

Technical Guide on Audit of Urban Improvement Trusts and Development Authorities



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Email : aasb@icai.in

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Foreword

Urban Improvement Trusts and Development Authorities are responsible for the improvement and expansion of urban areas. In India, these Authorities are playing an important role by planning, coordinating and supervising the proper, orderly and rapid development of urban areas in their jurisdictions. Audit of these entities involve many issues and unique peculiarities. Hence, auditors undertaking audits of these entities need guidance in the form of a technical guide on auditing dealing with such aspects.

Over the years, the Auditing and Assurance Standards Board of ICAI has been issuing various Technical Guides on auditing aspects for the benefit of the members. I am happy that the Board has brought out this “Technical Guide on Audit of Urban Improvement Trusts and Development Authorities”. The Technical Guide has been written in simple and easy to understand language and provides comprehensive guidance on various issues involved in audit of these entities to assist auditors in discharge of their professional responsibilities.

My compliments to Chairman, Vice-Chairman and other members of the Auditing and Assurance Standards Board for their proactive initiative and sincere efforts in bringing out this Technical Guide for the benefit of the members.

I am sure that the members and other interested readers would find this Technical Guide useful.

August 31, 2018
New Delhi

CA. Naveen N.D. Gupta
President, ICAI

Preface

Urban Improvement Trusts and Development Authorities are constituted under the respective State Acts with the object of improvement and expansion of urban areas. Their major functions are planning, coordinating and supervising the proper, orderly and rapid development of the region and executing plans and schemes for development of the region. Many of these entities still follow cash basis of accounting. Further, there is no specific auditing guidance available regarding audits of such entities. These factors make the task of auditors of such entities quite challenging.

As a proactive step, the Auditing and Assurance Standards Board (AASB) of ICAI decided to develop a Technical Guide to provide guidance to the members conducting audits of such entities. It gives me immense pleasure to place in hands of the members, this “Technical Guide on Audit of Urban Improvement Trusts and Development Authorities” brought out by AASB. The Technical Guide has been written in simple and easy to understand language and contains detailed guidance on various issues involved in audits of these entities.

I am extremely grateful to CA. Vishnu Dutt Mantri, Jaipur and his team members viz., CA. Prahalad Gupta, Jaipur, CA. Tarun Agarwal, Jaipur, and CA. Dhananjay Gokhale, Mumbai for sparing time out of their professional and personal preoccupations to write this Technical Guide for the benefit of the members.

I wish to express my sincere thanks to Honourable President, ICAI and Honourable Vice-President, ICAI for their guidance and support to the activities of the Board.

I wish to also place on record, appreciation of Vice-Chairman of the Board, all Members of the Board and the Council for their suggestions, support and guidance in finalising this Technical Guide and other pronouncements of the Board. I also wish to thank CA. Megha Saxena, Secretary, other officers and staff of the Board for their continued co-operation.

I am confident that the Technical Guide would be well received by the members and other interested readers.

August 30, 2018
Jaipur

CA. Shyam Lal Agarwal
Chairman,
Auditing and Assurance Standards Board

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Chapter 1

Introduction

1.01 The history of contemporary planning practice in India date back to the enactment of the Bombay Improvement Trust Act 1920. Subsequently, similar Acts were enacted in other Presidencies. Following this, Urban Development Authorities were set up under Development Authority Acts for addressing the problems of fast growing towns and cities and formulating Master Plans which apart from having strong spatial connotations also have both social and development aims. Statutory process of master plan formulation in India was inspired by the erstwhile comprehensive planning system envisaged under the Town and Country Planning Act, 1947 of United Kingdom. As most of the Town Improvement Trust Acts then in force in various states did not contain provisions for preparation of Master Plans, a need was felt to have a Comprehensive Town and Country Planning Act on the lines of U.K. Accordingly, Central Town and Country Planning Organization (TCPO) drafted the Model Town and Regional Planning and Development Law in 1962, which formed the basis for various States to enact Town and Country Planning Acts, with modifications to suit local conditions.

1.02 Since 1996, many changes have taken place in the field of urban development especially in view of emerging needs / requirements of urban settlements due to rapid population growth and other reasons like globalization and liberalization. Towns and cities are subject to unprecedented changes in terms of requirements of infrastructure and other basic services / amenities.

1.03 Urban Improvement Trusts and Development Authorities **(hereinafter referred as “entities”)** are

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constituted under the State Acts with the object of improvement and expansion of Urban Areas. These entities have been set-up for planning, coordinating and supervising the proper, orderly and rapid development of area in which several other Government Departments, local authorities and other organisations are engaged. Such entities be enabled either itself or through other entities to formulate and execute plans, projects and schemes for the development of the region including creating housing, community facility, civic amenities and other infrastructure.

Major functions of these entities are as under:

1.04 The major function(s) of these entities are mainly consisting of planning, coordinating and supervising the proper, orderly and rapid development of the region and of executing plans and schemes for such development and to provide for matters connected thereto. The main objects of these entities shall be to secure the integrated development of the Region and for that purpose, these entities perform following functions: -

- a. Urban planning including the preparation of master plan and carrying out survey for the purpose and making alteration therein as may be deemed necessary;
- b. Formulation and sanction of the projects and schemes for the development of the Region or any part thereof;
- c. acquisitions of the land or any property necessary for or effected by, the execution of the schemes;
- d. the relaying out of any land comprised in the Scheme;
- e. the construction and reconstruction of building, roads, bridges, culverts, drainage, sewerage and all other urban amenities and facilities;
- f. the formation, construction and alteration of the streets;
- g. the closure or demolition of dwelling or portion of dwelling units for human habitation;

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- h. the drainage system, water supply and lighting of the streets;
- i. forming of the open spaces for the benefit of the area comprised in the scheme;
- j. all or any of the sanitary arrangement required for the area developed in the Scheme;
- k. the establishment and construction of the market and other places of public requirements and convenience;
- l. the limitation of the areas within which special trades or industries may or may not be carried on or which are reserved for exclusive use for residential or other purposes;
- m. the division of any land into plots for erection of the building for residential purpose;
- n. the provision of the facility for communication;
- o. the planting and preservation of the tree and plantation;
- p. the sale, letting, exchange of any property or land comprised in the Scheme;
- q. The reclamation or reservation of land for garden, afforestation for the provision and other needs of population.

