:

- a) Evaluation of data used by the management
- b) Testing the calculations and re-computing the estimates
- c) Comparison with previous periods
- d) Where found necessary, obtain an independent estimate and compare the same with the management's estimates and arrive at a conclusion.
- e) Reviewing events that may have taken place subsequent to the audit period, but which events may have an impact on the estimates of the previous years.

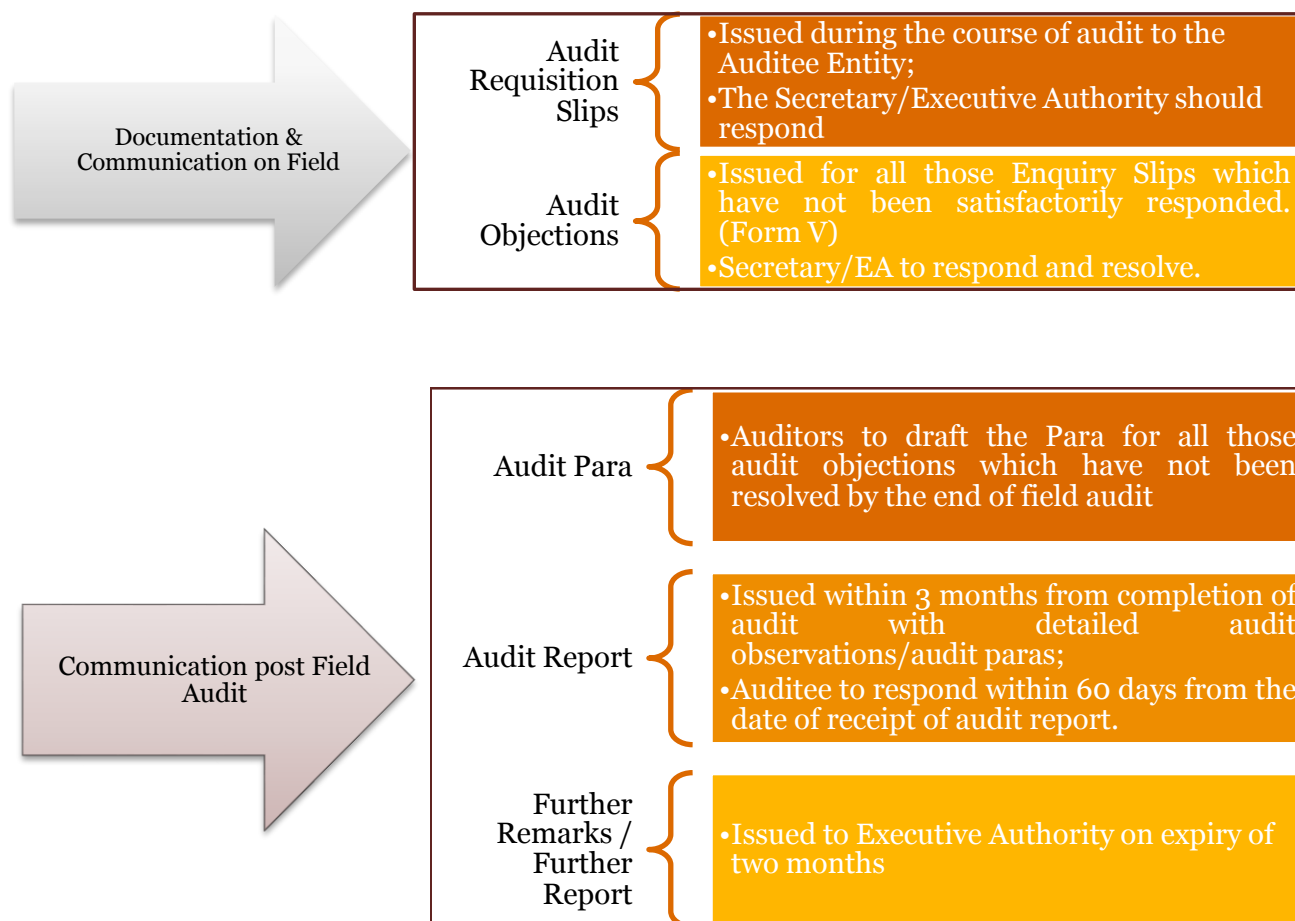
Part II of this Audit Manual details various audit procedures to be performed by auditors in carrying out their audit of the Schedule institutions. For this purpose, the Schedule institutions have been categorized into twenty categories and the general procedures as well as specific procedures for those categories are detailed in Part II. This will serve as a guidance note for the field auditors.

10.5. Documentation of observations/audit results

- a) Rule 11 of the Rules require that all objections by auditors should be raised in Form V as appended to the Rules under his/her signature day by day as the audit proceeds and shall obtain an acknowledgment from the Head of office of the local authority/local fund with date of receipt. On receipt of the replies to the points raised, he/she shall wherever necessary re-issue for further action, any items on which final or sufficient action has not been taken or on which enquiries made have not been satisfactorily answered. Such re-issues shall be marked as “further remarks” in the Objection Statement in Form V. The content of Form V is:
 - i. Voucher No
 - ii. Particulars of Payment
 - iii. Objection or suggestion
 - iv. Last date fixed for return of the audit objection statements
 - v. Reply of Local Authority/Local Fund
 - vi. Note of admission or fresh remarks by auditors
 - vii. Further remarks of the Local Authority/Local Fund
 - viii. Final remarks of the Auditor.
- b) While generally, objections settled may not be included in the audit reports, Rule 13 of the Rules requires that objections settled shall be included in the report if the irregularities are of a serious nature or point to any defect in procedure or error in principle.
- c) Auditors will have to document their findings (observations) in their audit work papers; the audit evidence collected and analyzed by auditors during the course of audit may give rise to observations which could be any or all of the following:
 - i. Non production of accounting and financial records which may result in direct “disclaimer” form of audit certificate.
 - ii. Errors, mistakes, misrepresentations, misclassifications, nonexistence of assets reported, poor maintenance of records and account books and non-compliance with rules and regulations.
 - iii. Wrong accounting policies and procedures, noncompliance with regulatory accounting framework.

- iv. Control failures, management override of controls and generally overall weak internal controls.
 - v. Under/Over recovery of revenues, under/over-payments; incorrect assessment of revenues, expenditure exceeding budgets etc.
 - vi. Expenditure not achieving its purpose and Entity failing in its objectives, etc.
- d) Auditors are expected to evaluate the errors in terms of why and how they occurred and their full implications on the audit report and audit certification. The reporting will depend upon the “Reporting Materiality” set by the auditors during the audit planning stage. It is important that auditors maintain continuous communication with the Auditee Entity during the course of audit to ensure that the management is given an opportunity to rectify the errors pointed by the auditors immediately.
- e) It is also important that auditors pursue the errors and control failures and follow up with management for their corrective action in the books of accounts as the accounts are expected to reflect proper accounting of transactions and auditors are required to issue audit certificates to the management based on such accounts. In doing so, the auditors may continue to follow their current approach of (i) issuing audit notes and/or (ii) audit paras and seek compliance with those audit notes/paras. In cases where such compliance is not possible, then the auditors should include all such issues in audit report and based on the materiality of such errors, consider issuing an adverse or a qualified audit certificate.

The audit observations/results may be documented and communicated to the Auditee Entity in any or all of the following manner:



10.6. Exit Conference

The audit team should conclude field audits with an Exit Conference with the Management of the Auditee Entity. For this purpose, the team leader prepares the audit highlights based on the audit observations documented as above.

- a) The audit highlights should ideally be brief and crisp and contain the actual problems noticed. During the meeting, management also identifies the focal point/s for compliance with specific audit findings.
- b) Audit highlights can be furnished to management at least two days before the scheduled Exit Conference so that the management will have adequate time to respond in writing.
- c) The conference should be presided by the Head of Audit Office, Batch Leader; a power point presentation of the audit highlights will facilitate discussion.
- d) The team leader should prepare the minutes of the Exit Conference and send them to the Auditee institutions for reference and record purposes.

The discussion at Exit Conference should lead to a formal closure of audit and submission of necessary audit reports.

10.7. Audit Completion Procedures

Section 10 of the Act stipulates that the audit of accounts prepared and presented for audit under section 9 of the Act, shall be completed by the auditor within six months of the date of its presentation for audit. Audits are closed after completion of the field work as per the audit programmes and properly drafting and documenting the audit observations/findings as explained in 10.1 to 10.6 above. In addition, in a financial and compliance audit, audit completion procedures are performed to ensure that the financial statements comply with all disclosure requirements; sufficient and reliable audit evidence is obtained and documented in the audit work papers to form an opinion on the financial statements (books of accounts) and issue of an appropriate form of audit certificate i.e. unqualified, qualified, adverse and disclaimer.

Before an overall review of financial statements is undertaken, auditors should prepare lead schedules for major accounts/groups of accounts, and agree them with the General Ledger and other books of accounts. The accounts and the related amounts in the financial statements should be cross referenced to the lead schedules to ensure accuracy and correctness.

The overall review of financial statements after the completion of field audit is done to ensure if:

- a) The financial statements comply with statutory and regulatory requirements in terms of form and content.
- b) Accounting policies of the Auditee Entity conform to the relevant Accounting Standards (if any), rules and instructions of the Government, requirements of the parent Act and/or best practices appropriate for the Auditee and have been properly disclosed and consistently applied.
- c) The financial statements are consistent with the results of the audit procedures. In this connection it may be noted, that adjustments as a result of audit should be carried out by the Audit Entity to ensure these statements are consistent with the audit procedures; else the audit report should clearly state that the audit driven adjustments are not done in the financial statements.

- d) The concept of going concern is tested in preparing the financial statements.
- e) The manner of disclosure within the financial statements is fair / proper

As soon as the audit is completed, the auditors shall also require the Executive Authority of the institution concerned to intimate the addresses of the persons held responsible for the losses detected in the audit. The addresses of such persons shall be ascertained and intimated to the auditors by the Executive Authority within one month or a shorter period as may be required by the auditors.

10.7.1. Review of Subsequent Events

In performing the closing procedures of audit, auditors should review all events that may have occurred subsequent to the date of balance sheet and issue of Audit Certificate that may have an impact on the financial statements. Audit teams should perform suitable audit procedures to identify all subsequent material events and ensure that evidence on those events is collected and analyzed to ensure they are properly accounted or disclosed as the case may be. However, generally, review of these events may be more relevant in accrual system of accounting. The audit procedures generally to be performed are:

- a) Enquiries with management to ascertain their procedures for identifying subsequent events;
- b) Reading minutes of management meetings and board meetings and taking note of material events that may have an impact on the financial statements.
- c) Obtaining written representations from management;
- d) State Legislature proceedings occurring after the period end which might have an impact on the auditee. In particular, the implications of any Parliamentary decisions, reports or new legislation, which might require adjustment of, or disclosure in, the financial statements, should be considered.

10.7.2. Review and Supervision over Audit Work

The field audit standards of the CAG require that 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. This will be in addition to the powers of the Directorate to review and edit the audit reports before they are issued to the Local Authority/ Local Fund.

Day-to-day supervision should be exercised by the Team Leader (normally the Audit Officer in charge). Generally, the responsibilities of the Team Leaders are:

- a) To ensure that the audit work is carried out in accordance with the audit plan, more particularly, in tune with the audit objectives;
- b) Identification of important issues in the course of audit and to ensure that no significant matters in the context of the audit objectives and evidence required remain unresolved;
- c) Audit evidence collected fulfils the criteria and the requirement of the audit;
- d) The work performed and the results including the process of audit are separately documented, first in support of audit findings, conclusions and recommendations and then in support of due diligence exercised by the audit team and above all ensuring that the objectives of audit are fully met.
- e) The team leader should make sure that other members of the team are aware of what is required of them and that the work performed by them conforms to the standards. If an audit programme cannot be fully executed, the Team Leader should ensure that any changes to it receive the approval of higher authority.

The work of the audit staff at each level and audit phase is properly supervised during the audit, and a senior member of the audit staff reviews documented work. Review may happen in different phases and the final review done by a senior member before the audit observations and opinions for audit reports are finalized, as review brings more than one level of experience and judgment to the audit task and ensures 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).
- 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.

