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PG AND RESEARCH DEPARTMENT OF COMMERCE

AUDITING

INTRODUCTION

Auditing is an important professional task carrying heavy responsibility and calling for commensurate skill and judgment.

In the early stages of civilization, the methods of maintaining accounts were very crude. The size of business-houses was very small and with little amount of capital, the number of transactions to be recorded was so small that each individual was in a position to maintain his accounts and check for himself all his transactions.

ORIGIN OF AUDITING

The origin of auditing may be traced back to the 18th century when the practice of large-scale production was developed as a result of Industrial revolution. However, it is difficult to ascertain when auditing, as we know it today, came into vogue. It is found that some systems of checks and counterchecks were applied for the purpose of maintaining public accounts, rather accounts of public institutions as early days of ancient Egyptians, the Greeks and the Romans.

Meaning of Auditing

The term audit is derived from the latin word “Audire”, which means, “To hear”. In early days, the objects of audit were to verify the receipts and payments. Separate persons were appointed to check the accounts. Their duty was to hear from the book-keepers matters relating to the transactions of the business.

In 15th century was an important period during which a great impetus was given to trade and commerce by the Renaissance in Italy and the principles of double entry book keeping were evolved and published in 1494 at Venice (Italy) by Luca Pacioli. He mentioned and described the duties and responsibilities of an auditor. Since, then, there have been lot of changes in scope and definition of audit and the duties and responsibilities of an auditor.

Definition of Auditing

Spicer and Pegler: "Auditing is such an examination of books of accounts and vouchers of business, as will enable the auditors to satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and that the profit and loss account gives true and fair view of the profit/loss for the financial period, according to the best of information and explanation given to him and as shown by the books; and if not, in what respect he is not satisfied."

The book "an introduction to Indian Government accounts and audit" "issued by the **Comptroller and Auditor General of India**, defines audit “an instrument of financial control. It acts as a safeguard on behalf of the proprietor (whether an individual or group of persons) against extravagance, carelessness or fraud on the part of the proprietor's agents or servants in the realization and utilisation of the money or other assets and it ensures on the proprietor's behalf that the accounts maintained truly represent facts and that the expenditure has been incurred with due regularity and propriety. The agency employed for this purpose is called an auditor."

FEATURES OF AUDITING

1. Audit is a systematic and scientific examination of the books of accounts of a business;
2. Audit is undertaken by an independent person or body of persons who are duly qualified for the job.
3. Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.
4. Audit is a critical review of the system of accounting and internal control.
5. Audit is done with the help of vouchers, documents, information and explanations received from the authorities.
6. The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

7. The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

OBJECTIVES OF AUDITING

There are two main objectives of auditing, the primary objective and the secondary or incidental objective.

1. Primary objective

As per Section 227 of the Companies Act 1956, the primary duty (objective) of the auditor is to report to the owners whether the balance sheet gives a true and fair view of the Company's state of affairs and the profit and loss A/c gives a correct figure of profit of loss for the financial year.

2. Secondary objective – it is also called the incidental objective as it is incidental to the satisfaction of the main objective. The incidental objectives of auditing are:

I. Detection and prevention of Errors, and

II. Detection and prevention of Frauds.

I. Detection and Prevention of Errors

Error refers to unintentional mis-statements or mis-descriptions in the records or books of accounts by the books keepers. In other words, they are unintentional mistakes arising on account of negligence or ignorance. Errors may be basically of two types :

(A) Principal Errors and

(B) Clerical Errors

(A) Errors of Principle:

These errors arise generally when the principles of accountancy are not observed while recording a transaction. For instance a capital expenditure is recorded as revenue expenditure or vice versa. Such errors are difficult to detect as the Trial Balance tallies inspite of such errors. Basically it arises on account of ignorance of accounting principles. Following are the examples of principles errors:

1. Wages paid for installation of plant and machinery is recorded as wages paid to workers
2. Revenue receipt is recorded as a capital receipt
3. Incorrect provisions for doubtful debts
4. Incorrect provisions for discount on debtors
5. Rent paid to landlord debited to the landlord account instead of rent ac account
6. Overvaluation or undervaluation of stock on account of ignorance

(B) Clerical Errors: These errors arise on account of negligence of the accounting staff. They are called technical errors clerical errors may be further divided as errors of omission, Errors of Commission.

1. Errors of Commission:

It includes posting errors, casting errors and totalling errors. For example ale to A has been recorded in B's A/c, it is a posting error or it is recorded in A's A/c but the amount is wrongly recorded. Similarly the balance of Rs.510 is carried forward as Rs.501, and then it is a casting error. Certain errors will not affect the trial balance for example posting in a wrong account will not affect the trial balance but if there is a totalling error or a casting error then the trial balance does not agree.

2. Errors of Omission:

In the process of recording the accounting clerk may omit a transaction from recording either fully or partially. If a transaction is fully omitted, then it will be difficult to trace out, as both the debit and the credit are missing and the trial balance will tally inspite of these errors. However if a transaction is partly omitted, then only one aspect of the transaction is recorded. In this case it is easier to locate such an error.

C. Errors of Duplication: Errors of duplication arise when an entry in a book of original entry has been made posted twice. These errors do not affect the agreement of trial balance hence can't be located.

D. Errors of Compensation: An error of compensated or counter balanced by another is called compensating errors. Compensating errors will not affect the trial balance and as such, will not be detected easily. These errors may or may not affect the profit and loss account

II. Detection and Prevention of Frauds

According to the standard Auditing practices issued by the Institute of Chartered Accountants of India, the term fraud refers to intentional misrepresentation of finance information by one or more individuals among management or third parties. In other words, it is intentional or wilful misrepresentation r deliberate concealed of a material fact with a view to deceive, cheat or mislead another person.

Frauds may be of different types:

1. Manipulation of accounts,
2. Misappropriation of cash,
3. Misappropriation of Goods.

1. **Manipulation of Accounts:**

   Manipulation of accounts is said to be committed when a person makes a false entry in the books of accounts knowing it to be wrong, alters or destroys a true entry in the business records or prevents the making of a true entry in the business records. Normally it is done by people at the top management level. It is done to overstate or understate the profits and the financial conditions of the business so as to serve their purpose.

1. Manipulation may be done in any of the following ways :
2. Non provisions of depreciation on fixed assets
3. Overvaluation or undervaluation of assets
4. Recording revenue expenditure as capital expenditure
5. Showing expenses of the next year in the current year’s profit and loss account
6. Not recording currents year’s accrued expenses etc.

A common form of manipulation of accounts is known as “window Dressing.”

2 Misappropriation of Cash:

Misappropriation of cash is also called embezzlement of cash. It means fraudulent appropriation of cash belonging to another person by one who has been entrusted to it. Misappropriation may take place in the following ways:

1. Not recording full cash sales and pocketing a part of the proceeds
2. Teeming and Lading
3. Misappropriation the money received from sale of goods sent on sale or return basis
4. Making fictitious entries in customer’s accounts for bad debts, discount etc.
5. Misappropriation the amount received from sale of defective goods by not recording such sale
6. Recording fictitious cash purchase
7. Recording payments to fictitious creditors
8. Not recording discounts received from creditors
9. Recording payments to dummy or ghost workers and pocketing the money, etc.