Administration of the Urban Improvement Trusts / Development Authorities

1.05 These entities are controlled by the State Government and managed by members nominated by the State Government representing from various departments.

The sources of revenue are mainly from sale of land, ground rent in the nature of urban assessment fees, conversion charges and various charges and levies under land and building regulation etc.

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The expenditures are mainly on the acquisition of land, provision of civic amenities, roads, public park, bridge, electrification, sewerage, drainage and sanitation. They also incur expenditure on maintenance of various urban amenities.

Maintenance of Books of Account and method of accounting

1.06 These entities are required to maintain proper books of account and other relevant records and prepare annual financial statements including the Balance Sheet in such form as the State Government may prescribe. The accounts of these entities are subjected to audit annually by the provisions of Local Fund Audit Act of respective States.

These entities generally follow cash basis of accounting, however few of them have shifted to accrual basis of accounting. Generally, these entities follow general accounting principles and in addition to local fund audits, also get their accounts audited under the provisions of the Income Tax Act, 1961 for getting exemption of the Sections 11 and 12 of the Income Tax Act, 1961 wherever required.

Objectives of the Technical Guide

1.07 There is no specific implementation guide or guidance which has been issued for audit of such entities however audit of these entities is conducted either as an annual audit of the financial statements as prescribed under the relevant act and/or the audit is conducted as per requirement of section 12A(1)(b) of the Income Tax Act, 1961. The auditor is required to express the true and fair opinion on the statement of affairs and statement of income and expenditure following applicable Standards on Auditing, keeping in view the basis of accounting followed by the entity.

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This Technical Guide identifies specific matters to assist the auditor which are important while reporting on the financial statement with the greater emphasis where such entities follow cash basis of accounting so as to enhance proper and consistent reporting of the cash receipts, cash payments and cash balances of the entity. It will also enhance comparability with the entity's own financial statements of previous periods and with the financial statements of other entities.

Chapter 2

Audit of Specific Accounting Aspects

Accrual basis of accounting is well defined system of maintaining the books of account where recognition of revenues and expenses is made as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments. While under cash basis of accounting, transactions and events are recognized only when cash is received or paid by the entity.

The audit of entities where accrual system of accounting is followed is carried out as per applicable financial reporting framework, however many of these entities follow cash system of accounting and the guidance available to auditors is limited, therefore various important features related to cash basis of accounting are discussed in detail in this section.

Cash Basis of Accounting

2.01 Cash basis of accounting is generally defined as:

“The cash basis of accounting recognises transactions and events only when cash (including cash equivalents) is received or paid by the entity. Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date. The measurement focus in the financial statements is balances of cash and changes therein. Notes to the financial statements may provide additional

information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, inventories, investments and property, plant and equipment.”

Cash Receipts

2.02 The auditor should examine that where entity follows cash basis of accounting, transactions are accounted for only when money actually received. During verification of revenue/other transaction of receipts, special care required while audit of year end transactions, accounted as receipts in the books, related to amount received through cheque, so as to ascertain whether money actually received such as: -

- Cheques received on or before the end of the accounting year but realization took place after end of the accounting year, such receipts are also considered as actually received;
- Cheques received prior to the end of the accounting year and deposited after end of the accounting year are generally recognised as receipts by accounting of cheques in hand;
- Cheques received before the end of accounting year and dishonored on presentation are excluded from accounting and not recognised as receipts;
- Receipts of cheques after the end of accounting year are not recognised in the current period;
- Direct credit of money / funds received in the Bank by any mode on or before the end of accounting year related to any transactions are accounted as receipts;
- All transactions of cash received before the end of accounting year are accounted and recognised in the books.

Cash Payments

2.03 In cash basis of accounting, the auditor should take special care while examination of transactions of payment, to ascertain that the payment has been actually made on or before the end of the accounting year, such as:

- Cheque issued after the end of accounting period are not considered as payment for the current financial year and not accounted;
- Payment made through the cheques on or before the end of accounting year where cheque presented for payment before or after the end of the accounting period are accounted as expenditure or otherwise only in the situation when the cheques are not dishonored when presented;
- Payment made through the cheques on or before the end of accounting year but dishonored on presentation before the end of financial year “due to insufficient funds” but cleared on representation after the end of the accounting year are not accounted in the current accounting year;
- Cheques issued but not presented for payment till the validity of the cheques are accounted in the books as payment by credit to “Stale Cheques” or the related expenditures / transaction are reversed in terms of the specific accounting policies followed consistently and disclosed appropriately;
- In the situation cheques issued in the current year but expired due to non-presentation for payment during the current year and cheque re-issued in place of expired cheques which are dishonored on presentation due to insufficient funds are not recognised as expenses.