The review of the audit work may be divided into two stages as is normally practiced in CAG audits and is as detailed below:

First Stage Review

The first stage review involves a detailed examination of the audit work carried out by the audit team and will include a detailed examination of the essential elements of the audit, the documentation and evaluation of systems, and the completed substantive and compliance test procedures and other information supporting the work done and the conclusions drawn. The first stage reviewer will need to ensure that the work has been done in accordance with the approved audit plan and any amendments to it, and also that work has been done in accordance with the applicable auditing standards and conventions and practices. In particular, the reviewer should ensure that:

- a) The standing files are complete and up to date;
- b) Approved audit programmes/procedures have been used;
- c) Understanding of Auditee Entity along with its systems and controls has been fully documented;
- d) Working papers are complete and properly referenced;
- e) The conclusions reached are supported by evidence contained in the working papers.
- f) The first stage reviewer checked all calculations crucial to the audit conclusion.

The review should agree or disagree or comment otherwise on the audit conclusions reached for the purpose of the report. The review should be evidenced in the working papers (for example, through comments, initialed pages, etc.) of the work done by the reviewer. Any comments or questions which the reviewer requires the audit party to answer should be documented on a separate review sheet. If there are matters still outstanding when the working papers are submitted for first stage review they would have been highlighted for the reviewer's attention. The reviewer should recommend action on these matters and add any further point to be brought to the notice of the second stage reviewer. Once the first stage review is completed, the files (both permanent and working files) should be passed on to the second stage reviewer.

Second Stage Review

The second stage review covers all significant matters, particularly areas where judgments have been made. The second stage reviewer takes responsibility for the final conclusion on the audit including any qualifications proposed. This review is a selective examination of the working papers carried out in sufficient depth for the reviewer to satisfy himself/herself that the audit work has been done satisfactorily. Thus the second stage reviewer has also to satisfy himself that the first stage review has been properly carried out. The further checks made by the second stage reviewer should be evidenced by initials and remarks.

The second stage review normally accomplishes the following:

- a) Selective review of working papers and the comments of the first reviewer;
- b) Review of financial statements with the evidence to ensure conclusions reached are adequate for an opinion;
- c) All outstanding matters have been cleared prior to submission of the files to the appropriate authorities of KSAD for review of draft audit report and forwarding the files to the Directorate for necessary review and editing, if any.

The review should be evidenced by signature/initials etc. in the work papers/files to ensure that:

- a) Completion of review of the papers supporting the examination of the account
- b) Sufficient, relevant and reliable evidence have been obtained to support audit opinion and certification contemplated in the audit and issue of an audit certificate
- c) Recommend to the competent authority the form of opinion/certificate to be given namely (a) qualified (b) unqualified (c) adverse or (d) disclaimer.

11. Audit Reporting

11.1. Regulatory Framework for Reporting

The regulatory framework with respect to audit reporting is :

Section 13 of the Act read with the Rule 18 of the Rules provides for issuance of a report by the auditor on the accounts audited and examined by him, as soon as practicable after the completion of the audit, but not later than three months thereafter. Except to the extent specified in Section 14 of the Act, the form, content, and style of the report has not been specified. This section does not also seem to require the certification of annual financial statements. The Audit Report shall be sent to the head of the Local Authorities/Local Funds concerned with copies to the controlling authorities/Government or as may be specified under the law governing the local body/local fund. The report shall be as concise as possible but contain all the relevant facts.

Section 14 of the Act requires the inclusion of the following statements in reports issued under Section 13:

- a) Every payment which appears to him to be contrary to law.
- b) The amount of any deficiency or loss which appears to have been caused by the negligence or misconduct of any person.
- c) The case of misappropriation or misutilization of the local fund.
- d) The amount, if any, received which is required to be brought into account but has not been brought into account by any person; and
- e) Any other material impropriety or irregularity which he has observed in the accounts.

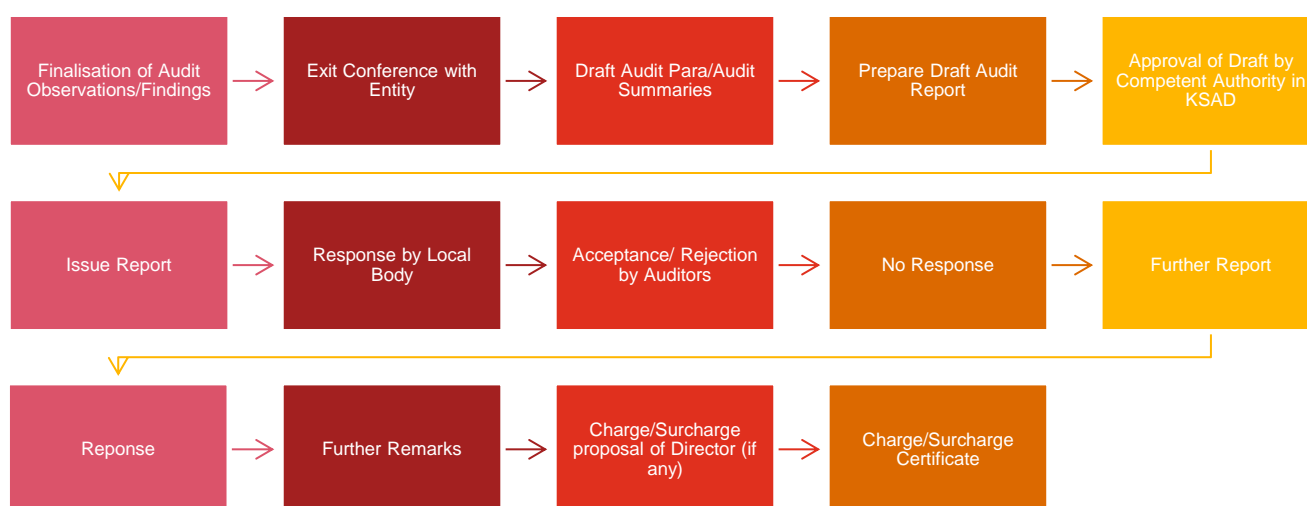
In addition to Section 14 of the Act, Rule 19 of the Rules, stipulates that the audit report shall have two separate parts:

- a) Part I showing the details of clear cases of loss on receipt side in which shall be incorporated :
 - Cases in which the amount, if any, received which is required to be brought into account but has not been brought into account by any person;
 - The cases of misappropriation of collections made; and
 - Cases of any deficiency or loss of money due to short realization/non realization of dues which appears to have been caused by the negligence or misconduct of any person.
- b) Part II showing details of clear cases of loss on payment side in which shall be incorporated.
 - Cases of misutilization of funds
 - Cases of payments which appears to be contrary to law
 - Cases of any deficiency/loss of any property, stock, etc.
 - Cases of excess payment made; and
 - Cases of avoidable expenditure.

The Auditing Standards of the CAG applicable for Panchayat Raj Institutions and Urban Local Bodies and the Guidelines for Certification for Audit of Panchayat Raj Institutions issued by the CAG, require that the local fund auditors issue an “Audit Certificate” upon completion of the audit. The standards and the guidelines postulate that the primary objective of certification is “expression of an opinion” on the financial statements presented by the auditee and audited by the local fund auditors. These standards and guidelines are relevant only for LSGIs and not for other institutions included in the Schedule to the Act.

The Audit Standard SA 700 and SA 700 A (which is the revised version) issued by the ISSAI deal with the form and content of the auditor's report issued as a result of an audit of financial statements. Financial statements generally refer to (i) Balance Sheet (ii) Profit & Loss Account or Income & Expenditure Account (iii) Receipts & Payments Account together with schedules and notes thereon; notes generally includes a summary of accounting policies, explanatory information, and other information required to be included in the financial statements under the applicable acts and rules. However, this audit standard is strictly not applicable to KSAD and the content of the standard may be taken as a "best practice".

11.2. Reporting Process



11.3. Basic Form and Content of an Audit Report

The CAG and the ISSAI standards provide for the following similar and basic requirements for the form and content of the audit report:

- a) In the government audit parlance, normally the audit report in case of financial audits are in the form of audit certificates.
- b) Words to be used in expression of opinion:
 - i. CAG recommends usage of the following words:
 - In Cash Basis accounting the words **properly presents** are required to be used
 - In hybrid (partial cash/partial accrual), the words **presents fairly** are required to be used
 - In accrual basis of accounting, the words **true and fair** are required to be used.
 - ii. As per ISSAI this could be by way of:

“In our opinion, the accompanying financial statements **present fairly**, in all material respects, [...] in accordance with [the applicable financial reporting framework]”; **or**

“In our opinion, the accompanying financial statements **give a true and fair view of**[...] in accordance with [the applicable financial reporting framework]. “

- c) **An opinion** on whether the financial statements are prepared, in all material aspects, in accordance with the applicable financial reporting framework. The opinion of auditors should be clear on both the truth and fairness/proper presentation/fair presentation (as appropriate) and the regularity of the transactions recorded in the financial statements.
- d) **Opinions expressed** in the report could be (i) unqualified (or unmodified) (ii) qualified opinion (iii) adverse opinion or (iv) disclaimer. These different types of opinion are discussed in the following exhibit:

| Nature of Matter giving rise to Modification | Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements | |
|---|---|--|
| | Material but not Universal and Fundamental | Material and Universal and Fundamental |
| Financial Statements are Materially Misstated | Qualified Opinion | Adverse Opinion |
| Inability to obtain sufficient and appropriate evidence | Qualified Opinion | Disclaimer Opinion |

Different Types of Audit Opinion

1. An Unqualified Opinion is given when in the opinion of auditors the financial statements are prepared in accordance with applicable financial reporting framework in all material aspects and are free from any material errors, irregularities or misstatements; it is also necessary to ensure that books of accounts do not contain any material errors, irregularities and misstatements. This also requires the following:
 - Accounting policies are followed consistently
 - There are adequate disclosures relevant for a proper understanding of financial statements
 - Departures from accounting rules/standards are adequately explained and justified in the opinion of auditors.
2. A Qualified Opinion, is given when in the opinion of auditors there are material misstatements in the financial statements, either individually, or in aggregate, which can distort the financial information/financial statements as a whole. A qualified opinion is also given when auditors are unable to obtain audit evidence to conclude that financial statements are free from material misstatements. A qualified opinion may also be expressed when:
 - The auditors are uncertain as to whether material error does, or does not, exist in the accounts – uncertainty can arise either because of evidence not being available or auditors not able to reach an objective opinion on the outcome of any situation or a statement due to underlying circumstances.
 - Disagreement with the Management on matters/transactions dealt with in the books of accounts and financial statements which are material enough to distort the financial information/statements.
3. An Adverse Opinion, is given when having obtained all audit evidence, in the opinion of auditors, there are material misstatements which are not only material but pervasive for the whole set of financial statements and books of accounts. In other words, when auditors have fundamental disagreements on the books and the financial statements, an adverse opinion is expressed. The auditors should generally state that:
 - ...because of the significance of the matter(s) described in the Basis for Adverse Opinion section, the accompanying financial statements do not present fairly (or give a true and fair view of) [...]
4. A Disclaimer Opinion, is given when there exist fundamental uncertainties and the auditors are unable to obtain sufficient and appropriate evidence and as a result conclude that misstatements in the financial statements can be both material and pervasive. In all such cases auditors will state in their reports that they are unable to form and give any opinion on the accounts and financial statements. This can be generally expressed as:
 - ...because of the failure to keep proper accounting records....., we are unable to form an opinion..... OR

- ...because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements...