3 Misappropriations of Goods:

It refers to fraudulent application of goods by those who handle them. It can be done by recording sales of larger quantities and misappropriating the balance or by recording purchase of large quantities receiving less quantity and then receiving the balance amount privately.

BASIC PRINCIPLES OF AUDIT

AAS-1 describes the basic principles, which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out. These are:-

1. Integrity, objectivity and independence:

The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and appear to be free of any interest which might be regarded. Whatever it's actual effect, as being incompatible with integrity and objectivity.

2. Confidentiality:

The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is legal or professional duty to disclose. It is remarked that an auditor should keep his ears and eyes open but his mouth shut.

3. Skill and competence:

The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence. This can be acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognized for this purpose and practical experience under proper supervision.

4. Work performed by others:

When the auditor delegates work to assistant* or uses work performed by other auditors or experts, he will continue to be responsible for forming and expressing his opinion on the financial information. At the same time he is entitled to rely on work performed by others provided he exercises adequate skills and care and is not aware of any reason to believe that he should not have relied. The auditor should carefully direct, supervise & review work delegated by assistants. He should obtain reasonable assurance that work performed by other auditors or experts is adequate for this purpose.

5. Documentation:

The auditor should document matters, which are important in providing evidence that the audit was carried out in accordance with the basic principles.

6. Planning:

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of client's business. They should be further developed and revised, if required, during the course of audit.

7. Audit evidence:

The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive test procedure. It will enable him to draw reasonable conclusions there from on which he has to base his opinion on the financial information.

8. Accounting system & internal control:

The auditor should gain an understanding of the accounting system and related internal controls. He should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

9. Audit conclusions and reporting:

The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. The audit report should contain a written expression of opinion of the financial information. It should comply with the legal requirements. In case of a qualified opinion, adverse opinion or disclaimer of opinion is given or reservation on any matter is to be made reasons thereof.

Limitations of auditing

1. **Non-detection of errors/frauds:-**

Auditor may not be able to detect certain frauds which are committed with mollify intentions.

2. **Dependence on explanation by others:**

Auditor has to depend on the explanation and information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.

3. Dependence on opinions of others:

Auditor has to rely on the views or opinions given by different experts viz Lawyers, Solicitors, Engineers, and Architects etc. he can not be an expert in all the fields

4. **Conflict with others:**

Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal judgment plays an important role. It differs from person to person.

5. **Effect of inflation :**

Financial statements may not disclose true picture even after audit due to inflationary trends.

6. **Corrupt practices to influence the auditors** :

The management may use corrupt practices to influence the auditors and get a favourable report about the state of affairs of the organisation.

7. **No assurance** :

Auditor cannot give any assurance about future profitability and prospects of the company.

8. **Inherent limitations of the financial statements :**

Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgement of the owners. Certain non-monetary facts can not be measured. Audited statements due to these limitations can not exhibit true position.

9. **Detailed checking not possible :**

Auditor cannot check each and every transaction. He may be required to do test

AUDITING Vs INVESTIGATION

Points of difference	Auditing	Investigation
1. objects	The object is to find out whether balance sheet and profit and Loss account exhibit a rue and fair view of business.	It is undertaken to know the essential facts about a matter under inquiry. It is done with some special Purpose of view.
2 period	It usually covers one accounting year.	It may cover more than one accounting year.
3 conducted	It is conducted for proprietors only.	It is carried out on behalf of any party interested in the matter.
4 scope	It is restricted to balance sheet and profit and toss account.	It is wider in scope. It may be carried out beyond balance sheet.
5. compulsion	Audit is legally compulsory for companies.	It is voluntary. It is required under certain circumstances.
6 time	It may be conducted at the end of the year.	It may be conducted at any time in case of suspicion about any transaction.
7. report	Form of report is prescribed. It is presented to the shareholders.	Form of report is not prescribed. It is presented to the client.
9. qualifications	Owners appoint the auditors.	Even third party can appoint an investigator.
9. qualifications	The statutory auditors must posses proper qualifications.	Even an employee preferably a chartered accountant may be appointed as investigator.
10. rework	Re - audit is not generally undertaken.	Re - investigation may be undertaken.

Accounting Vs Auditing

Points of difference	Accounting	Auditing
1. meaning	It is recording of all the day to day transactions in the books of accounts leading to preparation of financial statements.	It is the critical examination of the transactions recorded in the books of accounts.
2. nature	It is concerned with finalisation of accounts.	It is concerned with establishment of reliability of financial statements.
3. objects	The object is to ascertain the trading results.	The object is to certify the correctness of financial statements.
4. commencement	Accounting commences when book keeping ends.	Auditing begins when accounting ends.
5. scope	It involves various financial statements. It involves maintenance of books of accounts. It does not go beyond books of accounts.	It depends upon the agreement or upon the provisions of law. It goes beyond books of accounts.

ADVANTAGES OF AUDITING

A. For Business itself

1. The accounts of a business and its financial position can be examined by an independent and qualified auditor.
2. Errors and fraud are located very easily at an early date and chances of their further occurance are reduced to the minimum.
3. The auditing of accounts makes the clerks who maintain them alert, careful and vigilant, and more so they prepare accounts very carefully in future and keep them up to date.
4. Money can easily be borrowed from banks and other money lenders on the basis of properly audited accounts.

B. For the management:

1. To detect and prevent errors and frauds.
2. To get advice on financial affairs.
3. To compare the statement of one year with previous years because of their uniformity.
4. To borrow money from financial institutions and banks.
5. To review the system of internal check and control.

C. For others:

1. The insurance companies can easily settle their claims arising on account of loss by fire.
2. In the case of amalgamation and absorption, the purchasing company can calculate purchase consideration on the basis of audited accounts.
3. Audited accounts are very useful to settle disputes for higher wages or bonus.
4. The taxation authorities can very well rely on the audited accounts for purpose of imposing sales tax, income tax, wealth tax etc.,

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8. **Inherent limitations of the financial statements :** Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgement of the owners. Certain non-monetary facts can not be measured. Audited statements due to these limitations can not exhibit true position.
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ACCOUNTANT

Accountant is a man who supervises and analyses the work of a book keeper and finds out the results of a final accounts. Accounting is concerned with the preparation of the final accounts to show the results of the business at the end of the particular period. Modern accounting has become the foundation of the whole structure of commerce. It serves as eyes and ears to management.

AUDITOR

He is a person who critically examines the record of accounts books, vouchers, balance sheet and profit and loss accounts. He satisfies about the accuracy of accounts. If the balance sheet does not represent the true picture of the business, auditor reports to the share holders. Sometimes he also advises to the company.

DIFFERENCE BETWEEN ACCOUNTANT AND AUDITOR :-

We may find the following differences in them :

1. **Meaning:** Accounting means the maintaining of the books of accounts. Auditing means examining the books of accounts and reporting means to report about their accuracy.