Note: Cash receipts / cash payments means transactions by way of cash and transactions through banking system.
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Information to be Presented in the Statement of Cash Receipts and Payments

2.04 Many of these entities are preparing the receipts and payments account, in addition to Income and Expenditure Account or Profit and Loss Account and Balance Sheet. In case of receipts and payments account, the auditor shall examine that the statement of cash receipts and payments should present the following amounts for the reporting period:

- (a) Total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations;
- (b) Total cash payments of the entity showing separately a sub-classification of total cash payments using a classification based on either the nature of the payments or their function appropriate to the entity's operations; and
- (c) Opening and closing cash balances of the entity.

Reporting on a Net Basis: Cash Receipts and Payments

2.05 The auditor should examine and verify that total cash receipts and total cash payments, and cash receipts and cash payments for each sub-classification of cash receipt and payment, shall be reported on a gross basis, however following are the situations where cash receipts and payments may be reported on a net basis when:

- a. they arise from transactions which the entity administers on behalf of other parties and which are recognised in the statement of cash receipts and payments; or
- b. they are for items in which the receipts and related payments are in quick succession, the amounts are large, and the maturities are short.

Recognition of Revenue and Expenditure

2.06 The auditor shall examine that under cash basis of accounting, revenue and expenditure are recognised only when cash is received or paid by the entity. Certain matters where auditors require care in recognition of receipts and payments are already discussed in detail in paragraph 2.02 and paragraph 2.03 above.

Chapter 3

An Overview of Certain Standards on Auditing (SAs)

Initial Considerations

While auditing the financial statements of these entities, an auditor has to follow all Standards on Auditing (SAs) as may be applicable based on the system of accounting being followed by the entity. Though, all requirements of these SAs have not been stated in this Technical Guide as they apply uniformly, an overview of certain SAs are given for ready reference as below.

Terms of Audit Engagements

3.01 SA 210, “Agreeing the Terms of Audit Engagements” requires that for each period to be audited, the auditor should agree on the terms of the audit engagement with the entity before beginning significant portions of fieldwork.

It is imperative that the terms of the engagement are documented, in order to prevent any confusion as to the terms that have been agreed in relation to the audit and the respective responsibilities of the management and the auditor, at the beginning of an audit assignment.

3.02 When establishing the terms of engagement, the auditor should agree on his understanding with the management as to the objectives and scope of the audit engagement, the extent of management’s responsibilities and his own responsibilities. This minimizes the risk of misunderstanding in future and there is no expectation gap between both the parties.

3.03 The form and content of audit engagement letter may vary depending on the nature of the entity and its activities, but it would generally include reference to following:

- The objective of the audit of financial statements.
- Management's responsibility for the financial statements.
- Management's responsibility for selection and consistent application of appropriate accounting policies, including implementation of the applicable accounting standards along with proper explanation relating to material departures from those accounting standards.
- Management's responsibility for assessment of the entity's ability to continue as a going concern.
- Management's responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the income and expenditure of the entity for that period.
- Management's responsibility for the maintenance of adequate accounting records and internal controls for safeguarding the assets of the entity and for preventing and detecting fraud or other irregularities.
- The scope of the audit, including reference to the applicable legislation, regulations, and the pronouncements of the ICAI.
- The fact that having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

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- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.
- The fact that the audit process may be subjected to a peer review and/or quality review under the Chartered Accountants Act, 1949.

3.04 The auditor may also include the following matters in the engagement letter:

- Arrangements regarding the planning and performing the audit, including the fact that the audit will be carried out in accordance with the auditing standards generally accepted in India. Further, it should be spelt out that the audit would be performed to obtain reasonable assurance about whether the financial statements are free of material misstatements. It should also be clearly specified that the audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements including assessment of the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. However, having regard to the nature of the audit and volume and complexity of transactions, persuasive rather than conclusive nature of audit evidence, together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.

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- Request for the Entity to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the entity.

3.05 The following are certain specific aspects which need to be kept in mind while issuing an engagement letter in case of audit of these entities:

- The use and source of specialised accounting principles, with particular reference to any requirements under the law or regulations applicable to the entity, e.g., the Urban Improvement Trust Act, Development Authority Act on matters, such as, presentation of the financial statements.
- The form and contents of the financial statements (including disclosures) and auditor's report as laid down in the respective act etc., if any.

Initial Engagements

3.06 SA 510, "Initial Audit Engagements-Opening Balances", deals with the auditor's responsibility relating to opening balances when conducting initial audit engagement. Opening balances include financial statement amounts as well as matters requiring disclosures.

3.07 The auditor needs to perform the audit procedures as mentioned in SA 510 and if after performing those procedures, the auditor concludes that the opening balances contain misstatements which materially affect the financial statements for the current period and the effect of the same is not properly accounted for and adequately disclosed, the auditor should express a modified opinion, as appropriate.

Assessment of Engagement Risk

3.08 The assessment of engagement risk is a critical part of the audit process and should be done prior to the acceptance of an audit engagement since it affects the decision of accepting the engagement and also in planning decisions if the audit is accepted.

3.09 The process of assessing engagement risk consists of identifying risk factors and exercising professional judgment to determine whether such factors, separately or in combination, are significant enough to require a special response. Prior to accepting an engagement, the auditor should obtain a preliminary knowledge of the activities of the entity and understand the specialised function and activities of the entity to be audited.

3.10 For a prospective audit engagement, the auditor should assess engagement risk based on past experience in the industry, the information obtained from predecessor auditors, inquiries of senior management, those charged with governance, and other appropriate sources. For a continuing audit engagement, the auditor should assess engagement risk based on his experience with the entity and additional audit procedures performed in the previous audits.

3.11 For an audit engagement for which a higher engagement risk is assessed, the auditor should respond appropriately in planning and performing the audit. The auditor then needs to determine whether the increased engagement risk is pervasive to the audit engagement as a whole, as a result of one or more pervasive risks, or as a result of one or more specific risks.