- e) The report should basically satisfy the following:
- i. It should have a suitable title or heading
 - ii. It should be signed and dated – the date signifies that auditors have considered the effect of events or transactions up to that date which can be beyond the date of the financial statements.
 - iii. It should contain audit objectives and scope as this information fixes the purpose and contours of the report.
 - iv. It should have complete opinion/s which should be appended to and published with the financial statements to which they relate.
 - v. The report should be addressed to the proper authority and named in the report.
 - vi. The report should have name of the auditee entity, period of financial statements, etc.
 - vii. The reports should clearly identify the legislation or other authority under which the audit was conducted.
 - viii. If Audit Standards are mandatory (like in the case of audit of Panchayat Raj Institutions) then the report must specify that audit was done in accordance with those standards.
 - ix. It should be issued within the timelines provided by the Act and Rules.
- f) The report should clearly state the **responsibility of the management of the Auditee and the Auditors**. In this connection it is desirable if the KSAD obtains a clear and unambiguous representation from the management (Management Representation) (i) on the nature of risks and controls within the entity, and (ii) management of those risks and controls (iii) that the books of accounts show the current and true picture of all transactions relating to the entity for the period under audit (iv) that annual financial statements submitted by the entity for audit are correct and in accordance with the applicable laws, rules and regulations.
- g) The CAG and ISSAI standards suggest that the audit reports should state the **basis of opinion** in the audit report and normally this relates to the following:
- i. A statement to certify that audit was conducted in accordance with the applicable audit standards for e.g. in case of PRI and ULBs, the standards prescribed by CAG for such audits. Where there are no mandated audit standards, a statement to the effect that no audit standards have been prescribed for the audit.
 - ii. A statement to the effect that audit was conducted in accordance with the relevant legislative authority.
 - iii. A statement that audit process includes examining, on a test basis/100% examination, (based on what auditors have done) evidence relevant to the amounts, disclosures and regularity of transactions included in the financial statements.
 - iv. A statement to the effect that audit evidence obtained and examined is sufficient and appropriate to provide a basis for the opinion (or where audit evidence could not be collected to form an opinion, the fact must be so stated)

11.4. *Certification of Annual Financial Statements*

The purpose of financial and compliance audit is to provide an independent opinion to stakeholders and the Audit Reports serve several purposes for the key stakeholders on the truth and fairness of the financial information and the statements. The Audit Reports provide credibility to the financial statements/information of the audited entity and enhance confidence of the stakeholders in using such statements. It is therefore important that KSAD auditors to whom the power is delegated by the Act and Rules and/or the Director, not only issue an Audit Report but also certify the annual financial statements along with the management of the audited entity. Such certification is also required as these financial statements are annexed to the Audit Report and are referred to in that report for expression of audit opinion on them.

11.5. *Form and Content of Audit Report*

11.5.1. *Report Format for all Financial & Compliance Audits*

| Part I | |
|---------------|---|
| 1. | An Overview of the Functioning, Accountability Mechanism and Financial Reporting of the Auditee and this generally should cover, Activities, Goals and Objectives; Budgets and Budget Execution; Funds Received from Government and Utilisation; Maintenance of Books of Accounts and Records and Preparation of AFS, Internal Control Deficiencies, Tax/Revenue Collections and Deficiencies; Expenditure Inappropriateness; Delays in Projects and Schemes; Issues with Governance and Improvements required; Asset creation and maintenance, etc. |
| 2. | Audit Scope, Objectives and Methodology |
| 3. | Audit Observations/Paras – Revenue Receipts and Income (the reporting may preferably follow the Criteria, Condition, Effect and Cause style as illustrated in the para 11.5.1 above) <ol style="list-style-type: none"> Current Year Audit Objections <ol style="list-style-type: none"> Audit Objections not impacting Revenue Audit Objections resulting in Loss of Revenue Previous Years' Audit Objections to the extent not closed(brought forward from earlier years) <p>This section may include the following (this is only illustrative and not exhaustive)</p> <ol style="list-style-type: none"> Whether taxes, fees; rents, rates and miscellaneous demands, , auction sales of moveable or immovable properties, unserviceable articles etc., are levied/raised in accordance with the relevant and applicable Laws, Rules, and Regulations Whether assessment has been made properly in each case, as prescribed and if there is undue delay in finalizing the demand of any tax, fees, rents, etc., and furnishing the demand list. Whether any modification/remission/rectification, etc., has been carried out in the levy of taxes, etc., during the audit year. If so, are they in order and done under proper authority and whether they have been duly written up in the demand list. Whether total demand has been written correctly in the DCB in respect of each item for each period of demand and collection Was any periodical revision as prescribed had fallen due. Whether such revision has been made and enforced promptly. Whether periodical lists of persons liable for paying taxes, etc., have been written up as prescribed. Has any demand become time-barred because of undue delay in raising it or in collecting it. If so, give details of such items with names and designations of persons responsible. Whether auctions have been conducted as per rules and proper records maintained. Whether lease agreements are correctly executed and kept in safe custody. Whether adequate security deposits have been recovered from parties as prescribed. Whether all dues were collected regularly; specify lapses, if any. Are there any lapses in issuing and accounting for receipts? |

| | |
|-------|---|
| x. | Whether receipts books (used and unused) are properly maintained and accounted for as per rules. |
| xi. | Whether all receipts/collections have been duly credited in the bank accounts and registers of the local fund/authority? Specify all cases of omission or commission, mistakes etc. |
| xii. | Whether collections are correctly and promptly recorded in Demand Collection and Balance Register. Whether this register is maintained and closed periodically as prescribed. |
| xiii. | Whether effective steps are taken to collect arrear demands. Whether the system of demand and collection of revenues in force is fool proof and does not give room for any short demand, misappropriation or leakage of revenue. |
| xiv. | Whether revenues from the assets of the local body being realized properly. |
| 4. | <p>Audit Observations/Paras – Expenditure/Payments (the reporting may preferably follow the Criteria, Condition, Effect and Cause style as illustrated in the para 11.5.1 above)</p> <p>a) Current Year Audit Objections</p> <p>i. Audit Objections not impacting Expenditure</p> <p>ii. Audit Objections resulting in disallowances – Illegal/Irregular payments</p> <p>b) Previous Years’ Audit Objections to the extent not closed (brought forward from earlier years).</p> <p>This section may include the following (this is only illustrative and not exhaustive)</p> <p>i. Whether all items of expenditure have been approved and sanctioned by competent authority.</p> <p>ii. Are proper vouchers with the signature of authorized person for all items of expenditure available and are these adequately supported to justify the accuracy, economy and effectiveness.</p> <p>iii. Has the expenditure been incurred (i) as per relevant rules in public interest; (ii) as per the provision of budget estimate and (iii) the amount was paid to the person entitled to receive it with his acknowledgement and is properly supported?</p> <p>iv. Whether services rendered or supplies made by the payees have been properly placed on record and their quality have been ensured and there has been no overpayment.</p> <p>v. Whether any wasteful/unprofitable or any avoidable expenditure was incurred or whether any expenditure was incurred excessively. Was payment made to an improper person or illegally? Furnish details of all items of irregular expenditure.</p> <p>vi. Whether number of persons employed is in accordance with the rules and sanction given by the appropriate authority. Are service records of employees maintained correctly as prescribed?</p> <p>vii. Whether pay and allowances paid to the employees are as per the prescribed scales and rules?</p> <p>viii. Whether travel and other employee expenses have been duly approved by competent authority and paid at the prescribed rates.</p> <p>ix. Has all expenditure on contingencies been incurred as per rules and with proper authority.</p> <p>x. Whether proper estimate for each work has been prepared? Has it been approved by competent authority.</p> <p>xi. Are prescribed tender procedures followed wherever necessary.</p> <p>xii. If the work was entrusted on contract, whether proper agreement as per rules was obtained from the contractor. Has the payment been made to the contractor and penalty levied where necessary, as per the agreement?</p> <p>xiii. Are there any problems/issues with measurement book and if competent officer took measurement before payment was made to contractors</p> |
| 5. | <p>Audit Observations/Paras – Balance Sheet Items (the reporting may preferably follow the Criteria, Condition, Effect and Cause style as illustrated in the para 11.5.1 above)</p> <p>a) Current Year Audit Objections</p> <p>b) Previous Years’ objections to the extent not closed (brought forward)</p> <p>This section may include the following (this is only illustrative and not exhaustive)</p> <p>i. Discrepancies in asset records, asset accounting, asset maintenance and ownership, asset utilization and irregularities in purchase/construction of assets if any.</p> <p>ii. Discrepancies in bank accounts, operation, irregularities with investments records, their purchase, etc., to be reported.</p> |

| | |
|----------------|---|
| iii. | Whether all advances have been sanctioned as per rules by competent authority. Are they being recovered as prescribed? |
| iv. | Indicate the items of advances still pending adjustment and comment on them, if necessary, after examining the reasons for non-adjustment. |
| v. | If physical verification of assets including cash and stores being done; discrepancies /shortages between actual and book figures to be reported. |
| vi. | Whether the local body has obtained any loan. If so, whether the sanction of the Government/Competent Authority has been obtained as per relevant Act & Rules. Have there been any irregularities with such loans? |
| vii. | Whether annual instalments are paid regularly for the loans obtained. |
| viii. | Loan disbursements to office bearers of the local body/authority- competent authority approvals and irregularities if any. |
| ix. | Whether government schemes are being implemented effectively and proper records maintained and reports/returns submitted in accordance with the scheme guidelines and prescribed procedures. Whether completion certificates and utilisation certificates have been sent for each project or scheme. Irregularities in the operation of the schemes to be reported. |
| x. | Whether beneficiaries under each scheme have been identified and their names kept on record. |
| 6. | Audit Observations/Paras – Administrative Inefficiencies (the reporting may preferably follow the Criteria, Condition, Effect and Cause style as illustrated in the para 11.5.1 above) <ul style="list-style-type: none"> a) Current Year Audit Objections b) Previous Years' objections to the extent not closed (brought forward) |
| Part II | |
| 1. | Audit Report/Certificate. |
| 2. | Annual Financial Statements – duly certified by Executive authority & Auditors |
| 3. | Notes on Accounts (Disclosures) |
| 4. | Schedules to AFS |
| 5. | Cash Flow Statement |
| 6. | Analytical Ratios |

11.6. Review of Draft Audit Reports

Post the Exit meeting, Team Leader has to prepare the audit report in the format discussed above and submit the draft audit report to the head of the respective KSAD office immediately on completion of the audit. The Head of office then forwards this draft audit report to the scrutiny team for their evaluation and comments. If there are queries by the scrutiny team, the same will be discussed with the audit team for rectification. Post rectifications of this, the draft report has to be further updated. Once all such scrutiny comments are addressed, the Audit Report is issued, except in case of major auditee institutions. However, in the case of audit of large institutions like KSHB, Universities, Devaswom Boards, Municipal Corporations, etc., the draft report as finalized by the field office is sent to the Head Office (Directorate) for necessary review. The report will be sent to a scrutiny team in the Directorate and any changes/amendments will be discussed with the field office and the draft report is corrected for the recommended changes by the Directorate which is then approved by the Directorate for issuance to the Local Authority/Local Fund. Post approval from the Directorate, the Head of the KSAD audit office issues the audit report.

11.7. Submission of Audit Reports

As per Section 13 of the Act read with Rule 18 of the Rules, the audit report has to be issued within 3 months from the completion of the audit. The audit report should be addressed to the Secretary/Executive Authority/Competent Authority of the Audited Entity. The Audit Report as approved by the head of the field office or the Directorate as the case may be, may either be sent by registered post with acknowledgement due or be delivered in person in the latter case dated

acknowledgement of the head of the local authority/local fund for the receipt of the same shall be obtained in the local delivery book.

In terms of Section 15 of the Act read with the Rule 23 of the Rules, the following actions are expected from the Auditee Entity and the auditors:

- a) On receipt of the Audit Report, the Executive Authority of the Local Authority/Local Fund, remedy/rectify the defects or irregularities pointed out in the report and send to the auditors within two months of the receipt of Audit Report, a rectification report in regard to defects/irregularities.
- b) On receipt of the rectification report, the auditors may take the following actions:
 - i. Accept the explanations given by the Executive Authority and drop the objections or
 - ii. Hold the objections/defect/irregularities as specified in the Audit Report and decide if such defects/irregularities should be charged/surcharged and if so against whom.
- c) Auditors should intimate within two months “further remarks” to the Executive Authority with copies to Officers to whom audit reports are issued.
- d) In cases where no rectification report is received from the Executive Authority within the time given, the auditors shall send a “further report” in the manner of “further remarks” which shall state the following:
 - i. Whether the defects/irregularities can be regularized by any method;
 - ii. Whether they can be condoned by any authority, if not, admitted of being regularized;
 - iii. Whether the amounts to which defects or irregularities relate, should be charged/surcharged and if so against whom.