2. **Performance of Work:** Accountant job is performed by the accountant. and Auditing job is performed by the auditor.
3. **Appointment:** Accountant is appointed by the management where as Auditor is appointed by the share holders.
4. **Nature of Job:** Accountant job is a mechanical nature and Auditor job is not so mechanical in that sense.
5. **Qualification :** For the accountant no specific qualification is required whereas the auditor specific qualification is required.
6. **Responsibility :** Accountant responsibility is fixed by the management and auditor responsibility is fixed by law.
7. **Submission Of Report :** Accountant is not required to submit any report. Auditor is required by law to submit the report.
8. **Fixation Of Rights:** Rights and duties of accountant are fixed by the management. Rights and duties of an auditor are fixed by the law.

9. **Time :** In case of accounting, period is usually one year and the period of auditing is usually less than one year.
10. **Purpose :** Accounting purpose is to show the financial position of the business. Auditing verifies the true picture of the financial statement.
11. **Record / Data :** Accounting is related with the present record, whereas Auditing is related with the past record.
12. **Employment :** Accountant is a permanent employee. Auditor is not a permanent employee.

13. **Reward:** Accountant reward is called salary. Auditor reward is called free.

14. **Liability:** After preparing the final accounts accountant has no liability whereas Auditor has liability after presenting the audit report.
15. **Importance:** Accounting is necessary for every business and Auditing is not necessary for every business.
16. **Rules :** Accounting is not governed by code of conduct laid down by the institute. Auditing is governed by the charted accountant code of conduct.
17. **Evaluation :** The accountant can not determine the efficiency of its own function and Auditor also cannot determine the efficiency of its own function but he can determine the efficiency of all the business.
18. **Methods :** Accounts uses the method of valuation and depreciation. The auditor uses manual and computerized method.
19. **Knowledge :-** Accountant must have the knowledge of accountancy. Auditor must have the knowledge of accounting as well as auditing.
20. **Removal :-** Accountant can be removed from his job at any time. Auditor can not be removed till the completes his period of appointment.
21. **End and Start :-** Auditing begins where accounting ends.

Qualities of auditor

I. **professional qualities**

1. Knowledge in Accounts
2. Knowledge in Business Law
3. Knowledge in techniques of auditing
4. Knowledge in computer Accounting
5. Knowledge in tax laws
6. Knowledge in economic laws
7. Knowledge in statistics and mathematics
8. Knowledge in audit case laws
9. Knowledge in business organization and management
10. Knowledge in technical details of business under audit.

II. **Personal Qualities:**

1. **Honesty**: An auditor must be honest in his work if he has to carry out his duties successfully.
2. **Tactful:** The auditor should be tactful in dealing with the client's staff.
3. **Ability to work hard:** The auditor must have a painstaking attitude and willingness to work hard.
4. **Impartial:** The auditor should not be influenced by any bias in discharging his duties. He should be impartial.
5. **Cautious and vigilant:** An auditor must be vigilant in his work.
6. **Methodical:** He must perform his duties methodically, and should be thorough, and complete in his work.
7. **Ability to trace out facts and figure**: Auditor should posses a realistic attitude towads his work. He should able to trace out facts and figures.
8. **Always inquisitive:** The auditor should not be suspicious. He should always be inquisitive.
9. **Courage:** The auditor should be bold enough to discharge his duties. He must not certify what he does not believe true.
10. **Ability to maintain secrets**: The auditor should have the ability to maintain secrets and should not disclose the secrets of his clients to anybody.
11. **Ability to communicate**: The auditor must have the ability to prepare audit report correctly and forcefully, precisely, concisely and clearly.
12. **Common Sense:** A auditor should posses a good common sense.

CLASSIFICATION OF AUDIT

Auditing are of many types. Geneally, they can be classified into broad categories. they are as follows:

1. classification on the basis of the organization
2. classification on the basis of the method of performance

A. Classification on The Basis of the Organization

1. Private Audit: Private concerns also differ in their form of organization. So the can again be classified into four types:

1. Audit of sole trading concerns
2. Audit of partnership firms
3. Audit of individuals
4. Audit of other private institutions

Though audit of accounts of private concerns is not compulsory, from 1985 onwards, if a private concern's turnover exceeds Rs. 40 lakhs, audit has been made statutory.

2. Audit under statute:

Definition of 'Statutory Audit': A legally required review of the accuracy of a company's or government's financial records. The purpose of a statutory audit is the same as the purpose of any other audit - to determine whether an organization is providing a fair and accurate representation of its financial position by examining information such as bank balances, bookkeeping records and financial transactions. In case of certain concerns, audit has been made compulsory. They are as follows:

1. Public corporation
2. Joint stock companies
3. Trusts
4. Banks
5. Co-operative societies
6. Other institutions.

3. Government Audit: Government audit is applicable to government department and departmental undertakings. Government of India maintains a separate department known as Accounts and Audit Departments. Government audit is divided into several branches like Defence, Railways, Posts and telegrams audit. It works only for government offices and departments.

4. Internal Audit: Internal audit is an examination of books of accounts, which is conducted by the salaried officials of a business firm known as internal auditors throughout the year. Thus, the scope of internal audit according to this traditional view limited. But today internal audit is considered as an effective means of control with view to scope.

DIFFERENCE BETWEEN INTERNAL AUDIT AND STATUTORY AUDIT

Following are the main points of difference between internal audit and statutory audit:

1. Appointment:

The management of the organization makes the appointment of an internal auditor. The statutory auditor is appointed by different authorities. First statutory auditors are appointed by the shareholders in the annual general meeting.

2. Qualification :

qualifications of the statutory auditor are prescribed in the companies act, 1956. Essentially a person should be a practicing chartered accountant to be appointed as a statutory auditor. There are no fixed qualification for the position of an internal auditor.

3. Objects:

The main object of the statutory audit is to form an opinion on the financial statement of the organization auditor has to state that whether the financial statements are showing the true and fair view of the affairs of the organization or not. The main object of the internal audit is to detect and prevent the errors and frauds.

4. Scope:

The scope of the statutory audit is fixed by the companyâ€™s act 1956. it can not be changed by mutual consent between the auditor and the management of the audited business unit. The scope of the internal audit is fixed by the mutual consent of the auditor and the management of the unit under audit.

5. Remuneration:

Remuneration of the statutory auditor is fixed by the appinting authority, I e in case of first auditors, the auditors the directors fix the Remuneration in case of the subsequent auditors the company in its general meeting fixes the remunration. In case of internal auditor the management who appoints him fixes his Remuneration.

6. Report :

The statutory auditor submits his report to the shareholder of the company in its general meeting. The internal auditor submits his report to the management of the company who is also his appointing authority.

7. Removal:

The procedure of removal of the statutory auditor is very complex. Only the company in the general meeting can remove the auditor. It also has to take the permission of the central government. The management of the entity can remove internal auditor.

DIFFERENCE BETWEEN INTERNAL AND EXTERNAL AUDIT

	EXTERNAL AUDIT	**INTERNAL AUDIT**
Reports	shareholders or members who are outside the organisations governance structure.	The board and senior management who are within the organisations governance structure.
Objectives	Add credibility and reliability to financial reports from the organisation to its stakeholders by giving opinion on the report	Evaluate and improve the effectiveness of governance, risk management and control processes. This provides members of the boards and senior management with assurance that helps them fulfil their duties to the organisation and its stakeholders.
Coverage	Financial reports, financial reporting risks.	All categories of risk, their management, including reporting on them.
Responsibility for improvement	None, however there is a duty to report problems.	Improvement is fundamental to the purpose of internal auditing. But it is done by advising, coaching and facilitating in order to not undermine the responsibility of management.