3.12 The auditor would ordinarily need to document the assessment of engagement risk, factors identified as increasing engagement risk, and, if the additional information obtained during the engagement indicates a change in engagement risk, the auditor would need to document his considerations as to whether the planning decisions remain appropriate and the effect, if any, on the audit plan. A yearly

assessment of engagement risk will ensure the firm's continuing independence and ability to act and that the engagement risk is still within the firm's pre-determined appetite for risk.

Planning

3.13 SA 300, "Planning an Audit of Financial Statements" requires that the auditor shall undertake the following activities prior to starting an initial audit:

- (a) Performing procedures required by SA 220, "Quality Control for an Audit of Financial Statements" regarding the acceptance of the client relationship and the specific audit engagement; and
- (b) Establish understanding of the terms of engagement as per SA 210, "Agreeing the Terms of Audit Engagements".

3.14 Planning would involve (1) establishing overall audit strategy to set the scope, nature, timing, extent of resources required and direction of audit and (2) developing audit plan which contains description of nature, timing and extent of audit procedures to be performed. The audit plan needs to be properly documented with respect to timing, extent of checking, audit procedures to be followed at assertion level and should be flexible and updated or changed as and when necessary. Further, the audit plan should be communicated to the audit team.

SA 220 establishes standards on the quality control, generally, and with regard to the work delegated to assistants on an individual audit.

Before starting initial audit engagement, the auditor should perform procedures required under SA 220 regarding client acceptance etc. The auditor also needs to ensure that a proper communication has been sent to the predecessor

auditor. The auditor should also keep in mind the requirements of SQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”.

The Engagement Team

3.15 The selection of the engagement team is a key activity in the development and execution of an effective and efficient audit plan. The assignment of qualified and experienced professionals is an important component of managing engagement risk. The size and composition of the engagement team would depend on the size, time available to complete the assignment, nature, and complexity of the entity’s operations.

3.16 The audit engagement partner should be satisfied that the engagement team collectively has the appropriate capabilities, competence, and time to perform the audit engagement. The audit engagement partner should determine that the engagement team selected is appropriate for the audit engagement.

3.17 The audit engagement partner should also see if additional technical assistance or specialised knowledge is required as a result of the nature and characteristics of the audit engagement. This may require the inclusion of one or more experts like IT, tax, legal, actuarial, post-employment benefits, etc.

Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

3.18 It is the auditor’s responsibility to identify and assess the risks of material misstatement in financial statements and assertion levels, through understanding the entity, its

environment and its internal control system. This would help the auditor in designing and implementing various audit procedures as response to such assessed risk areas and reduce the risk to acceptably low level.

3.19 SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" lays down that the auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement in the financial statements whether due to fraud or error, and sufficient to design and perform audit procedures.

3.20 In performing audit of an entity, the auditor should have or obtain knowledge of the business sufficient to enable him to identify and understand the events, transactions and practices that, in the auditor's judgment, may have a significant effect on the financial statements or on the examination or comments in the audit report. Such knowledge is used by the auditor in assessing inherent and control risks and in determining the nature, timing and extent of audit procedures. Understanding the entity and its environment is a continuous and cumulative process of gathering and assessing the information and relating the resulting knowledge to audit evidence and information at all stages of the audit.

3.21 The auditor can obtain knowledge of the entity from various sources which also includes:

- Discussion with management of the entity.
- Discussion with internal/concurrent/other audit personnel regarding the nature, timing and extent of work done by them and review of their audit reports, especially how issues raised are closed.

- Discussion with peers (other auditors) and with legal and other advisors who have provided services to the entity or within the industry.
- Discussion with knowledgeable people outside the entity.
- Other regulatory pronouncements.
- Documents produced by the entity (for example, minutes of meetings, annual reports, etc.).

3.22 SA 330, 'The Auditor's Responses to Assessed Risks' deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315 in a financial statement audit.

The auditor should plan the audit so that it is responsive to the assessment of the risk of material misstatement based on the auditor's understanding of the entity and its environment, including its internal control. The auditor should perform risk assessment procedures to provide for a basis for the identification and assessment of risk of material misstatement at the financial statement and assertion level.

3.23 As part of assessment of risk of material misstatement, the auditor should determine which of the identified risk are in the auditor's judgment, risk that require special audit consideration. One or more significant risk normally arises on most audit, in exercising this judgement, the auditor should consider inherent risk to determine whether the nature of risk, the likely magnitude of the potential misstatement including the possibility that the risk may give rise to multiple misstatement, and the likelihood of the risk occurring are such that they require special audit consideration.

Audit Documentation

3.24 SA 230, “Audit Documentation” deals with the auditor’s responsibility to prepare audit documentation for an audit of financial statements. It refers to documentation as “the working papers prepared or obtained by the auditor and retained by him, in connection with the performance of his audit”. Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Quality Control

3.25 The auditor/audit firm should establish a system of quality control designed to provide reasonable assurance that the auditor/firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partner(s) are appropriate in the circumstances and will survive the test of relevant regulatory, legal or other action that may arise in future. This system of quality control

should consist of policies designed to achieve its objectives and the procedures necessary to implement and monitor compliance with those policies. The nature of the policies and procedures developed by individual or firms to comply with SQC will greatly depend on various factors such as the size, maturity, geographical location, type of work handled and other operating characteristics.

Reporting Standards

3.26 The reporting standards deal with the auditor's responsibility to issue an appropriate report. It is important to note that an auditor should also place due emphasis on the formats and requirements of SA 700 (Revised), SA 705 (Revised), SA 706 (Revised) and other SAs related to "Audit Conclusions and Reporting" as applicable.