11.8. Audit charge / Audit fee

KSAD gets their revenue in the form of Audit Fee from the auditee institutions. The audit fee is fixed at 1% of the income of the auditee institutions. Some of the income items are exempted from calculating the audit fee. Audit fee is exempted for organisations like local bodies, orphanages, etc. Guruvayur Devaswom is directly bearing the cost of audit. The Audit fee is normally charged after the issuance of the Audit Report as detailed above.

11.9. Consolidated Audit Report to Government (CAR)

In terms of Section 23 of the Act read with Rule 25 of the Rules, the Director, KSAD, shall by 30th September every year, send to Government a Consolidated Audit Report on the accounts audited by KSAD during the previous financial year. While no format has been prescribed by him for such CAR, it is within the powers of the Director, KSAD to include such information/items that he/she may like to bring to the notice of the Government. The CAR is prepared based on the seriousness of the irregularities (if any) found in all the audit reports issued by KSAD during the year.

The Government shall lay the CAR within three months of its receipt before the Legislative Assembly for its information and action. Legislative committee will call for meeting with relevant official both from KSAD and auditee institutions to discuss further (if any issues are found for such discussions). If there is any audit para included in the CAR, which needs to be reviewed and action to be taken, the power of taking any such decisions / actions is vested only with the legislative committee.

12. Audit Documentation

Audit Documentation has been defined in the Audit Standard SA 230 issued by the ICAI as ‘the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “workpapers” are also sometimes used). Similar definitions exist in the Auditing Standards issued by CAG of India. These standards provide the general form and content of the audit work papers which may be adopted by KSAD. Audit work papers need to be maintained to document matters which are important in providing evidence that the audit was carried out in accordance with the applicable audit standards or the best practices. Audit work papers assist in planning and performance of audit and facilitate supervision and review of the audit work and provide evidence of the audit work performed. The work papers should be preserved for such period as prescribed by relevant rules of KSAD and if there are no regulatory prescriptions, for such time as is required to meet the professional requirements of record retention. Audit work paper facilitate the following:

- a) Support the planning, performance and review of audit engagements
- b) Provide evidence for audit opinions and results and the reports issued
- c) Document if the audit objectives and scope were achieved
- d) They support the accuracy and completeness of the work performed.
- e) Provide a basis for review and supervision and quality and peer reviews

The ownership of the audit work papers rests with KSAD and not individual auditors. Upon completion of field audit and issue of audit reports, it is the responsibility of the auditors concerned to update the audit files and file and archive the work papers so that they can be retrieved when needed.

12.1. Form and content of audit working papers

- a) The audit work papers normally record the audit plan, the nature and extent of the auditing procedures performed, and the conclusions drawn from the evidence obtained;
- b) the form and content of working papers normally depend on the following factors:
 - Activities, Programs, Schemes etc. of the entity; nature and complexity of auditee entity
 - Condition of books and records at Auditee Entity and the controls therein on which auditors place their reliance; identified risks of material misstatements;
 - Significance of evidence obtained; nature and extent of audit enquiries and objections noted/identified;
 - Type of audit; audit methodology and tools used;
 - Direction, supervision and review of the work performed by audit assistants/junior auditors;
- c) Some of the examples of audit work papers are audit plans, audit programs, audit checklists, third party letters and confirmations, financial statements and their lead schedules, groupings, audit enquiries, audit objections in terms of Form V, audit requisition, communication with auditee, etc.
- d) Audit work papers may be categorized in to (i) Permanent File and (ii) Current File.

12.2. Permanent audit file –content

- a) Data/Information about the Auditee Entity including the regulatory requirements and the organizational structure;
- b) Relevant extracts of Act, Rules, Court Orders relating to the audit;
- c) Extracts from important legal documents, agreements and minutes of the board/council meetings;
- d) Copies of audited financial statements for previous years;
- e) Analysis of significant ratios and trends;
- f) Document relating to evaluation of internal controls related to the accounting system. This may be in the form of narrative descriptions, questionnaires or flow charts, or a combination thereof;
- g) Copies of management letters, representations etc.
- h) Notes regarding significant accounting policies, list of books and records relevant for audit etc.
- i) Audit Objections and disallowances relating to previous years that were not settled.
- j) Compliance with audit findings of earlier years.

12.3. Current audit file –content

- a) Audit plan and audit program check lists, questionnaires etc. and a record of audit procedures performed; details of audit evidence examined and collected for work papers for audit objections.
- b) Copies of communication relating to the audit allocation and audit resources used.
- c) Material weaknesses in internal controls as observed and documented.
- d) Evidence that the work performed by assistants was duly supervised and reviewed.
- e) Extracts of matters in the minutes of the board meetings and council/general body meetings as are relevant to audit.
- f) Analysis of transactions and ledger balances; lead schedules, Annual Financial Statements etc.,
- g) Copies of communications with Auditee including audit enquiry slips, audit objections, audit paras etc., and response received from auditee.
- h) List of audit observations for the audit period; evidence for resolution of defects/deficiencies as pointed by auditors – unresolved issues to be reported.

13. Procedures for Charge/Surcharge

13.1. Circumstances under which persons responsible can be charged / surcharged

Activities relating to levying surcharge and charge by the auditors are provided in Sections 2 (l), 14, 15, 16 and 17 of the Act and Rules 20, 21, 22 and 23 of the Rules. The auditors should familiarize with the provisions contained in the above sections and rules before proceeding with the levying of surcharge and charge. The salient features of the Act and the Rules as well as the procedures for disposing the surcharge and charge cases from the audit report are given in this section. As per Section 2(l) of the Act, 'Surcharge' is an amount for which the auditor, in exercise of the powers vested in him under this Act, makes a person liable for loss, waste, misapplication or misappropriation of any money or other property belonging to any local authority. As per Section 16 (1) of the Act, the auditor may disallow any item which appears to him to be contrary to law and surcharge the same against the person making or person or body of persons authorising the making of the illegal payment. The auditor may as well charge against any person responsible therefor, the amount of any deficiency or loss caused by the negligence or misconduct of that person or any sum received which ought to have been, but has not been brought into account by that person. The auditor shall, in every such case, certify the amount due from such person.

The surcharge and charge emanate from the audit report issued by the auditor. As per Section 14 of the Act, the auditor shall include in the audit report a statement of –

- a) Every payment which appears to him to be contrary to law;
- b) The amount of any deficiency or loss which appears to have been caused by the negligence or misconduct of any person;
- c) The cases of misappropriation or misutilisation of the local fund;
- d) The amount, if any, received which is required to be brought into account but has not been brought into account by any person;
- e) Any other material impropriety or irregularity which he has observed in the accounts.

13.2. Fixing Loss and Responsibility

Loss includes direct loss, waste, misapplication or misappropriation of any money or other property belonging to the auditee institution. Except for direct loss, it would not be possible to specify all other kinds of losses and the procedure to calculate the amount of loss, in the Audit Manual. As per the Act also, the auditor has to report every payment which appears to him to be contrary to law, the amount of any deficiency or loss which appears to have been caused by the negligence or misconduct of any person etc. Thus, there is a lot of subjectivity in assessing the losses. Therefore, the amount of loss can be calculated only based on logical considerations for each case and can only be left to the discretion of the auditor. As the Director alone can issue the Surcharge/ Charge notice and certificate, it can be taken that the Director would exercise a uniform procedure to determine the loss for each situation using his discretion.

13.3. Procedure for Surcharge/ Charge proceedings

Rule 20 of the Rules contains the detailed procedure for surcharge/ charge proceedings as given below:

- a) The officer authorised to issue the report on the audit of accounts of a local authorities/ local funds shall, while issuing the further remarks under sub-rule (3) of rule 23 of KLFA rules, forward to the Director a proposal for charge/ surcharge action in respect of the pending cases of losses pointed out in the audit report concerned. The charge/ surcharge proposal shall be in Form VIII appended to the Rules;
- b) On receipt of the proposals for charge/ surcharge proceedings from the officer authorised to issue the audit report, the Director shall as early as practicable but before the completion of four months from the date of receipt of such proposals, issue charge/ surcharge notices to the officer(s) held responsible for the losses detected by the auditors.
- c) The charge/ surcharge notices shall be in Form IX /IX (A) appended to the KLFA Rules;
- d) The charge/ surcharge notices (in duplicate) along with extracts of the relevant objections in the audit report shall be communicated to the person against whom it is made by registered post with acknowledgement due.
- e) The duplicate copy of the charge/ surcharge notice shall be returned to the Director by the person receiving it, with his dated acknowledgement in proof of having received the notice;
- f) Copy of the charge/ surcharge notice shall be issued to the Executive Authority concerned.
- g) Unless the person served with a charge/ surcharge notice remit the amount involved in the notice to the Executive Authority concerned and furnish the details thereon to the Director within two months from the date of receipt of the notice, or furnishes satisfactory explanations, such person shall be served with charge/ surcharge certificate in Form X /X(A) appended to the Rules, with copy to the Executive authority concerned.
- h) The report showing details of remittance of amounts involved in the charge/ surcharge notices to be furnished by the person(s) responsible under sub-rule (7) to Rule 20 shall be forwarded to the Director through the Executive Authority concerned. The Executive Authority shall transmit the same to the Director with a certificate to the effect that the details furnished have been verified by him and found correct.
- i) The charge/ surcharge certificate (in duplicate) shall be communicated to the person against whom it is made, by registered post with acknowledgement due.
- j) The duplicate copy of the charge/ surcharge certificate shall be returned to the Director by the person receiving it with his/ her dated acknowledgement affixed on it.
- k) The charge/ surcharge certificate shall be served on the persons responsible within a period of two years (earlier four months which is amended by GO P No 374/ 06/ Fin dated 22/9/2006) from the date of receipt of the charge/ surcharge notice by such person.
- l) The Director shall serve on the person responsible for any loss to a local authority/ local fund supplementary charge/ surcharge notice or charge/ surcharge certificate relating to the audit report if the circumstances so warrant.
- m) Every sum charged/ surcharged by the Director on any person shall be remitted by such person to the Executive Authority within one month from the date of receipt of such charge/ surcharge certificate, unless within that time such person files an application before the District Court against the decision of the auditor. Such amount, if not so paid or such amount

as the District Court shall declare to be due under sub- section (3) of section 16 of the Act shall be recoverable under the provisions of the Kerala Revenue Recovery Act, 1968 (15 of 1968) for the time being in force, as if it were arrears of public revenue due on land.