B. CLASSIFICATION ON THE BASIS OF THE METHOD OF PERFORMANCE

On the basis of performance audit can be classified into six types as shown below

1. Continuous Audit
2. Periodical Audit
3. Interim Audit
4. Balance Sheet Audit
5. Special Audit
6. Cost Audit

1. Continuous Audit:

A continuous audit is one where auditor’s staff is occupied continuously on the accounts the whole year round, or where the auditor attend at intervals fixed or otherwise, during currency of the financial year and performs an interim audit.

Advantages of continuous auditing

1. **Easy to quick discovery of errors:**

Errors and frauds can be discovered easily and quickly as the auditor checks the accounts at regular intervals and in detail. As an auditor visits the client after a month or two or so on, the number of transactions will be small and hence, the errors will be detected easily and quickly.

2. **Knowledge of technical details:**

Since the auditor remains more in touch with the business, s/he is in a position to know its technical details and hence can be of great help to her/his clients by making valuable suggestions.

3. **Quick presentation of accounts:**

As most of the checking works are already performed during the year, the final audited accounts can be presented to the shareholders soon after the close of the financial year at annual general meeting.

4. **Keeps the client's staff alert:**

As the auditor visits the clients at regular intervals, the clerks are very regular in keeping the accounts up-to-date. They will see that there is no in accuracy or frauds as it would be detected by the auditor at the next visit

5. **Moral check on the client's staff:**

If the auditor pays surprise visit, it will have a considerable moral check on the clerks preparing the accounts as they do not know when the auditor may pay a visit to check. Moral check will be more valuable to make staff alert and careful.

Disadvantages of Continuous Audit

1. **Alteration of figures:** Figures in the books of account which have already been checked by the auditor at previous visit, may be altered by a dishonest clerk and the frauds may be committed.

2. **Disturbance of client's work:** The frequent visits by the auditor may disturb the work if the client and cause inconvenience to the latter.

3. Expensive : Continuous audit is an expensive system of audit because an auditor devote more time. So, company needs to pay more amount as the remunerations of an auditor

4. Quaries may remain outstanding : The audit clerk may lose the thread of work and the queries which s/he wanted to make may remain outstanding as there might be a long interval between two visits.

5. Extensive note taking : Extensive note taking may be necessary in order to avoid any alteration in the figures after the audit.

2. PERIODICAL AUDIT

Annual audit or periodical audit is done at the close of the financial or trading period when final accounts are prepared. In such case, the auditor visits his client only once year and checks the accounts in one visit till he is not in position to cover the accounts pertaining to the whole of the period.

3. OCCASIONAL AUDIT:

As the name indicates, this type of audit is conducted once a while whenever the need arises and the client desire it to be carried out. This is possible only in case of proprietor concerns such as a soletrader’s business or partnership business.

4. OPERATIONAL AUDIT:

The idea of operational audit is of recent origin and has become a matter of wide concern with the expansion of industrial and economic activities. The operational audit is desired to aim at improve the profitability of industrial enterprise and also at achieving the other organizational objectives, social and otherwise.

5. MANAGEMENT AUDIT:

Management audit is also known as Efficiency audit. However, it can be said that the management audit is an audit conducted to examine all aspects of management in a business. Improvement in efficiency and maximum utilization of resources of a business are the tools for its success.

6. COST AUDIT:

By the term cost audit is meant the detailed checking of the costing system, technical and accounts to verify their correctness and ensure adherence to the objective of cost accountancy.

COVERAGE OF AUDIT: On the basis of coverage audit, the audit may be complete audit or partial audit.

7. COMPLETE AUDIT

When an auditor is appointed to check each and every transaction, total balance, book of accounts with the help of the relevant vouchers, documents, correspondence, etc., it is said to be complete audit. Under complete audit, nothing is to be left from checking by an auditor. But complete audit is neither practicable nor feasible.

The final audit lacks the advantages which result in the case of continuous audit. If the auditor has several clients whose financial year ends on the same date, it may be difficult for the auditor to finish the work of all his clients. But the advantages are that there is less danger of manipulation of figures after they have been checked.

This type of audit is satisfactory especially in the case of small concerns. This class of audit is usually adopted by almost all concerns. But in the case of large concerns, it takes more time to complete the audit and hence presentation of accounts to the shareholders is delayed.

8. PARTIAL AUDIT:

In the case of complete audit, all the records and books of accounts are subjected to audit by the auditor but when audit is conducted on some of the records and books of a part or whole of the period, it is called partial audit. Partial audit may relate to some part of the work for some or whole of the trading period. Partial audit is not practicable again.

9. BALANCE SHEET AUDIT:

As is apparent from the name itself, in Balance Sheet audit, the auditor checks capital, reserves, assets, liabilities, etc., given in the balance sheet. He checks only for those documents which are related to the items given in the Balance sheet. Such an audit is not conducted to check Profit and Loss account and similar transactions. The work of auditors is confined to the Balance Sheet alone.

10. INTERIM AUDIT

An annual audit is one which is conducted at the close of the financial year and an interim audit is that kind of audit which is conducted for a part of the accounting year with some interim purpose. Such an interim purpose may be, for example, declaration of an interim dividend by a joint stock company.

11. FINANCIAL AUDIT:

Financial audit is examination of financial statements to express opinion on the truth and fairness condition and operating results of the entity. The statutory or external audit is generally financial audit.

WHAT DO YOU MEAN BY INTERIM AUDIT? EXPLAIN ITS MERITS AND DEMERITS.

The audit is conducted in between two annual audits. Generally, this audit is conducted to find out interim profits so that interim dividend declaration is possible. In another sense, this audit is conducted between two Periodical or Balance Sheet Audits.

Advantages of Interim Audit

1. This type of audit is to be conducted where the publication of interim figures are necessary.
2. Completion of final audit is easy.
3. Errors and frauds can be detected during the course of the year.
4. There is a moral vigil on the staff of the client in this type of audit.

Disadvantages of Interim Audit

1. Chances for alteration of figures after the audit
2. The auditor has to prepare notes while finishing his interim audit.
3. This audit adds the work burden.

AN AUDITOR IS A WATCH DOG BUT NOT A BLOOD HOUND – DISCUSS.

With regard to qualities of an auditor, a famous judge L.G. Lopes in the case of Kingston Cotton Mills Company (1896) referred that:

'An Auditor is not bound to be detective or to approach his work with suspicion, or with the foregone. conclusion that there is something wrong. He is a watch dog but not a blood hound. He is justified in believing tried servants of the company and is entitled to rely upon their representation provided, he takes reasonable care'.

i. **An auditor is a watch dog**

Like a watch dog, an auditor makes every effort to safeguard the interest of his client. He is always very alert and detects error and frauds; He used to be very honest and tact and inform the clients whenever he suspects.

ii. **Auditor is not a blood hound**

Duty of auditor is not a blood – hound. He believes the servants of the company and relies upon their representation made because he examines the records prepared by them. It is not his duty to harm those who commit frauds, errors and misappropriation. He shall not harm the persons whose work he has to certify. He should be very loyal, honest, tactful, sincere and systematic.