3.27 SA 700(Revised), "Forming an Opinion and Reporting on Financial Statements" deals with the auditors' responsibilities to form an audit opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements, where the auditor expresses unmodified opinion when the auditor concludes that financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

3.28 SA 705(Revised), "Modifications to the Opinion in the Independent Auditor's Report" and SA 706(Revised), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the situation when auditor expresses modified opinion or includes an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's Report.

3.29 SA 705(Revised) establishes three types of modified opinion, namely a qualified opinion, an adverse opinion and

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a disclaimer of opinion based on the professional judgment considering the method of accounting followed by the entity. The decision regarding which type of modified opinion is appropriate depends upon:

- a. The nature of the matter giving rise to the modification, that is whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence may be materially misstated; and
- b. The auditor's judgement about the pervasiveness of the effect or possible effects of the matter on the financial statements.

3.30 The auditor should express qualified opinion when:

- a. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive, to the financial statements.
- b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

3.31 The auditor should express adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements individually or in aggregate, are both material and pervasive to the financial statements.

3.32 The auditor should express disclaimer of opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial

statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

3.33 SA 706(Revised) deals with the situation when auditor includes an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report when the auditor considers it necessary to:

- (a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
- (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Chapter 4

Special Features of Urban Improvement Trusts / Development Authorities

Allotment/Sale of Land falling in the Jurisdiction and Development works

4.01 The land falling in the jurisdiction of these entities vest in their favour by the virtue of the State Act(s). Mostly, all the Government land vest to these entities. The revenue generated from allotment/sale of the land, urban assessment fee (Ground Rent) and conversion charges of land etc. are generally shared with the State Government and local authorities as per the direction of the State Government.

4.02 These entities are mainly involved in development of urban area and urbanization of land under their jurisdictions and involved in systematic and planned infrastructure development of roads, drainage, sewerage and other amenities. In this process of urbanization these entities allot, reserve land for other Government agencies / departments who are associated in providing various public services and facilities like electricity, telecommunication, health, safety and security etc. The surplus land is identified in this process and demarcated for sale and many of times large area of land are planned for development of the residential schemes to cater the needs of housing for various segments of the public.

The land is allotted/sold by these entities in following manner:

- a. Sale of plots of surplus / planned land.
- b. Allotment / sale of plots under residential scheme.

4.03 The surplus land identified during development plan are disposed with the object for urban development to buyers for construction and development of residential / commercial complexes including setup of facilities like school, hospital, Cinema Hall, Recreation Center, Clubs, Hotel and Restaurants and other public amenities and to provide other basic infrastructure for urban development.

The entity also releases the sector road plans of the area where such vacant land/ plots are available for sale and according to plan, execute various works including construction of the sector roads, other internal connecting roads, sewerage and drainage system, streets lighting, development of gardens, plantation and development of reserved green belts etc.

4.04 Further, many of the times these entities are also involved in developing of scheme of residential plots consisting of block(s) and sectors(s) having different sizes of the plots duly demarcated with development of the road, fencing, common garden, community center, street lights, sewerage and drainage system etc. These developed plots are generally sold through open auction or allotted to various intended buyers as per their income group through lottery system as per reservation criteria for different categories as prescribed by Government.

Accounting through Funds

4.05 Certain entities follow system where revenue realised from the various activities are transferred to funds for development of area under their region and accumulated balance of the fund are incurred for development of the amenities / facilities in region.

In some States there may be dedicated Water and Sewerage Fund and income from these services (taxes and

charges) is kept in this fund and expenditure are also met out of the fund. The concept of funds brings accountability and better transparency for activity specific monitoring of inflow and out flow and controlling and reporting.

4.06 The methodology adopted for routing of transactions through the funds is not appropriate as income and expenses are not classified or sub-classified based on the nature of receipts and payments or their function. All cash payments items may be sub-classified using classification based on the nature of payments or their function.

The first method is referred to as the nature of payments method. Payments are aggregated according to their nature (for example, purchases of materials, transport costs, wages and salaries), and are not reallocated amongst various functions within the entity.

The second method, referred to as the functional method of classification, classifies payments according to the program or purpose for which they were made. Such presentation often provides more relevant information to users, although the allocation of payments to functions can be arbitrary and may involve considerable judgment.

4.07 The entity may opt any of the method for classification of the payments either based on nature or function and follow it consistently while presentation of the financial statements to facilitate better disclosures and comparability.

Funds are also transferred for achieving certain specific objectives e.g. certain entities are entrusted to create social infrastructure from the funds allocated by Minister of Parliament or Minister of Legislative Assembly. The accounting of receipts of money and expenditure incurred are carried out as depository work or as revenue and expenditure on receipts and payments basis. The entity is required to disclose the accounting policy in this regard in the manner as the treatment of such allocated funds are made.

Acting as Government Agent

4.08 Many of these entities are working as an extended arm of Government and functioning as collector of the taxes revenue charged in their jurisdiction on behalf of the Government on account of Property Tax, Urban Improvement Tax / Cess etc. and performing various activities on behalf of the state Government, which may be termed as agency business where the entities are getting certain percentage of the revenue as a compensation in lieu of its administrative / management cost.

4.09 In many cases, the cash the entity receives, in respect of transactions it administers as an agent for others, will be deposited directly in the bank account of the ultimate beneficiaries of the cash. In these cases, the entity will not control the cash it receives in respect of the transactions it administers and these cash flows will not form part of the cash receipts, cash payments or cash balances of the entity. The accounting of amount collected on behalf of Government are credited to Government Account in such situation and revenue recognised only to the extent as directed or decided by the Government.