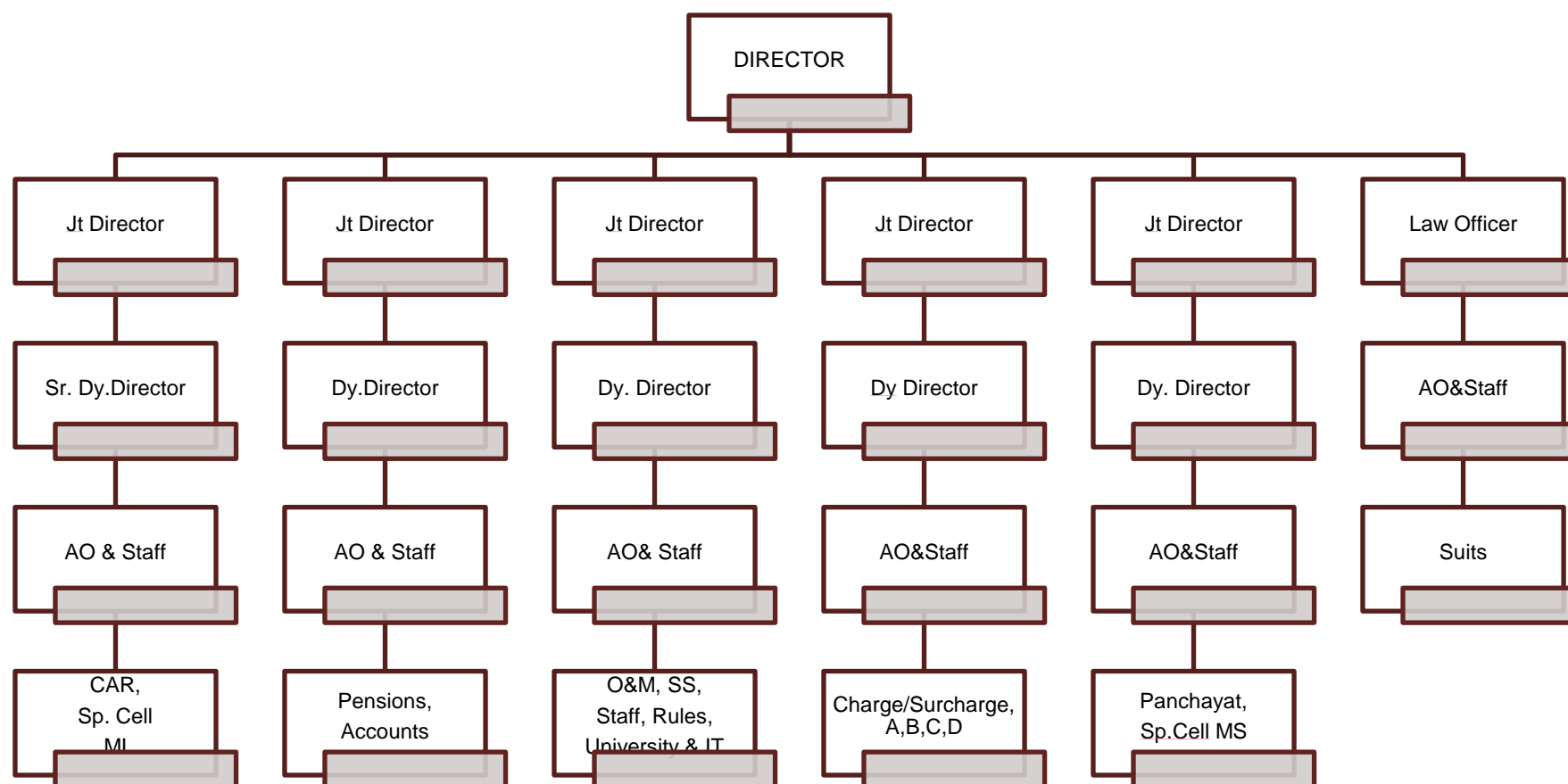
As per section 17 of the Act, the Director shall exercise general supervision and control over the discharge by the auditors of their duties under this Act and he may condone a payment made from a local fund, which appears to him to be contrary to law, if in his opinion there was no negligence or misconduct on the part of the person making or authorising such payment and if such payment does not exceed rupees one hundred in each case.

13.4. Procedure to dispose of or carry over surcharge/ charge related matters in audit reports

- a) As the Surcharge/ Charge notices as well as Surcharge/ Charge certificates are issued by the Director, KSAD, it would be his primary responsibility to proceed with the matter until the same are finally disposed of. The Director shall prepare a separate report on the matters relating to the surcharge/ charge of the auditee entity along with the audit report. The report should contain the following details.
- b) The details of Surcharge/ Charge notices and certificates issued during the year of audit.
- c) The details of all cases of surcharge/ charge certificates pending to be disposed by the Auditee Entity or appropriate authority.
- d) All surcharge/ charge related matters should be entered in the Surcharge/ charge register kept in the KSAD directorate. A separate special cell created in the Directorate should be delegated to take actions relating to all surcharge/ charge related matters. The special cell should submit quarterly reports of pending cases of Surcharge/ Charge, to the Director, KSAD
- e) After the Surcharge/ charge related matters are transferred to the special cell, that part of the audit observations should be treated as closed in sub office and the audit report need be processed for the remaining irregularities contained therein.
- f) The Director, KSAD shall review the quarterly report of pending surcharge/ charge, once in three months and propose further action including action to transfer the liability into the books of accounts or DCB statement of the auditee entity, as applicable.
- g) Once the liability on account of surcharge/ charge is transferred into the books of accounts or DCB statement of the auditee entity, it would also be the responsibility of the executive authority of the auditee entity to take further action on the matter. The Executive Authority of the auditee entity should submit quarterly status reports of all outstanding cases of Surcharge/ Charge to Director, KSAD.
- h) A consolidated report on all surcharge/ charge related matters of every Auditee Entities should also be included in the Annual Administrative Report of KSAD for continuous review and follow up.

Appendix 1

Organization Structure of Directorate of KSAD (Refer Para 2.1)



Appendix 2

Internal Control Questionnaire – LSGI (refer para 5.4)

| S No | Questions | Yes | No | NA | Comments of auditors |
|----------|--|-----|----|----|----------------------|
| 1 | General Controls | | | | |
| 1.1 | Does management understand that implementing an adequate internal controls system is its responsibility? | | | | |
| 1.2 | Has management performed a risk assessment and adopted the appropriate compensating controls? | | | | |
| 1.3 | Does the municipality have written documentation of its accounting procedures? | | | | |
| 1.4 | Are the duties of officials and employees clearly defined and in writing? | | | | |
| 1.5 | Does the municipality have an independent professional audit done on an annual basis | | | | |
| 1.6 | Is a budget system used to monitor revenues and expenses? | | | | |
| 1.7 | Does management and staff understand what is meant by segregation of duties? | | | | |
| 1.8 | Are duties properly segregated so that no individual can perform all related elements of a transaction? | | | | |
| 1.9 | Are financial statements prepared by the local body comply with the general standards issued by the C&AG of India? | | | | |
| 1.10 | Do the financial records and statements adequately describe the transactions and operations of the local body? | | | | |
| 2 | Accounting System | | | | |
| 2.1 | Is the general accounting/general ledger/journal entry/register maintenance function segregated from: | | | | |
| | • custody and control over cash? | | | | |
| | • custody and control over securities? | | | | |
| | • custody and control over inventory? | | | | |
| 2.2 | Are staff performing the general accounting/general ledger/journal entry function segregated from those performing the detail recording functions for: | | | | |
| | • accounts receivable? | | | | |
| | • accounts payable? | | | | |
| | • purchasing? | | | | |
| 2.3 | Does the Local Body have an adequate accounting policy and procedure that cover amongst others the following? • analyze account balances to ensure transactions have been properly recorded? Is the procedure followed? • adjustments to the records (journal entries)? • accounting processes for all significant account balances and classes of transactions? • identify revenues, expenditures and balances of government program funds separately for each grant/program/scheme etc. • classify revenues/receipts by source, grant and project properly • classify expenditures/disbursements by grant, project and activity properly | | | | |

| | | | | | |
|----------|--|--|--|--|--|
| | <ul style="list-style-type: none"> ensuring collections and disbursements are recorded accurately and promptly in the correct fund or account and in the correct general ledger account? authorizing and recording inter-bank and inter-fund transfers and providing for proper accounting for those transactions. | | | | |
| 2.4 | Does the Local Body maintain an updated accounting manual which is accessible to all appropriate employees? | | | | |
| 2.5 | Do all journal entries include identification of the accounts in which they are to be recorded? | | | | |
| 2.6 | Are accounting transactions recorded in a timely manner to accurately reflect the entity's financial position at any point in time? | | | | |
| 2.7 | Is a double entry system in use that includes a general ledger and subsidiary ledgers? | | | | |
| 2.8 | Are the subsidiary ledgers balanced and reconciled to the general ledger monthly? | | | | |
| 2.9 | Is there a complete and current chart of accounts that includes descriptions of items posted to each account? | | | | |
| 2.10 | Does the accounting system allow for timely recording of transactions, easy viewing of transaction data, and timely creation of financial reports and reporting of data to higher authorities | | | | |
| 2.11 | Are account reconciliations and account analysis regularly performed and reviewed by a knowledgeable person other than the preparer of such reconciliations. | | | | |
| 2.12 | Are all adjusting journal entries approved in writing by designated higher authorities? | | | | |
| 2.13 | Are financial recording documents prepared (cheques, receipts, purchase orders, etc) in duplicate and pre-numbered? | | | | |
| 2.14 | Are all receipts, forms, etc., regularly accounted for as issued or voided? Is there a proper inventory record for such receipt books/form books, etc. | | | | |
| 2.15 | Are detailed books and records and registers as required under the Accounting Rules of the Local Body prepared and maintained | | | | |
| 2.16 | Are all accounting records adequately protected against fire, theft, manipulation, unauthorised access etc. | | | | |
| 2.17 | Is access to accounting records limited to designated employees with responsibility for such records? | | | | |
| 2.18 | Are all accounting records, including the supporting documents, retained in compliance with the local body's records retention policy and according to government policy, if any | | | | |
| 3 | Controls over Cash and Bank | | | | |
| 3.1 | Is there a complete listing of all bank accounts opened and maintained by Local Body? | | | | |
| 3.2 | Have all those bank accounts been reported to the accounting department and/or the other designated officials? | | | | |
| 3.3 | Are all cash collections deposited timely into respective bank accounts? Is there adequate control to ensure such deposits? | | | | |
| 3.4 | Are all cheques/DDs collected properly recorded in the cheque registers and timely deposited in banks? Is there adequate control to ensure such deposits? | | | | |
| 3.5 | Is a secure area provided for processing and safeguarding cash receipts? Is access to such area restricted to authorised personnel only? | | | | |
| 3.6 | Is the secured area locked when not occupied? | | | | |
| 3.7 | Is Cash adequately protected by using registers, safes, or locks and kept in areas of limited access? | | | | |
| 3.8 | Is cash collected by bill collectors adequately safe guarded? Is it deposited daily with the Local Body Cash Department and matched with the copy of the bills/receipts issued by the bill collector? | | | | |
| 3.9 | Is machine printed receipt issued for cash transactions? Is there a proper control on these receipt books? Do the | | | | |

| | | | | | |
|----------|--|--|--|--|--|
| | receipts/challans show the appropriate revenue code? | | | | |
| 3.10 | Are all collections entered into the accounting system in a timely manner? Is there adequate procedure to ensure such entry and also notifying the higher authorities when not recorded timely? | | | | |
| 3.11 | Does the same employee accept funds, document or deposit them, and post the activity in the accounts? | | | | |
| 3.12 | Are all payments/disbursements, except for small petty cash items, paid by cheque or direct deposit or fund transfer? | | | | |
| 3.13 | Is a proper receipt or acknowledgement obtained for all payments whether paid by cash or bank? | | | | |
| 3.14 | Is a cheque register maintained and cheques issues recorded in such registers? | | | | |
| 3.15 | Does the same employee who writes the vouchers and cheques also sign the cheques? | | | | |
| 3.16 | Are unused cheques properly controlled and protected from misuse? | | | | |
| 3.17 | Are there adequate disbursement procedures to ensure the following? <ul style="list-style-type: none"> • furnishing invoices and supporting documents to the preparer and signer of the cheques/DD/fund transfer orders, prior to signing such instruments, to help assure funds are disbursed only for authorized purposes; and to help ensure laws, rules, and regulations are followed? • Limits are set for cash and bank payments and such limits are adhered to • Requiring two or more signatures for issuing cheques/payment instructions to banks • Cheques issued are followed up until they are realised by the concerned parties and that the returned cheques (if any) are properly entered in the cheque register and are cancelled. | | | | |
| 3.18 | Are the invoices approved by someone other than those who sign the cheque/payment instructions? | | | | |
| 3.19 | Are there adequate controls to ensure all payments are made on a timely basis and in accordance with all purchase orders and contracts and other purchase procedures? | | | | |
| 3.20 | Are there adequate controls to ensure duplicate payments are not made to parties? | | | | |
| 3.21 | Are original invoices (no copies) totalling the amount of the disbursement attached to each voucher before payment? | | | | |
| 3.22 | Are there adequate controls to ensure each disbursement is properly vouchered and approved by the proper authorities before the disbursement occurs? | | | | |
| 3.23 | Are there adequate procedures for reconciliation of bank balances with books of accounts? | | | | |
| 3.24 | Is reconciliation of bank balances with books done regularly; at least monthly and action taken to correct the books where necessary with approval from designated authorities? | | | | |
| 3.25 | Are there controls to review and approve of all reconciliations and investigation of unusual reconciling items by an official not responsible for receipts and disbursements, including recording evidence of the review and approval, by signing the reconciliation? | | | | |
| 3.26 | Is there a practice of signing blank cheques by the local body officials? | | | | |
| 3.27 | Is there an adequate insurance cover available for the cash in safe and cash in transit? | | | | |
| 4 | Controls over Collections and DCB | | | | |
| 4.1 | Are there adequate procedures to ensure that demands are raised in time and recorded correctly in DCB register for necessary follow up? | | | | |
| 4.2 | Are assessments, billing, collection and posting performed by separate employees or departments so that no one individual or one department can influence the outcome? | | | | |
| 4.3 | Does the local body have a policy regarding adding penalties and interest to delinquent accounts? | | | | |
| 4.4 | Are there adequate procedures to record collections in DCB and the Cash Book and Ledgers? Are these procedures | | | | |