MEANING OF AUDIT PROGRAMME

Audit programme is nothing but a list of examination and verification steps to be applied set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statement of account produced for audit or on the basis of an appraisal of the accounting records of the client.

An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.

FACTORS OF AUDIT PROGRAMME

While construction an audit programme, the Auditor should keep the following points in his mind-

- to operate within the scope and limitations of the assignment.
- to determine the avidence reasonably available and identify the best avidence for deriving the necessary satisfaction.
- to apply only those steps and procedures, which are useful in accomplishing the verification purpose in the specific situation.
- to consider all possibilities of error.
- to co-ordinate the procedures to be applied to related items.

ADVANTAGES OF AUDIT PROGRAMME

1. It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
2. It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
3. Selection of assistants for the jobs on the basis of compatibility becomes easier when the work is rationally planned, defined and segregated.
4. Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger is significantly less and the audit can proceed systematically.
5. The assistance, by putting their signature on programme, accepts the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
6. The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
7. It serves as a guide for audits to be carried out in the succeeding year.
8. A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

DISADVANTAGES OF AUDIT PROGRAMME

1. The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
2. The programme often tends to becomes rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.

3. Inefficient assistants may take shelter behind the programme i.e., defend deficiencies in their work on the ground that no instructions in the matter is contained therein.
4. A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.
5. All these disadvantages may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observed matters objectively and bring significant matters to the notice of supervisor/principal.

AUDIT WORKING PAPERS

MEANING:

The audit working papers constitute the link between the auditor's report and the client's records. Documentation is one of the basic principles listed in AAS 1. according to AAS 3 (reproduced in Appendix l), documentation refers to working papers prepared or obtained by the auditor and retained by him in connections with performance of his audit.

OBJECTS OF AUDIT WORKING PAPERS

The objects of an auditor's working papers are to record and demonstrate the audit work from one year to another. Therefore, working papers should provide for:

1. Means of controlling current audit work;
2. Evidence of audit work performed;
3. Schedules supporting or additional item in the accounts; and
4. Information about the business being audited, including the recent history.

Working papers are varied in nature but the foundation of all working paper can be traced to:

1. the basic constitutional document like memorandum and Articles of association, partnership Deed, trust deed, etc.;
2. the contents of the minute books;
3. the contents of the balance sheet and the profit and loss account; and
4. the letter of engagement.

IMPORTANCE OF AUDIT WORKING PAPERS:

I. IT provides guidance to the audit staff regard to the manner of checking the schedules.
II. The auditor is able to fix responsibility on the staff member who signs each schedule checked by him.
III. It acts as an evidence in the court in the court of law when a charge of negligence is brought against the auditor.
IV. It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retained them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

FACTOR DETERMINING FORM AND CONTENTS OF AUDIT WORKING PAPERS:

Working papers should record the audit plan, nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. The form and content of working papers are affected by matters such as:

1. Nature of the engagement.
2. Form of the auditor's report.
3. Nature and complexity of the client's business.
4. Nature and condition of the client's records and degree of reliance on internal controls.
5. Need in particular circumstances for direction, supervision and review of work performed by assistants.

Working papers should be designed and properly organized to meet the circumstances of each audit and the auditor's needs in respect thereof. The standardization of working papers (for example, checklists, specimen letters, standard organisation of working papers) improves the efficiency with which they are prepared and reviewed.

MAIN FUNCTIONS/ IMPORTANCE AUDIT WORKING PAPERS

1. It provides guidance to the audit staff with regards to the manner of checking the schedules.
2. The auditor is able to fix responsibility on the staff member who sign each schedule checked by him.
3. It acts as an evidence in the court of law when a charge of negligence is brought against the auditor.
4. It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirement of record retention.

ESSENTIALS FEATURES OF AUDIT WORKING PAPERS

As audit working papers are quite useful they should be prepared properly. They should have the following essentials:

a) **Standard form -** they should be prepared in a standard form. The subject matter should be arranged under various heading and sub- headings.
b) Proper layout – there should be proper design and layout of the working papers. This will bring uniformity into the maintenance of working papers.
c) **Space for margins –** there should be enough space for margin after each note for noting down the auditor's remarks and decisions.
d) **proper organisation and arrangement –** the working papers should be properly organized and arranged. In other words the working papers should be so organized and arranged that the auditor will be able to locate any particular matter easily.
e) **Completeness –** the audit working papers should be complete in all respects. They should contain detailed information on all essential facts or points.
f) **Clarity and Accuracy** – the working papers should be quite clear and self explanatory. The information contained in the working papers should be accurate.
g) **Good quality paper** – paper of good quality should be used for working papers as they are subject to frequent handling further the paper used should be of uniform and convenient size so that they can be easily filed.

UNIT II

INTERNAL CONTROL

Introduction

Internal control means different things to different people. This causes confusion among businessman, legislators, regulators and others. Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

1. Effectiveness and efficiency of operations.
2. Reliability of financial reporting.
3. Compliance with applicable laws and regulations.

The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources. The second relates to the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases, reported publicly. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

Definitions of Internal Control

De Paula [1989] defined internal controls as a system of controls, financial and otherwise established by management in order to carry on the business of the company in an orderly and efficient manner to ensure the adherence to management policies, safeguard the assets, and secure as much as possible the completeness of an internal control system.

Thomas Evans, in his book "International Accounting and reporting "defines internal controls as policies and procedures that an organization develops to safe guard its resources and provide for the reliability of financial records.

The **International Standards of Auditors** define internal controls as a system comprising of controls environment and procedures. It includes polices and ways adapted by management of an enterprise to assist it in achieving its objectives.

Nature of Internal control
Internal controls can be detective, corrective, or preventive by nature.
1. Detective controls are designed to detect errors or irregularities that may have occurred.
2. Corrective controls are designed to correct errors or irregularities that have been detected.
3. Preventive controls, on the other hand, are designed to keep errors or irregularities from occurring in the first place.

SCOPE OF INTERNAL CONTROL SYSTEM
It is very important to have an internal control system for an organisation. There is no universal model of internal control, system. It is up to every company to design an internal control system which is suitably adapted to its situation. Internal control is neither limited to a set of procedures nor to financial controls. Operational control such as quality control, work standards, budgetary control, periodic reporting, policy appraisal, quantitative controls etc are all parts of internal control system.

INTERNAL CONTROL OBJECTIVES
Internal control objectives are desired goals or conditions for a specific event cycle which, if achieved, minimize the potential that waste, loss, unauthorized use or misappropriation will occur. They are the conditions which we want the system of internal control to satisfy. For a control objective to be effective, compliance with it must be measurable and observable. Internal audit evaluates the organisation's system of internal control by accessing the ability of individual process controls to achieve seven pre-defined control objectives. The control objectives include:

1. **Authorization** - the objective is to ensure that all transactions are approved by responsible personnel in accordance with their specific or general authority before the transaction is recorded.
2. Completeness - the objective is to ensure that no valid transactions have been omitted from the accounting records.
3. **Accuracy -** the objective is to ensure that all valid transactions are accurate, consistent with the originating transaction data, and information is recorded in a timely manner.
4. **Validity** - the objective is to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.
5. **Physical Safeguards and Security** - the objective is to ensure that access to physical assets and information systems are controlled and properly restricted to authorized personnel.
6. **Error Handling -** the objective is to ensure that errors detected at any stage of processing receive prompts corrective action and are reported to the appropriate level of management.