However, in other cases the cash received will be deposited in bank accounts controlled by the entity acting as an agent and the receipt and transfer of that cash will be reported in the statement of cash receipts and payments of the entity.

4.10 The auditor should examine the underlying arrangement and verify that transactions and balances related to such arrangements are properly presented in the financial statements. Further, the auditor should verify and ensure that the accounting policy of recognition of income from such transaction is properly disclosed.

Urban Assessment fee / Ground Rent and Other revenue

4.11 These entities are empowered to collect the ground rent from all the buyers of the land to whom lease hold land is sold, as per the terms of the lease. Further to this, these entities are recovering the interest and penalty on delay in

payment of these charges. The amount of lease money becomes due every year and option to the buyers are given to pay one-time lease money at any time during the period of lease.

4.12 In addition to this, these entities are collecting various fees and charges like conversion charges, development charge, sewerage/ drainage development fee, building plan/ map approval fee, set-back regularisation fee, fee for merging of plots and fee for sub-division of the plots and penalty on delay in construction of house etc.

The auditor should check that the revenue of the entity from these activities is properly classified in appropriate heads and properly disclosed in the financial statements.

Lease Rentals, Fees and Other Sources of income

4.13 These entities are also collecting lease rent and charges from properties, advertisement rights, signage and display boards fee, rentals from community centers, parking slots rentals and other rentals and entrance fee from the historical properties and gardens and trade licence fee etc.

The auditor should check that the revenue of the entity from such activities is properly classified in appropriate heads and properly disclosed in the financial statements.

4.14 In audit of these entities, following are the other areas which may require greater audit focus during the audit.

Revenue Related Risk

4.15 The auditor needs to examine the compliance of 'Accounting Standards' as may be applicable based on the method of accounting followed and accounting policies disclosed, in planning and performing procedures to respond to the risk, which mainly includes:

- Incorrect recognition of revenue;
- Sharing of the revenue out of the sale proceeds of the land not accounted as per direction of the State Government and excess revenue recognised;

- Recognition of advance receipts as revenue;
- Non-Recognition of provisional / part receipts of taxes as revenue;
- Non-recognition of earlier years' revenue due / received consequent to reassessment;
- Non-recognition of refund and remission made during the current year due to excess / incorrect demand raised and recovered in past.

Expenditure Related Risk

4.16 These includes:

- Recognition of expenditure without actual payment;
- Recognition of advance made recoverable / adjustable as expenses;
- Non-Recognition of provisional / part payment made towards services / supply as an expenditure;
- Non-recognition of earlier years expenditure consequent of recognition of part payment recognised as advance incorrectly in past;
- Expenditure incurred on maintenance / development of public / civic amenities are wrongly recognised as fixed assets.

Revenue / Capital Grant

4.17 Following are the instances of risk related to accounting of grant:

- Incorrect accounting of the revenue grant of the funds received from Government for other activities / purposes.
- Temporary advance / funds received are recognised as revenue grant incorrectly.
- Capital grant received for specific purpose however wrongly considered as revenue grant.

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- Revenue grant recognised as income or receipts without getting proper approval or actual receipts of money.
- Advance received wrongly considered as grant.
- Grant utilised for the purpose other than for which it was provided and utilisation incorrectly considered.

Fixed Assets Related Risks

4.18 Following are the instances of fixed assets related risk:

- Incorrect capitalization of cost incurred towards repairs and maintenance;
- Fixed assets acquired but wrongly charged to revenue;
- Advance given for execution of the work wrongly capitalised as assets;
- Incorrect classification of assets leading to incorrect depreciation;
- Incorrect/excess capitalisation of the fixed assets not in accordance with AS 10 (Revised), "Property, Plant and Equipment";
- Assets acquired with the support of the specific capital grant not recognised as an asset.

Chapter 5

Audit Approach and Procedures

Audit of Revenue

5.01 Revenue in respect of Urban Assessment Fee / Ground Rent

The urban assessment fee / ground rent is a major recurring source of the income of these entities. These entities are maintaining the particulars of the land sold by them on lease and maintain the particulars of the location, owner, area of the land, nature of the land and applicable ground rent rates on the area. These entities are authorities maintaining the zone / area wise record of the land owners and owner wise demand are raised for the ground rent on year to year basis on the due dates. These authorities are empowered to charge the interest on the ground rent in case the payment is not made on the due dates, further various schemes are announced to encourage the defaulters to pay the past dues with rebate in interest. Scheme of Rebate on timely payment of ground rent is also announced for regular payers of the dues.

5.02 The verification of the revenue from ground rent requires understanding of the accounting policy followed by the entity.

5.03 In case of accrual basis of accounting, the verification of revenue recognised from ground rent involves following aspects to examine:

- Whether revenue in respect of Urban assessment fee / ground rent recognised in the period in which they become due and ascertainable.

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- In case of new or changes in assessments of lease rent / ground rent, it can be accrued in the month in which the demand is served.
- In respect of the demand outstanding beyond certain years, provision shall be made against these receivables keeping in view the period of default, based on the provisioning policy of the entity.
- Any additional provision against demand outstanding (net on overall basis) required to be made during the year shall be recognised as expenditure and any excess provision written back during the year shall be recognised as income of the entity.
- Demands raised with retrospective effect due to error will be treated as prior period income to the extent it pertains to earlier years.
- Advance payment received towards any taxes, levies etc. shall be recognised as liability.
- In cases where a provisional assessment is made, revenue shall be recognised in respect of the entire amount provisionally assessed. At the time of final assessment, necessary adjustment to the revenue shall be made based on final assessment.