| | | | | | |
|----------|---|--|--|--|--|
| | strictly followed? | | | | |
| 4.5 | Is DCB properly reconciled to Cash Book and Ledger and Other Subsidiary Ledgers? | | | | |
| 5 | Controls over Tax and Non-Tax Revenues | | | | |
| 5.1 | Are there adequate procedures to ensure that taxes are properly assessed and demanded? Are these procedures followed strictly? | | | | |
| 5.2 | Is the tax rate/s for different types of taxes supported by appropriate Law/Rule/Regulation and/or Government Order? | | | | |
| 5.3 | Have all adjustments to tax assessments been properly authorised in writing by designated authority in the Local Body? | | | | |
| 5.4 | Are there adequate procedures for tax remissions, write offs and other adjustments to be given to the tax payers and are these procedures strictly followed? | | | | |
| 5.5 | Are taxes collected compared year to year to ensure there are no unusual trends and action taken where necessary? | | | | |
| 5.6 | Are uncollected taxes for a year properly carried over to next year for collection? Are there adequate procedures to ensure such carry over and collection? | | | | |
| 5.7 | Are pre-numbered receipts issued for tax collections and do these receipts correctly capture the revenue account code and number? | | | | |
| 5.8 | Does the Local Body act for collection of over-dues or they just hope they will be paid and there is no real action from the entity? | | | | |
| 5.9 | Is an appropriate receivable entry passed in the books for amounts due but not collected? Does it match with DCB and other records? | | | | |
| 5.10 | Are there procedures to publish in the local newspapers the details of delinquent tax payers' details? | | | | |
| 6 | Controls over Procurement of Works and Stores | | | | |
| 6.1 | Does the local body strictly follow the Kerala Government's procurement rules and procedures that apply to such entities? | | | | |
| 6.2 | Is there a procurement plan and a procurement budget for ensuring proper control on procurement of goods and services? | | | | |
| 6.3 | Are the functions of purchasing, receipt of goods, and payment of invoices performed by different employees? | | | | |
| 6.4 | Is proper sanction and approval from designated authority obtained prior to incurring expenditure on works and stores? | | | | |
| 6.5 | Are the sanctions and approvals correctly recorded in respective registers? | | | | |
| 6.6 | Does the local body maintain an approved vendor list and perform procedures to detect fictitious vendors and relationships of employees with the vendors? | | | | |
| 6.7 | Does the local body use the purchase methods and follow tendering rules as prescribed in the all the Rules that apply to it? | | | | |
| 6.8 | Does the local body use Purchase Orders/Work Orders/Contracts for all its procurement? Note the exceptions for detailed analysis, if any. | | | | |
| 6.9 | Are all expenditures supported by original invoices and other related supporting documentation? | | | | |
| 6.10 | Are all expenditures sanctioned and approved by the designated officials of the local body before procurement is made and payment is disbursed? Note the exceptions if any for detailed analysis. | | | | |
| 6.11 | Are the incoming goods properly recorded in the stock and other records? Does the local body follow a GRN/MRN | | | | |

| | | | | | |
|------|---|--|--|--|--|
| | system for all its receipt of goods? | | | | |
| 6.12 | Are registers and M Books for assets under construction being maintained and updated timely and correctly? | | | | |
| 6.13 | Are entries in the M Book and other registers approved by designated official of the local body? | | | | |
| 6.14 | Are assets under construction inspected periodically by higher officials? | | | | |
| 6.15 | Are there proper inspections procedures for the purchased goods and is there a material certification procedure in place? Are these procedures followed strictly? | | | | |
| 6.16 | Are the invoices from vendors authorised and approved by designated officials before the same are paid? | | | | |
| 6.17 | Are the invoices cancelled with “paid” stamps after payment is done to ensure they are not paid twice? | | | | |
| 6.18 | Are there detailed inventory records (stock registers, bin cards, etc.) maintained and updated such that they reflect the correct balance as on any day? | | | | |
| 6.19 | Are there proper safeguards in place to prevent theft, misuse and loss of goods and materials from the Stores? | | | | |
| 6.20 | Is physical count done for all stores items at least annually and adjustments to be books made with approvals from designated officials of the local body? | | | | |
| 6.21 | Are there procedures to ensure obsolete, surplus, and non-moving stores is identified and action taken by the local body as per the laid down procedures? | | | | |
| 6.22 | Is adequate insurance cover available for the inventory? | | | | |
| 7 | Controls over Payroll | | | | |
| 7.1 | Are personnel records like service books, leave records, etc., maintained for all employees and are these updated regularly? | | | | |
| 7.2 | Do physical controls exist over personnel records to prevent their loss or use by unauthorized personnel | | | | |
| 7.3 | Are there adequate procedures to ensure that employees’ salaries are calculated at the rates/scales approved and as fixed in the service books? | | | | |
| 7.4 | Are salaries and wage rates verified by someone outside of the payroll process? | | | | |
| 7.5 | Is access to service books and other personnel records restricted to authorised employees? | | | | |
| 7.6 | Are pay revisions/pay adjustments, etc., approved by designated officials of the local body and are verified by the KSAD? | | | | |
| 7.7 | Is monthly salary sheet approved by designated officials of the local body before the pay is disbursed? | | | | |
| 7.8 | Are salaries disbursed in cash? If yes, are there proper control on cash withdrawal for salaries and disbursement to employees? Is acknowledgement of employee taken for salaries disbursed? | | | | |
| 7.9 | Are there adequate procedures to ensure salaries are correctly recorded in the cash/bank book and other registers and respective ledger accounts? | | | | |
| 7.10 | Is an adequate attendance record maintained for all employees? Are these records approved by the designated officials of the local body? | | | | |
| 7.11 | Is over time pre-approved? | | | | |
| 7.12 | Are leaves (except casual leave) pre-approved? | | | | |
| 7.13 | Are there adequate procedures to ensure that days worked, leave and OT and deductions are correctly captured in the salary sheet and salary is correctly calculated? Are these procedures followed? | | | | |
| 7.14 | Are there procedures to ensure salary is not paid to non-existent employees? | | | | |
| 7.15 | Are salary sheets once approved for payment, corrected by any employee in charge of disbursing salaries? | | | | |
| 7.16 | Are there general ledger controls for classification of employee compensation and benefit costs so such costs are | | | | |

| | | | | | |
|----------|--|--|--|--|--|
| | recorded in the proper general ledger account? | | | | |
| 7.17 | Is there proper recording of accrued liabilities for unpaid employee compensation and benefit costs? | | | | |
| 7.18 | Are adjusting payroll journal vouchers approved by an authorized person who does not prepare salary sheets or service books. | | | | |
| 7.19 | Are salary advances (if any) pre-approved by designated authority? Are these advances correctly recorded in respective registers and recovered from monthly payroll? | | | | |
| 7.20 | Is salary advance account regularly reconciled? | | | | |
| 7.21 | Are there any overpayments to employees during the year? Note the cases for detailed audit. | | | | |
| 7.22 | Are unclaimed employee cheques/cash properly returned to the designated departments? | | | | |
| 7.23 | Is there a checklist and procedures to ensure correct deduction of income tax, PF, ESI etc? Are these correctly deducted every month? | | | | |
| 7.24 | Are taxes and PF and other statutory deductions made from employees deposited with respective government authorities timely and correctly? | | | | |
| 7.25 | Are there adequate procedures to ensure final settlements (in case of resignation, retirement, etc.) are correctly calculated, amounts due from employees properly recovered and the final settlement is sanctioned and approved by designated official of the local body? | | | | |
| 8 | Control over Assets | | | | |
| 8.1 | Are there adequate procedures for purchase, receipt, capitalisation and recording of assets in the respective registers and General Ledger? Are these strictly followed? | | | | |
| 8.2 | Is a Dead Stock/Fixed Asset Register being maintained and updated correctly? | | | | |
| 8.3 | Are assets as per these registers reconciled with the General Ledger and action taken for un-reconciling items? | | | | |
| 8.4 | Is there a system of coding and numbering the assets followed by the local body? | | | | |
| 8.5 | Are assets physically verified by the local body at least annually and adjusted with book balances (where necessary) with appropriate approvals from the designated officials? | | | | |
| 8.6 | Are proper safeguards in place to prevent loss or misuse or theft of assets? | | | | |
| 8.7 | Is a proper depreciation system being followed by the Local Body? Are assets correctly depreciated every year? | | | | |
| 8.8 | Do procedures exist for identification of non-working, obsolete and surplus assets exist? Does the local body take appropriate action on such assets? | | | | |
| 8.9 | Is all property and equipment properly secured? Is the insurance amount properly reviewed every year for its adequacy? | | | | |
| 8.10 | Are there adequate procedures for disposal of obsolete and non-working assets? Are these followed? | | | | |
| 8.11 | Are disposals of assets (if any) in accordance with the procedures and rules? | | | | |

Appendix 3

Internal Control Questionnaire – Universities (Refer Para 5.4)

| S No | Questions | Yes | No | NA | Comments of auditors |
|----------|--|-----|----|----|----------------------|
| 1 | General Controls | | | | |
| 1.1 | Does management understand that implementing an adequate internal controls system is its responsibility? | | | | |
| 1.2 | Has management performed a risk assessment and adopted the appropriate compensating controls? | | | | |
| 1.3 | Does the University have written documentation of its accounting procedures? | | | | |
| 1.4 | Are the duties of officials and employees clearly defined and in writing? | | | | |
| 1.5 | Does the University have an independent audit done on an annual basis? | | | | |
| 1.6 | Is a budget system used to monitor revenues and expenses? Are financial reports comparing budgeted balances with actual expenditure generated and reviewed by appropriate management? | | | | |
| 1.7 | Does management and staff understand what is meant by segregation of duties? | | | | |
| 1.8 | Are duties properly segregated so that no individual can perform all related elements of a transaction? | | | | |
| 2 | Accounting System | | | | |
| 2.1 | Is the general accounting/general ledger/journal entry/register maintenance function segregated from: | | | | |
| | • custody and control over cash? | | | | |
| | • custody and control over securities? | | | | |
| | • custody and control over inventory? | | | | |
| 2.2 | Are staff performing the general accounting/general ledger/journal entry function segregated from those performing the detail recording functions for: | | | | |
| | • accounts receivable? | | | | |
| | • accounts payable? | | | | |
| | • purchasing? | | | | |
| 2.3 | Does the <u>University</u> have an adequate accounting policy and procedure that cover amongst others the following? <ul style="list-style-type: none"> • analyze account balances to ensure transactions have been properly recorded? Is the procedure followed? • adjustments to the records (journal entries)? • accounting processes for all significant account balances and classes of transactions? • identify revenues, expenditures and balances of government program funds separately for each grant/program/scheme etc. • classify revenues/receipts by source, grant and project properly • classify expenditures/disbursements by grant, project and activity properly • ensuring collections and disbursements are recorded accurately and promptly in the correct fund or account and in the correct general ledger account? • authorizing and recording inter-bank and inter-fund transfers and providing for proper accounting for those transactions. | | | | |
| 2.4 | Does the <u>University</u> maintain an updated accounting manual which is accessible to all appropriate employees? | | | | |