7. **Segregation of Duties** - the objective is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing a transaction.

INTERNAL CONTROL ELEMENTS

Internal control consists of five interrelated components. These are derived from the way management runs a business, and are integrated with the management process. Although the components apply to all entities, small and mid-size companies may implement them differently than large ones. Its controls may be less formal and less structured, yet a small company can still have effective internal control. The components are:

1. **Control Environment:** The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.
2. **Risk Assessment:** Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.
3. **Control Activities:** Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.
4. **Information and Communication:** Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders.
5. **Monitoring:** Internal control systems need to be monitored—a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of

ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

ADVANTAGES OF INTERNAL CONTROL SYSTEM

1. **Increase in operational efficiency:**

One advantage of internal controls involves the efficiency they create. Technological advances to improve the accuracy of each transaction also streamline manual processes.

2. **Accurate Recording**

Another advantage of internal controls revolves around the accuracy in recording each transaction. Internal controls help prevent errors and irregularities from occurring. If errors or irregularities do occur, internal controls will help ensure they are detected in a timely manner. It creates confidence that only authorized transactions have taken place Safeguarding Assets It minimizes of the risk of fraud and misappropriation of assets. It involves fraud monitoring and prevention techniques. For example in case of a banking internal control system, mmonitoring activities include security cameras and security guards and prevention activities include cash counting by two employees at a time and cash reconciliation by non-tellers..

3. **Compliance**

Another advantage of using internal controls includes increasing compliance with regulatory agencies. Internal controls encourage adherence to prescribed policies and procedures. It assures that adequate documentation supporting transactions is created and retained.

4. **Protection of Employees**

Internal controls protect employees: 1) by clearly outlining tasks and responsibilities, 2) by providing checks and balances, and, 3) from being accused of misappropriations, errors or irregularities

5. **Benefits of Internal Control to the Auditor**

If the audit client benefits from a sound system of internal control, it is likely that the auditor will also be benefited. all of the above stated benefits help to promote a situation where the financial statements present a true and fair view. A good system of internal control will make life easier for the auditor

LIMITATIONS OF INTERNAL CONTROLS

No matter how well the internal controls are designed, they can only provide a reasonable assurance that
objectives will be achieved. Some limitations are inherent in all internal control systems. These limitations include:

1. **Judgment** - the effectiveness of controls will be limited by decisions made with human judgment under pressures to conduct business based on the information available at hand.
2. **Breakdowns** - even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes. Errors may also result from new technology and the complexity of computerized information systems.
3. **Management Override** - high level personnel may be able to override prescribed policies or procedures for personal gains or advantages. This should not be confused with management intervention, which represents management actions to depart from prescribed policies and procedures for legitimate purposes.
4. **Collusion** - control system can be circumvented by employee collusion. Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems. A well designed process with appropriate internal controls should meet most if not all of these control objectives.

INTERNAL CHECK

Internal check is best regarded as indicating checks on the day-to-day transactions which operate continuously as a part of the routine systems whereby work of one person is proved independently or is complementary to the work of another, the object being the prevention of or early detection of errors and frauds". The main objective of internal check is prevention of errors and frauds and/or detection of errors and frauds at the earliest. Internal check is a continuous process and is part of the day-to-day routine. It relates to all the transactions that take place every day. Internal check is achieved by complementary allocation of duties and by independent verification of the work of one person by another. Internal check is a part of internal control system. It ensures that all financial transactions are properly recorded.

It also ensures efficiency of the accounting system followed by the organization and enables easy preparation of financial statements. It achieves its main object of minimizing errors and frauds. A sound system of internal check increases the reliability of financial statements. Internal check discourages fraud and collusion among employees by instilling a fear of detection in their minds. Internal check assigns responsibilities to persons and enables maintenance of records and documents properly and thereby ensures smooth flow of work.

DIFFERENCE BETWEEN INTERNAL CONTROL SYSTEM AND INTERNAL CHECK SYSTEM

1. Internal control is the system of control established by the management in order to carry on business in an orderly and efficient manner, ensure adherence to management policies, safeguard assets and completeness of records whereas Internal check is a system of allocation of responsibility, division of work and methods of recording transactions, whereby the work of one employee is checked continuously by another.
2. Internal check system is one part of internal control system. Internal control is broader concept as compare to internal check system; it contains many more types of controls other than the internal check system.
3. In internal control system, controls other than the internal check system are internal audit system and other non- financial control systems like quality control, purchasing controls, marketing controls etc. The essence of internal check system is that the check should be automatic, continuous and objective while the essence of internal control system is in implementation of Internal check and Internal audit.

DIFFERENCE BETWEEN INTERNAL CHECK AND INTERNAL AUDIT

1. **Way of checking:** In internal check system work is automatically checked whereas in internal audit system work is checked specially.
2. **Cost involvement:** in internal check system checking is done when the work is being done. Mistake can be checked at an early stage in internal check system.
3. **Thrust of system**: Thrust of internal check system is to prevent the errors and whereas the thrust of internal audit system is to detect the errors and frauds.
4. **Time of checking:** In internal check system checking is done when the work is being done whereas in internal audit system work is checked after it is done. Mistakes can be checked at an early stage in internal check system.

INTERNAL CHECK WITH REGARD TO CASH RECEIPTS:

1. The receipts of cash must be handled by a separate clerk known as the cashier. As soon as cash is received, it should be entered into a rough cash book or diary. He should not be authorized to keep with him, to make expenditure out of it and to make entries in the ledger and other books of prime entry.
2. All remittances should be opened by the cashier in the presence of a responsible officer who is not connected the office of the cashier, and should be immediately by means of a rubber stamp as "Not Negotiable"- a/c payee only.

3. It is necessary from time to time bank reconciliation statement should be prepared by the cashier to reconcile bank and cash balances.
4. A proper system of recording cash sales should be in operation under proper control and supervision of a senior officer.
5. All cash received must be remitted to the branch on the every day of receipt.
6. Before the cash in kept inside the vault, the cashier and the responsible official must check up the total cash and tally it with daily total of cash receipt.
7. Printed receipts must be issued for all remittances received. The receipts must be signed by a responsible official.
8. The unused receipt books should be kept in the safe custody of a responsible under lock and key.
9. There should be separate arrangement for the custody and treatment of the bills received.
10. The payments in to the bank should be verified the next day by the responsible official.
11. A Proper system of affecting and recording cash sales should be in operation under proper control and supervision.