5.04 In case where the entity follows cash basis of accounting, recognition of the revenue under cash basis of accounting requires verification keeping in view the following aspects during audit that:

- Revenue in respect of urban assessment fee / ground rent shall be recognized only in the period in which they are realised.
- In case of announcement of new rates or changes in assessments of urban assessment fee/ ground rent, it is

accounted as revenue in the year in which the same is realised.

- Demands raised with retrospective effect due to error and realized in current year will also be treated as income of the current year.
- Advance payments received towards any taxes, levies etc. shall be recognised as liability.
- Part-payments received in respect of lease rent / ground rent shall be accounted as income.
- In cases where a provisional assessment is made, revenue shall be recognised in respect of the entire amount received provisionally. At the time of final assessment, the additional amount recovered / refunded, if any shall be adjusted in revenue as and when money received / paid/ refunded.

5.05 Audit of Other Revenue

The auditor should examine that income on account of various activities, irrespective of method of accounting followed is generally accounted on receipts of money in respect of following:

- Registration fee and trade license fee;
- Delayed / penal interest element and penalties on any revenue;
- Revenue in respect of property transfer charges;
- Subdivision charges/ merger charges;
- Building plan approval fee;
- Amount of security forfeited accounted as income in the year of approval of the same;
- The transit deposit and/or any other deposit received if forfeited shall be recognised as income in the year in which the right for claiming refund of deposit has expired.

The auditor should examine the accounting policy and ensure that appropriate disclosure is made in respect of the accounting of other items of income. Interest from FDR / bank balances in accrual system of accounting is accounted on due basis whereas in cash system of accounting interest income may be accounted on receipt basis.

5.06 Audit of Transactions: Agency Business

Many of these entities are acting as an agent of the Government and involved in various activities such as collection of revenue like cess / fee etc. In such a situation the auditor is required to examine that:

- Collections made on behalf of State Government i.e. on account of State Education Cess, Employment Guarantee Cess and Library Cess etc. shall be identified separately and credited to amount payable to State Government.
- The liability towards any dues to the State Government for collections on its behalf shall be recognised as and when they are collected.
- Revenue in respect of rebate from State Government for collection made on their behalf shall be recognised at the rates prescribed by the State Government based on methodology as prescribed.

Audit of Expenses

5.07 Where an entity follows accrual basis of accounting, recognition of expenditure is made as they are incurred (and not as money is paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments.

The auditor shall examine that:

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- All expenditures are accounted on accrual basis as and when incurred.
- Repairs and maintenance expenditures are accounted for related works contracts based on work certification made at the end of the accounting year and necessary provision are made in the accounts.
- All administration and staff expenses like salaries and other allowances shall be recognised as and when they are due for payment. In case payment is not made provision is required for the same.
- Interest on borrowings is accounted based on the terms of the loan borrowed up to the end of period and liability for interest accrued but not due for payment is accounted for.
- Retirement benefits are accounted as per actuarial valuation in accordance with the applicable accounting standard.

5.08 In case where the entity follows the cash basis of accounting, the accounting of the expenses is made as and when money is paid. In these cases, the auditor shall examine that:

- All expenditure is accounted on payment in cash or by cheque during the accounting period.
- No expenditure is accounted without payment in respect of works contracts based on work certification even if completion of the work executed before the end of the accounting year.
- No liability is created for works completed/ executed in the accounts in respect of any work contract.
- Any payment made through banks reflected in the bank statement on or before the end of the accounting year

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which relates to expenses are accounted as expenses in the current accounting year.

- No expenditure is accounted in respect of grant, assistance, award, prize or support of any kind to any agency or public based on the approval / declaration of assistance in absence of actual payment.
- Transaction of advance payment made is required to be identified and accounted as assets recoverable / adjustable.
- Payment made to vendors of the capital assets are required to be identified separately and accounted as assets / CWIP as the case may be.

Accounting of Government Grant

5.09 Accounting of Government Grant is generally made as per Accounting Standard 12, 'Accounting for Government Grants'. The auditor shall examine the compliance of the accounting standard made during the audit while verification of the transactions related to grant.

Revenue Grant

5.10 Many of these entities are getting the Government grant of revenue nature which is in the form of compensation for administration of various social amenities, such grant is recognised in the account as revenue grant as follow:

- Revenue grant recognised as income on actual receipt where entity follows cash basis of accounting. Under accrual system of accounting, revenue grant is accounted as income as and when it becomes receivable to the entity. Such a grant is recognised in the income statement of the period in which it becomes receivable based on the Government sanction / approval.
- Conditional revenue grant is recognised as revenue, to

the extent the amount incurred for the purpose for which the grant is received, where conditions are stipulated by the Government / grantor for end use of the grant for specific purpose. Unutilized conditional grant is accounted as refundable to the extent not utilised for specific use as per terms of sanction of grant. Grants received or receivable in respect of specific expenditure shall be recognised as income in the accounting period in which the corresponding revenue expenditure is charged to the expenditure account. In case of cash basis of accounting, however, the entity may record the conditional revenue grant on receipt basis as income and on payment towards expenditure as revenue expenses. In the year of refund, if any, it may be treated as expenditure.

Non-monetary Grant

5.11 Entities may receive non-monetary grant from the Government in the form of land or other resources, given at concessional rates.

Irrespective of the method of accounting used, in these circumstances, it is usual to account for such assets at their acquisition cost. Further, non-monetary assets given free of cost are recorded at a nominal value.