| | | | | | |
|----------|---|--|--|--|--|
| 2.5 | Do the financial records and statements adequately describe the transactions and operations of the <u>University</u> ? | | | | |
| 2.6 | Do all journal entries include identification of the accounts in which they are to be recorded? | | | | |
| 2.7 | Is a double entry system in use that includes a general ledger and subsidiary ledgers? | | | | |
| 2.8 | Are the subsidiary ledgers balanced and reconciled to the general ledger monthly? | | | | |
| 2.9 | Is there a complete and current chart of accounts that includes descriptions of items posted to each account? | | | | |
| 2.10 | Does the accounting system allow for timely recording of transactions, easy viewing of transaction data, and timely creation of financial reports and reporting of data to higher authorities | | | | |
| 2.11 | Are ledger accounts reviewed and reconciled at least monthly and on a timely basis? Are differences, negative balances, and/or unsupported transactions investigated and corrected timely? | | | | |
| 2.12 | Is the staff performing the reconciliation separate from the staff initiating and finalizing transactions? | | | | |
| 2.13 | Are all adjusting journal entries approved in writing by designated higher authorities? | | | | |
| 2.14 | Are financial recording documents prepared (cheques, receipts, purchase orders, etc) in duplicate and pre-numbered? | | | | |
| 2.15 | Are all receipts, forms, etc., regularly accounted for as issued or voided? Is there a proper inventory record for such receipt books/form books etc. | | | | |
| 2.16 | Are detailed books and records and registers as required under the Accounting Rules of the <u>University</u> prepared and maintained. | | | | |
| 2.17 | Are all accounting records adequately protected against fire, theft, manipulation, unauthorised access etc. | | | | |
| 2.18 | Is access to accounting records limited to designated employees with responsibility for such records? | | | | |
| 2.19 | Are all accounting records, including the supporting documents, retained in compliance with the <u>University's</u> records retention policy and according to government policy, if any | | | | |
| 3 | Controls over Cash and Bank | | | | |
| 3.1 | Are the collection and deposit preparation functions segregated from the accounting functions, including general ledger and accounts receivable maintenance? | | | | |
| 3.2 | Is there a complete listing of all bank accounts opened and maintained by <u>University</u> ? | | | | |
| 3.3 | Are all cash collections deposited timely into respective bank accounts? Is there adequate control to ensure such deposits? | | | | |
| 3.4 | Are all cheques/DDs collected properly recorded in the cheque registers and timely deposited in banks? Is there adequate control to ensure such deposits? | | | | |
| 3.5 | Is a secure area provided for processing and safeguarding cash receipts? Is access to such area restricted to authorised personnel only? | | | | |
| 3.6 | Is the secured area locked when not occupied? | | | | |
| 3.7 | Is Cash adequately protected by using registers, safes, or locks and kept in areas of limited access? | | | | |
| 3.8 | Is machine printed receipt issued for cash receipts transactions? Is there a proper control on these receipt books? Do the receipts/challans show the appropriate revenue code? | | | | |
| 3.9 | Are all collections entered into the accounting system in a timely manner? Is there adequate procedure to ensure such entry and also notifying the higher authorities when not recorded timely? | | | | |
| 3.10 | Does the same employee accept funds, document or deposit them, and post the activity in the accounts? | | | | |
| 3.11 | Are all payments/disbursements, except for small petty cash items, paid by cheque or direct deposit or fund transfer? | | | | |
| 3.12 | Is a proper receipt or acknowledgement obtained for all payments whether paid by cash or bank? | | | | |
| 3.13 | Is a cheque register maintained and cheques issues recorded in such registers? | | | | |

| | | | | | |
|----------|--|--|--|--|--|
| 3.14 | Does the same employee who writes the vouchers and cheques also sign the cheques? | | | | |
| 3.15 | Are unused cheques properly controlled and protected from misuse? | | | | |
| 3.16 | Are there adequate disbursement procedures to ensure the following? <ul style="list-style-type: none"> • furnishing invoices and supporting documents to the preparer and signer of the cheques/DD/fund transfer orders, prior to signing such instruments, to help assure funds are disbursed only for authorized purposes; and to help ensure laws, rules, and regulations are followed? • Limits are set for cash and bank payments and such limits are adhered to • Requiring two or more signatures for issuing cheques/payment instructions to banks • Cheques issued are followed up until they are realised by the concerned parties and that the returned cheques (if any) are properly entered in the cheque register and are cancelled. | | | | |
| 3.17 | Are the invoices approved by someone other than those who sign the cheque/payment instructions? | | | | |
| 3.18 | Are there adequate controls to ensure all payments are made on a timely basis and in accordance with all purchase orders and contracts and other purchase procedures? | | | | |
| 3.19 | Are there adequate controls to ensure duplicate payments are not made to parties? | | | | |
| 3.20 | Are original invoices (no copies) totalling the amount of the disbursement attached to each voucher before payment? | | | | |
| 3.21 | Are there adequate controls to ensure each disbursement is properly vouchered and approved by the proper authorities before the disbursement occurs? | | | | |
| 3.22 | Are there adequate procedures for reconciliation of bank balances with books of accounts? | | | | |
| 3.23 | Is reconciliation of bank balances with books done regularly; at least monthly and action taken to correct the books where necessary with approval from designated authorities? | | | | |
| 3.24 | Are there controls to review and approve of all reconciliations and investigation of unusual reconciling items by an official not responsible for receipts and disbursements, including recording evidence of the review and approval, by signing the reconciliation? | | | | |
| 3.25 | Is there a practice of signing blank cheques by the <u>University</u> officials? | | | | |
| 3.26 | Is there an adequate insurance cover available for the cash in safe and cash in transit? | | | | |
| 4 | Controls over Collections and DCB | | | | |
| 4.1 | Are there adequate procedures to ensure that demands are raised in time and recorded correctly in DCB register for necessary follow up? | | | | |
| 4.2 | Are assessments, billing, collection and posting performed by separate employees or departments so that no one individual or one department can influence the outcome? | | | | |
| 4.3 | Does the <u>University</u> have a policy regarding adding penalties and interest to delinquent accounts? | | | | |
| 4.4 | Are there adequate procedures to record collections in DCB and the Cash Book and Ledgers? Are these procedures strictly followed? | | | | |
| 4.5 | Is DCB properly reconciled to Cash Book and Ledger and Other Subsidiary Ledgers? | | | | |
| 5 | Controls over Revenues | | | | |
| 5.1 | Are there adequate procedures to ensure that different types of fees are properly assessed and demanded? Are these procedures followed strictly? | | | | |
| 5.2 | Are exemptions from payment of fees (if any) authorised in writing by competent authority in the <u>University</u> ? | | | | |
| 5.3 | Are there adequate procedures for emissions, write offs and other adjustments to be given to the students and others | | | | |

| | | | | | |
|----------|---|--|--|--|--|
| | and are these procedures strictly followed? | | | | |
| 5.4 | Is fees collected compared year to year to ensure there are no unusual trends and action taken where necessary? | | | | |
| 5.5 | Are uncollected fees for a year properly carried over to next year for collection? Are there adequate procedures to ensure such carry over and collection? | | | | |
| 5.6 | Are prenumbered receipts issued for fee collections and do these receipts correctly capture the revenue account code and number? | | | | |
| 5.7 | Does the <u>University</u> act for collection of overdues or they just hope they will be paid and there is no real action from the entity? | | | | |
| 5.8 | Is an appropriate receivable entry passed in the books for amounts due but not collected? Does it match with DCB and other records? | | | | |
| 6 | Controls over Procurement of Works and Stores | | | | |
| 6.1 | Does the <u>University</u> strictly follow the Kerala Government's procurement rules and procedures that apply to such entities? | | | | |
| 6.2 | Is there a procurement plan and a procurement budget for ensuring proper control on procurement of goods and services? | | | | |
| 6.3 | Are the duties for initiating requisitions, receiving purchased items, processing of invoices for payment, and reconciliation of the departmental ledger separated between two or more employees? | | | | |
| 6.4 | Is proper sanction and approval from competent authority obtained prior to incurring expenditure on works and stores? | | | | |
| 6.5 | Are the sanctions and approvals correctly recorded in respective registers? Are contracts and leases approved by all appropriate parties prior to the effective date of the contract? | | | | |
| 6.6 | Does the <u>University</u> maintain an approved vendor list and perform procedures to detect fictitious vendors and relationships of employees with the vendors? | | | | |
| 6.7 | Does the <u>University</u> use the purchase methods and follow tendering rules as prescribed in the all the Rules that apply to it? | | | | |
| 6.8 | Do University procedures ensure that the best combination of quality, total price, and delivery are evaluated when acquiring goods or services | | | | |
| 6.9 | Are purchase requisitions initiated and approved by employees specifically authorized to perform this task? | | | | |
| 6.10 | Are all invoices independently reviewed for completeness, accuracy, compliance with university directives, and agreement to supporting documentation (receiving reports and purchase orders) before approval for payment? | | | | |
| 6.11 | Do vouchers receive appropriate supervisory approval before payment? | | | | |
| 6.12 | Does the <u>University</u> use Purchase Orders/Work Orders/Contracts for all its procurement? Note the exceptions for detailed analysis, if any. | | | | |
| 6.13 | Are all expenditures supported by original invoices and other related supporting documentation? | | | | |
| 6.14 | Are all expenditures sanctioned and approved by the competent authorities of the <u>University</u> before procurement is made and payment is disbursed? Note the exceptions if any for detailed analysis. | | | | |
| 6.15 | Are the incoming goods properly recorded in the stock and other records? Does the <u>University</u> follow a GRN/MRN system for all its receipt of goods? | | | | |
| 6.16 | Are registers and M Books for assets under construction being maintained and updated timely and correctly? | | | | |
| 6.17 | Are entries in the M Book and other registers approved by competent authority of the <u>University</u> ? | | | | |

| | | | | | |
|----------|---|--|--|--|--|
| 6.18 | Are assets under construction inspected periodically by higher officials? | | | | |
| 6.19 | Are there proper inspections procedures for the purchased goods and is there a material certification procedure in place? Are these procedures followed strictly? | | | | |
| 6.20 | Are the invoices from vendors authorised and approved by competent authorities before the same are paid? | | | | |
| 6.21 | Are the invoices cancelled with “paid” stamps after payment is done to ensure they are not paid twice? | | | | |
| 6.22 | Are there detailed inventory records (stock registers, bin cards, etc.) maintained and updated such that they reflect the correct balance as on any day? | | | | |
| 6.23 | Are there proper safeguards in place to prevent theft, misuse and loss of goods and materials from the Stores? | | | | |
| 6.20 | Is physical count done for all stores items at least annually and adjustments to be books made with approvals from competent authorities of the <u>University</u> ? | | | | |
| 6.24 | Are there procedures to ensure obsolete, surplus, and non-moving stores is identified and action taken by the <u>University</u> as per the laid down procedures? | | | | |
| 6.25 | Are the purchase, storage, and issuance of supplies properly controlled to prevent over-purchasing, pilferage, deterioration, and damage? | | | | |
| 6.26 | Is adequate insurance cover available for the inventory? | | | | |
| 6.27 | Are maintenance agreements reviewed periodically, especially before they are renewed, to ensure that the equipment the maintenance agreement is intended to cover is still owned and used by the unit and that it is still in the unit’s best interest to continue to carry the maintenance coverage? | | | | |
| 7 | Controls over Payroll | | | | |
| 7.1 | Are personnel records like service books, leave records, etc., maintained for all employees and are these updated regularly? | | | | |
| 7.2 | Do physical controls exist over personnel records to prevent their loss or use by unauthorized personnel | | | | |
| 7.3 | Are there adequate procedures to ensure that employees’ salaries are calculated at the rates/scales approved and as fixed in the service books? | | | | |
| 7.4 | Are salaries and wage rates verified by someone outside of the payroll process? | | | | |
| 7.5 | Is access to service books and other personnel records restricted to authorised employees? | | | | |
| 7.6 | Are pay revisions/pay adjustments, etc., approved by competent authorities of the <u>University</u> and are verified by the KSAD? | | | | |
| 7.7 | Is monthly salary sheet approved by competent authorities of the <u>University</u> before the pay is disbursed? | | | | |
| 7.8 | Are salaries disbursed in cash? If yes, are there proper control on cash withdrawal for salaries and disbursement to employees? Is acknowledgement of employee taken for salaries disbursed? | | | | |
| 7.9 | Are there adequate procedures to ensure salaries are correctly recorded in the cash/bank book and other registers and respective ledger accounts? | | | | |
| 7.10 | Is an adequate attendance record maintained for all employees? Are these records approved by the competent authorities of the <u>University</u> ? | | | | |
| 7.11 | Is over time pre-approved? | | | | |
| 7.12 | Are leaves (except casual leave) pre-approved? | | | | |
| 7.13 | Are there adequate procedures to ensure that days worked, leave and OT and deductions are correctly captured in the salary sheet and salary is correctly calculated? Are these procedures followed? | | | | |
| 7.14 | Are there procedures to ensure salary is not paid to non-existent employees? | | | | |