INTERNAL CHECK REGARD TO CASH PAYMENTS:

1. A good system of internal check is one in which a separate person has charge of making paments.
2. Petty cash payment should be made by the petty cashier.
3. All Payments should be made by cheque, with the exception of those dealt with through petty cash.
4. It is necessary from time to time bank reconciliation statement should be prepared by the cashier to reconcile bank and cash balances.
5. Financial operations of business include expenditure towards purchases, manufacturing expenses, administrative expenses, selling and general expenses. Unless there is economy in expenditure the business returns will be less. Hence proper and systematic accountings of cash payments are necessary.
6. All cheques and bills should be scrutinized and signed by the proper authority.
7. Confirmation of accounts with the creditors should be made through direct correspondence.
8. All payments shall be made with proper authority and evidence in support of payments. Acknowledgement shall be obtained for all payments made.
9. All vouchers in support of payments shall be filed separately in serial order to facilitate verification. All payments as for as possible ones a certain amount shall be made by cheques.
10. Any payments should not made without the sanction of a responsible official who is authorized for the purpose of payments.
11. A proper system should be in operation for the payment of wages.

INTERNAL CHECK AS TO PURCHASES:

A purchase of goods may commence when a predetermined re-order level has been reached. The ensuing stages may be summarized as given below:

1. Authorization of Purchase requisition:

Check whether the requisitions are pre-printed, pre-numbered and authorized. See whether the purchase requisition have been authorized by competent official.

2. Issue of Request for quotation:

Check whether request for quotation have been issued or not. If not find the reasons of not issuing request for quotation. Check whether the requests for quotation have been issued to approved vendors.

3. Issue of Purchase order:

Check whether purchase order has been issued or not. If purchase order have been issued check whether it has been issued from the competent authority. Check whether the purchase order have been issued to the approved vendor who has given lowest quote. If not check the reasons. Check whether the reasons of issuing the purchase order to a vendor other than the lowest bidder have been approved by the competent authority.

4. Receipt of goods and entry of goods in store ledger:

Check whether the goods receipt is as per specification given in the purchase order. If not check whether the deviations have been recorded and the communication has been made to the supplier or not. Check whether the goods receipt have been properly recorded in store ledger or not.

5. Approval of payment of Supplier Invoice:

Check whether the amount has been approved by the competent authority.

6. Payment of supplier invoice:

Check whether the supplier bill have been paid correctly. Check whether all deduction for short receipt of goods, late delivery of goods, inferior quality of goods, advance payment for the goods have been done or not.

7. Accounting of Transaction:

Check whether accounting made is correct or not. Check whether correct expenses code have been debited or not. Check whether the applicable accounting standard have been complied with or not.

INTERNAL CHECK REGARDS TO PURCHASES RETURNS:

1. There should be a proper system of control in regard to purchase returns so that full credit may be ensured for all goods returned.
2. A statement should be prepared by the stores department for all goods returned.
3. The purchase departments should check such goods and prepare an advice note which should be sent to the Accounts departments.
4. The Accounts departments should further examine the advice note with original invoice and enter it in the purchase return book.
5. All goods returned should be entered in the purchase return book.
6. A credit note should be obtained from the supplier, that is, the creditor for each return of goods which should then be attached to the invoice if it is not yet paid.

INTERNAL CHECK AS REGARED SALES:

1. Check whether all the Sales of sold stock according to schedules. If not, prepare the list of the delay dispatches along with reason of the delay in dispatches.
2. Quantify the losses, for the material which are not dispatched with in time i.e. the company has paid the Airfreight/sea freight.
3. Check whether all the bills are made according to the purchase contracts with the customer. If not list out the discrepancy. Check the billing system and see whether the billing has been done through the authorized channel. Check for any informal billing system. If such system exists, analyze with management and report. List out the cases of delays in dispatches for sold & unsold stock after production. Also find out the average no of days taken to clear the stock after production. Review the system of stock records maintenance.
4. Check whether there is variance in actual and target sales prices. If so ascertain the reasons after discussions with marketing executives. Check whether the discount given is approved by the appropriate authority.
5. Invoice book should be prepared by the accounting department. The person responsible to prepare invoices will enter quantity, quality, price and any other particular invoice.

INTERNAL CHECK AS REGARDS SALES RETURNS:

1. All goods returned by the customers should be recorded in a goods inward book.
2. The statement of goods so returned when received should be sent to the dispatch department which should check it and then send it to the accounts department.
3. A credit note should then be prepared and singed by the responsible official before it is sent to the customer.
4. The sales return book should be written up with the help of the copies of credit notes issued. The number and date of credit notes should also be entered in this book.

The aim of such a system is to prevent an improper credit being passed in the books for fictitious returns and to avoid fraud involved in misappropriation equivalent cash.

INTRENAL CHECK AS REGARDS WAGES.

Wages are very important item of expenditure. There are great possibilities of frauds in concern employing a large number of workers. A suitable system of internal check for wages should be devised for the following objectives:

1. To avoid the inclusion of dummy workers in the list.
2. Payment of wages for right work to the right worker
3. To record the deductions properly.
4. To avoid the fraudulent manipulation of undistributed or unclaimed wages.

I. Maintenance of wages records:

1. Time records:

The time spent by each worker should be correctly recorded. For this purpose time recording clock, attendance register, and job cards should be used. The foreman in charge should initial the entries on the card. At the end of the week, the cards should be collected and sent to the wage office.

2. Piece-work records:

For piece-wage system each worker should be provided with a job card bearing his name, job number, nature of the work and the wage-rate. At the end, it is checked and this card is installed by the piece-work reviewer.

3. Overtime records:

Overtime cards should be sanctioned in advance by some authority who should issue overtime slips bearing the name and number of the worker. Such slips should be sent to the time keeper who then forwards them to the wage office.

4. **Pass-out records:**

The workers should not be allowed to leave the factory without the written permission. For this a pass-out slip is issued to the worker by same authority. Such slips are handed over to the gate keeper. The wage office should also be given copy of it.

II. Preparation of wages sheet: The wages should not be prepared by one clerk alone. A set of clerks should compare the records at the gate and the wage office and inquire about the difference, if any. For this the following point should be taken into account:

1. Base: The wages sheets should be prepared with the help of attendance register, overtime slip, and pass-out slip.

2. Separate sheets: Time-workers and piece-workers should be dealt in separate wage sheets

3. Checking: The wages sheet should be checked by some responsible official of the concern.

4. Signature: The wages sheets should be signed by those employees who participated in their preparation.

5. Approval: Each and every wages sheet should be approved by factory manager or managing director.

III. Payment of Wages:

1. Analysis:

Payment of wages is done by the pay clerk or cashier who draws from the bank the amount with coins required to cope with the wages.

2. Injunction:

Wages should not be paid by a person who took part in the preparation of wages sheets.

3. Identification:

Each worker should be asked to receive his wages personally in the presence of his foreman to identify him.

4. Care: Care should be taken that no payment is made to someone on behalf of a worker who is absent.

5. Cash department: Wages payment should be made by cash department, not by other persons.

6. Separate envelope: The amount of wages for each employee should be placed in an envelope bearing the name and number of the person.

7. Payment to absentees: Some special arrangements should be made for payment to the absentees.

8. Advance: Advances to workers should be discouraged and if it becomes unavoidable, they should be given through the petty cashier.

9. Casual workers:

If casual workers are also employed in the factory, a separate record should be maintained about them. They should be paid daily. Their daily records should be checked from time to time by some authority.

INTERNAL CHECK REGARDING STORES.