Capital Grant

5.12 Many of these entities are getting the capital grant from the Government for specific fixed assets with the condition to purchase, construct, or otherwise acquire such asset. Further, the Government also stipulates certain conditions with respect to its location, use and period to hold etc.

AS 12 prescribes two methods of presentation of capital grant in the financial statements related to specific fixed

assets, the entity may opt any of the method and follow it consistently.

Under the first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. There may be situation where the grant equals the whole, or virtually the whole, of the cost of the asset, in such situation the asset is shown in the balance sheet at a nominal value.

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. The allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged.

Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

The deferred income is suitably disclosed in the balance sheet, it is shown after 'Reserves and Surplus' but before 'Secured Loans' with a suitable description, e.g., 'deferred government grants'.

5.13 The auditor should review the accounting policy disclosed in respect of accounting of the grant and examine following specifically in case of accrual basis of accounting:

- a. Verify the conditions for sanction of the grant and the purpose for which grant is sanctioned.

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- b. Verify the conditions related to non-utilisation of the grant and situation where refund required to be made.
- c. Verify the compliance of the conditions attached to the sanction of grant and its utilisation for the specific assets and other conditions stipulated.
- d. Ensure that proper accounting policies in respect of accounting of the revenue grant and capital grant and appropriate disclosures as required by the accounting standard are made in the financial statements.
- e. Verify that the accounting treatment of the grant is made in accordance with AS 12.
- f. Ensure that capital grant received towards capital expenditure shall be treated as a liability till such time amount is not utilised for constructed or acquisition of assets. The capital grant should be considered utilised partly to the extent the expenditures are incurred on capital asset.
- g. Verify that grant received in the form of non-monetary assets (such as fixed assets given at a concessional rate) shall be accounted for on the basis of the acquisition cost, and appropriate disclosure in accounting policies and notes are made in this regard.
- h. Verify instances of non-monetary assets received free of cost from Government, it should be recorded in accounts at a nominal value (e.g. Rupee One).

In case any non-compliance of AS 12 is observed where the entity is following accrual system of accounting, the auditor is required to refer the accounting policy in respect of the grant and make appropriate disclosure about the non-compliance of the accounting standard in his report.

Accounting of Revenue from Sale of Land and Plots

5.14 Many of these entities are engaged in the activities of development of the residential schemes and sale of plots to the public, where payments towards the sale consideration are permitted in instalments over the period as specified in the terms of allotment / sale.

Accrual Basis of Accounting

5.15 Where the entity follows accrual basis of accounting, the revenue from real estate transactions, if any, is required to be accounted as per AS 9, "Revenue Recognition".

5.16 Accounting in respect of sale of land / plots is made based on allotment made and receivables are accounted based on the terms of allotment where buyer of the land entered contract to repay the sale consideration as per terms of allotment. Revenue from sale of land is accounted when the entity is legally entitled to recover and receive the amount of the sale effected.

Cash Basis of Accounting

5.17 Where these entities are following cash basis of accounting and expenditure paid on development activity is charged to revenue and no stock of unsold area / plots are recognised in the accounts. The revenue from sale of the plots is recognized on allotment to the extent of amount of receipts.

In cash basis of accounting where post allotment sale is cancelled the accounting of reversal of the sale is made whenever decision of refund / forfeiture is made and accounted accordingly. Interest on delayed payment is accounted as and when interest is received.

The sale consideration of the plot includes other applicable levies, like lease money, drainage and sewerage charges, urban improvement tax/ cess and layout plan charges etc., which is demanded from the buyers on allotment / sale confirmation. The appropriation of the sale consideration

received is made first towards the sale consideration and later towards the other levies and taxes or as in the manner as disclosed in the accounting policy.

5.18 The auditor should verify the accounting policy followed by the entity in respect of accounting of revenue from the sale of the land and examine the following:

- a. The auditor should verify the system of accounting followed by the entity and policy related to accounting the revenue disclosed in the accounts;
- b. That the accounting of the revenue has been made as per the policy disclosed in the accounts and the policy is consistently followed;
- c. In case the entity follows accrual system of accounting, the compliance of applicable Accounting Standards;
- d. In case the entity follows cash system of accounting, the auditor shall ensure the compliance of the policy and accounting made in this regard.

5.19 While performing an audit of these entities, the auditor is required to examine the accounting policy and methodology followed for recognition of the revenue from sale of land/plot. Further to this, the auditor is required to assess that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the entity as at the balance sheet date and of the surplus or deficit for the period ended on that date.

Accounting Policies and Explanatory Notes

5.20 It should be examined that the notes to the financial statements of an entity should present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and provide

additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity's financial statements. Further, notes to the financial statements should be presented in a systematic manner.

5.21 The auditor should examine and verify that the accounting policies followed by the entity are disclosed in the financial statements. The auditor should examine that accounting policies should describe all significant accounting policies that are necessary for a proper understanding of the financial statements. Further, it should be clearly communicated to the entity that inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.

Consistency of Presentation

5.22 The auditor should examine and review that the entity consistently follows the manner of presentation and classification of items in the financial statements from one period to next until significant change in the nature of the operations of the entity or a review of its financial statements presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or a change in presentation is required by an amendment to accounting standards or a change in legislation.

Comparative Information

5.23 The auditor should examine that comparative information should be disclosed in respect of the previous period for all information presented or required to be disclosed in the financial statements. Comparative information also needs to be included where/when it is relevant to an understanding of the current period's financial statements.

Reporting

5.24 Apart from the reporting requirements of the respective Act/ Rules, if any, under which these entities are formed, the auditors should report on the financial statements in accordance with the requirements of Standards on Auditing to the extent applicable.