| | | | | | |
|----------|--|--|--|--|--|
| 7.15 | Are salary sheets once approved for payment, corrected by any employee in charge of disbursing salaries? | | | | |
| 7.16 | Are there general ledger controls for classification of employee compensation and benefit costs so such costs are recorded in the proper general ledger account? | | | | |
| 7.17 | Is there proper recording of accrued liabilities for unpaid employee compensation and benefit costs? | | | | |
| 7.18 | Are adjusting payroll journal vouchers approved by an authorized person who does not prepare salary sheets or service books. | | | | |
| 7.19 | Are salary advances (if any) pre-approved by competent authority? Are these advances correctly recorded in respective registers and recovered from monthly payroll? | | | | |
| 7.20 | Is salary advance account regularly reconciled? | | | | |
| 7.21 | Are there any overpayments to employees during the year? Note the cases for detailed audit. | | | | |
| 7.22 | Are unclaimed employee cheques/cash properly returned to the designated departments? | | | | |
| 7.23 | Is there a checklist and procedures to ensure correct deduction of income tax, PF, ESI etc? Are these correctly deducted every month? | | | | |
| 7.24 | Are taxes and PF and other statutory deductions made from employees deposited with respective government authorities timely and correctly? | | | | |
| 7.25 | Are there adequate procedures to ensure final settlements (in case of resignation, retirement etc) are correctly calculated, amounts due from employees properly recovered and the final settlement is sanctioned and approved by competent authority of the <u>University</u> ? | | | | |
| 8 | Control over Assets | | | | |
| 8.1 | Are there adequate procedures for purchase, receipt, capitalisation and recording of assets in the respective registers and General Ledger? Are these strictly followed? | | | | |
| 8.2 | Is a Dead Stock/Fixed Asset Register being maintained and updated correctly? | | | | |
| 8.3 | Are assets as per these registers reconciled with the General Ledger and action taken for unreconciling items? | | | | |
| 8.4 | Is there a system of coding and numbering the assets followed by the <u>University</u> ? Are such numbers pasted on the asset/s in an appropriate place? | | | | |
| 8.5 | Are assets physically verified by the <u>University</u> at least annually and adjusted with book balances (where necessary) with appropriate approvals from the competent authorities? | | | | |
| | Are University Vehicles properly recorded and monitored? Are vehicle use records like log books maintained correctly? | | | | |
| 8.6 | Are proper safeguards in place to prevent loss or misuse or theft of assets? | | | | |
| 8.7 | Is access to Assets like Laboratories, Libraries, Data Centres, Projector Rooms, Conference Rooms etc properly monitored and restricted? | | | | |
| 8.8 | When moving assets from one department to another or one location to another, is the fixed asset register updated for new location and date of movement etc., | | | | |
| 8.9 | In case of a theft/loss of assets, is the appropriate authority notified immediately? Is a Police Complaint given immediately and FIR lodged? | | | | |
| 8.10 | Are the University buildings secured properly to log in after workhours entry and exit? | | | | |
| 8.11 | Is a proper depreciation system being followed by the <u>University</u> ? Are assets correctly depreciated every year? | | | | |
| 8.12 | Do procedures exist for identification of non-working, obsolete and surplus assets exist? Does the <u>University</u> take appropriate action on such assets? | | | | |

| | | | | | |
|----------|---|--|--|--|--|
| 8.13 | Is all property and equipment properly secured? Is the insurance amount properly reviewed every year for its adequacy? | | | | |
| 8.14 | Are there adequate procedures for disposal of obsolete and non-working assets? Are these followed? | | | | |
| 8.15 | Are disposals of assets (if any) in accordance with the procedures and rules? | | | | |
| 9 | Research Management Support | | | | |
| 9.1 | Are staff members responsible for contracts and grants familiar with the directives and procedures relating to contracts and grants? | | | | |
| 9.2 | Have staff and faculty been provided sufficient training to understand the special requirements of expending contract and grant funds, effort reporting, and in general ensuring compliance with grant or contract terms and government regulations in this regard? | | | | |
| 9.3 | Are appropriate procedures in place to ensure that all technical and progress reports are prepared by employees directly involved with the grant program or contract and are submitted to the sponsor or contractor in accordance with the terms of the agreement? | | | | |
| 9.4 | Are costs directly charged to a grant or used as cost sharing reviewed to assure they are reasonable, allocable, consistently treated, and meet any restrictions that apply? | | | | |
| 9.5 | Is there a control in place to ensure that expenses reported for purposes of cost sharing are not already charged directly to other sponsored projects unless specifically granted permission by both sponsors? | | | | |
| 9.6 | Are salaries of administrative, clerical staff, and non-salary administrative items charged directly to a grant or sponsored project only if such services and expenses are explicitly budgeted for in the grant? Are there procedures to ensure no double accounting for this expenditure? | | | | |
| 9.7 | Are reimbursements to sub grantees/subcontractors reviewed by designated authorities/Principal Investigators who ensures the appropriateness of such charges? | | | | |
| 9.8 | Are grant summary reports reviewed and reconciled to supporting documentation periodically to verify that balances agree to amount reported in accounting records and ledgers? | | | | |

Glossary of Audit Terms

| | |
|--|---|
| Accountability: | That responsibility to some outside or higher level of authority by a person or group of persons in an organization. With respect to ULBs and Local Funds, it can also mean the responsibility of the entities to the citizens for economic and efficient services and to government for proper implementation of schemes with due financial diligence and control and achievement of stated objectives of the programmes. |
| Appropriation | The amount authorised for expenditure under a major or minor head or sub - head or other unit of appropriation or part of that amount placed at the disposal of a disbursing officer. |
| Appropriation Accounts | Accounts prepared for each grant or appropriation in which is indicated the amount of the grant sanctioned and the amount spent under each level of head of account given in budget literature and on the grant as a whole. |
| Audit | Examination in totality, of all financial operations of an auditable organizations/ depts. involving public money with a view to ascertain whether due regard has been paid to regularity, probity, and propriety, economy, efficiency, and effectiveness in public expenditure. Audit also includes financial, compliance and performance audit of an auditable entity or any such examination in accordance with provision of accounting, rules and regulations framed there under. |
| Auditee or Audited Entity or Auditee Entity | The body, organisation or entity for which the KSAD is responsible for auditing. |
| Audit Evidence | Information that forms the foundation, which supports the auditor's opinions, conclusions or reports. Sufficient: information that is quantitatively sufficient and appropriate to achieve the auditing results; and is qualitatively impartial such as to inspire confidence and reliability. Relevant: information that is pertinent to the audit objectives. Reliable: Information that is consistent with the facts, i.e. it is valid. |
| Audit Mandate: | The audit responsibilities, powers, discretion and duties conferred on the KSAD under the Local Fund Audit Act, 1994 and Kerala Local Fund Audit Rules, 1996 and derived powers under Article 243 J and 243 Z of the Constitution of India |
| Audit Memorandum | A memorandum or letter issued during the course of audit for eliciting information, confirmation of facts or any other matter considered necessary by the auditor in conduct of audit. |
| Audit Objective | A statement of what the audit intends to accomplish and/or the question the audit will answer. This may include financial, regularity or performance issues. It will help in conducting audits more systematically to ensure that regulatory prescriptions are complied with. |
| Audit Procedures | Tests included in the audit programme/checklists to be carried out systematically and reasonably by the auditors in the conduct of audit |

| | |
|-----------------------------------|---|
| Audit Risk | The audit risk is the risk that the audit report may be inappropriate. The auditor performs procedures to reduce or manage the risk of reaching inappropriate conclusions, recognising that the limitations inherent to all audits mean that an audit can never provide absolute certainty of the condition of the subject matter. When the objective is to provide reasonable assurance, the auditor should reduce audit risk to an acceptably low level given the circumstances of the audit. The audit may also aim to provide limited assurance, in which case the acceptable risk that criteria are not complied with is greater than in a reasonable assurance audit. A limited assurance audit provides a level of assurance that, in the auditor's professional judgment, will be meaningful to the intended users. |
| Audit Scope | The framework, boundary or limits and subjects of the audit. |
| Audit Standards | Audit Standards issued by CAG and/or ICAI which provide minimum guidance for the auditor that helps determine the extent of audit steps and procedures that should be applied to fulfil the audit objective. |
| Capital Expenditure | Amount spent to acquire or upgrade productive assets (such as buildings, machinery and equipment, vehicles) to increase the capacity or efficiency of an entity for more than one accounting period. |
| Causes: | Entity actions that took place or should have taken place and created a result by not following an appropriate standard/procedure/rule/law |
| Conclusions | Conclusions are statements deduced by the auditor from the audit observations/findings |
| Criteria | Any standards used for measuring the results caused by the actions of the entity in any compliance/ performance audit situation. The criteria are the benchmarks used to evaluate the subject matter. Each audit should have criteria suitable to the circumstances of that audit. In determining the suitability of criteria the auditor considers their relevance and understandability for the intended users, as well as their completeness, reliability and objectivity (neutrality, general acceptance and comparability with the criteria used in similar audits). The criteria used may depend on a range of factors, including the objectives and the type of audit. Criteria can be specific or more general, and may be drawn from various sources, including laws, regulations, standards, sound principles and best practices. They should be made available to the intended users to enable them to understand how the subject matter has been evaluated or measured. |
| Economy | Minimising the cost of resources used for an activity, having regard to the appropriate quality |
| Effectiveness: | The extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity. |
| Findings (or Observations) | Findings (observations) are the specific evidence gathered by the auditor to satisfy the audit objectives; the results of an audit on the basis of the evidence obtained. |
| Independence: | The freedom of the auditors in audit matters to act in accordance with its audit mandate without external direction or interference of any kind. |

| | |
|--------------------------------|---|
| Internal Control: | The whole system of financial and other controls, including the organisational structure, methods, procedures and internal audit, established by the entity within its goals, to assist in conducting the business of the audited entity in a regular economic, efficient and effective manner; ensuring adherence to management policies; safeguarding assets and resources; securing the accuracy and completeness of accounting records; and producing timely and reliable financial and management information. |
| Materiality | Materiality is relevant in all audits. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs. |
| Professional Skepticism | Auditors should maintain appropriate professional behavior by applying professional skepticism, professional judgment and due care throughout the audit. The auditor's attitude should be characterized by professional skepticism and professional judgement, which are to be applied when forming decisions about the appropriate course of action. Auditors should exercise due care to ensure that their professional behavior is appropriate. Professional skepticism means maintaining professional distance and an alert and questioning attitude when assessing the sufficiency and appropriateness of evidence obtained through-out the audit. It also entails remaining open-minded and receptive to all views and arguments. Professional judgement implies the application of collective knowledge, skills and experience to the audit process. Due care means that the auditor should plan and conduct audits in a diligent manner. Auditors should avoid any conduct that might discredit their work. |
| Public Accountability | The obligations of persons or entities, including government departments, entrusted with public resources to be answerable for the fiscal, managerial and program responsibilities that have been conferred on them, and to report to those that have conferred these responsibilities on them. |
| Subject Matter | Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. It can take many forms and have different characteristics depending on the audit objective. An appropriate subject matter is identifiable and capable of consistent evaluation or measurement against the criteria, such that it can be subjected to procedures for gathering sufficient and appropriate audit evidence to support the audit opinion or conclusion. |
| Supervision | An essential requirement in audit work that provides proper leadership, direction and control at all stages of audit to ensure a competent, effective link between the activities, procedures and tests that are carried out and the aims to be achieved. |