The stores department has charge of preserving and issuing stores to the different departments. If the stores are not kept under proper control and a proper system of internal check is not adopted, the chances of fraud will arise. Besides this, the maintenance of stores and purchasing functions should be separated.

1. Receipt of stores:

On receiving stores, the stores department will prepare a 'Goods Received Note' in triplicate- one for – the purchase department, second- for the accounts department, third - for the stores department itself. All details about stores should be noted on the note. The stores should be properly checked after their receipt.

2. Preservation of stores:

The stores should be properly preserved before they are issued. The following points may be noted :

a. A separate place should be earmarked for each type of stores.
b. A system of proper numbering should be adopted for all stores and places where they are to be kept.
c. The use of bin cards should be made for preserving stores. Such bin cards should contain details about stores and have three columns for receipt, issue and balance of stores. Such bin cards may be kept hanging on the places where stores are preserved.
d. The stores should frequently be counted and checked by a responsible official who should also compare the bin cards with the stores ledger.
e. Stock-taking should be conducted at the end of a year or at regular or irregular intervals during the year, if necessary.
f. Difference, if any, between the actual stock and the balance of stock as shown by the books should be adjusted or written off after getting the sanction of the appropriate authority.

3. Issue of stores:

The issue of stores, an organized procedure may be like this:

a. The issue of stores should be made only against the requisition slip received from a department whose head should sign it.
b. After issue, the requisition slip should be sent to the accounting that will make entries for the issue.
c. The requisition slips used by the department should be of different colours.
d. Only the responsible clerk should have charge of issue of stores so that in case of fraud, may be held liable.
e. The stores officer should be seated near the gate so all issues may be made under his supervision.
f. A system of permits should be in operation for those who go out of the Stores Department. The permits should be entered in the Gate Book.
g. Whenever stores are returned by some department, a Stores Returned Note should be prepared and the return should be recorded in the Gate Book.
h. Stores returned should be entered in the bin cards.

4. Recording:

The following points may be noted as Recording:

a) A separate accountant should maintain the records of stores
b) If the stores are of small variety, ledgers may be maintained. But if there is a large variety of stores used in the business, stores records may be used.
c) The stores record cards may be of different size and colour.
d) The details in the stores record cards may be written up with the help of goods received notes, requisition slip, goods returned notes, etc.
e) The bin cards should be checked and compared from time to time with stores record cards.

RELATIONSHIP BETWEEN INTERNAL AUDITOR AND STATUTORY AUDITOR

Statutory Auditor and Internal Auditor both are independent entity. A statutory Auditor of a company cannot be the internal auditor of the same company. In certain cases, statutory auditor refers the report of internal auditor and he expresses his opinion based on the report of internal auditor. Similarly in certain cases, internal auditor also refers the report of statutory auditors. The relationship between statutory auditor and internal auditor may be summed up as given below:

1. Comment on the Internal Audit System in place: As Companies Audit Report Order 2003 issued under section 227 of the companies act, 1956 the statutory auditor has to comment upon the effectiveness and suitability of internal audit system laid down by the management. To discharge this responsibility statutory auditor should evaluate the internal audit system. He should evaluate the strength of the internal audit staff, their qualification and experience.

2. Evaluation of the actual work of internal auditor: After studying the internal audit system and structure actual work of the internal auditor should also be evaluated. Statutory auditor has to make use of the work of internal auditor. This he can do only when he himself puts faith in the work of internal auditor.

3. Relying on the work of internal auditor: Statutory auditor has to decide that up to what extant he can rely upon the work of the internal auditor. This will decide the extent of checking by statutory auditor. If he feels that internal auditor has properly done his work he can reduce the extent of his checking.

4. No reduction in responsibility: Relying on work of internal auditor in no way reduces the responsible for the discharge of his duties as statutory auditor. Relying on the internal auditor can only reduce the burden of the statutory auditor. For all his works statutory auditor would remain responsible.

UNIT III

VOUCHING

Meaning: Vouching means the examination of documentary evidence in support of entries to establish the arithmetic accuracy. When the auditor checks the entries with some documents it is called vouching. Vouching is the acid test of audit. It tests the truth of the transaction recorded in the books of accounts. It is an act of examining documentary evidence in order to ascertain the accuracy and authenticity of the entries in the books of accounts.

Definition of Vouching

According to **Dicksee** "Vouching consists of comparing entries in the books of accounts with documentary evidence In support thereof."

According to **Joseph Lancaster** "it is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This is, however, quite wrong, for vouching comprises such an examination of the ledger entries as will satisfy the auditor, not only that the entry is supported by the documentary evidence but it has been properly made upon the books of accounts."

Voucher

Any documentary evidence supporting the entries in the records is termed as a voucher. Any document, which supports the entries in the books of accounts and establishes the arithmetical accuracy, is called a voucher.

Examples of vouchers:

A bill, a receipt, an invoice, goods received note, salaries and wages sheets, goods inward and outward register, stores records, counterfoil of a cheque book, counterfoil of pay-in-slip book, bank statement, bank pass book, delivery challans, agreements, a material requisition slip, copy of purchase order, minute book, memorandum and articles of association, partnership deed, trust deed, prospectus etc. are the examples of vouchers.

IMPORTANCE OF VOUCHING

1. Ensures genuineness of the transactions
2. Enables to know transactions
3. Helps to know relevance of the transaction
4. Facilitates proper allocation of capital & revenue, expenditure
5. Detects frauds and errors
6. Decides authenticity of transactions
7. Ensures proper accounting
8. Compliance with law

9. Ensures proper disclosure

Procedure (or) special considerations to be borne in mind by the auditor in the course of vouching

1. Date of the voucher
2. The name of the party
3. Tick and audit rubber stamp
4. Authorisation by the authorised person
5. Revenue stamp of Re. 1 if it exceeds Rs.5000/-
6. Transaction relates to business
7. Revenue and capital
8. Amounts in words and figure
9. Account head
10. No assistance of member of clients staff to be taken for checking receipts
11. Not to accept receipted invoice
12. Missing vouchers
13. Important documents
14. Vouching of cash transaction
15. Proper filing
16. Signature of payee
17. Nature of payment
18. Noting in the audit note book
19. Alteration
20. Voucher control number

Objectives of vouching

The basic objectives of vouching are as under:

1. To ensure that all the transactions are properly recorded in the books of accounts.
2. To see the proper evidence supports all the entries of the transactions.
3. To make it sure that fraudulent transactions are not recorded in the books of accounts.
4. To see that all transactions relating to business are recorded in the books of accounts.
5. To see that all transactions are properly authenticated by a responsible person.

HOW WOULD YOU VOUCH CASH RECEIPTS?

VOUCHING OF CASH RECEIPTS TRANSACTIONS OR DEBIT SIDE OF THE CASH BOOK

1. Internal Check: The auditor has to satisfy himself that there is a good system of internal check in operation. This has to be thoroughly enquired into. He should fully understand the rules and regulations in vogue for granting receipts, making records thereof, dealing with the bank, etc.
2. Comparison of the Rough Cash Book with the Cash Book: Usually, cash receipts are first entered in the Rough Cash Book or the Diary before they are entered in the cash book. He should examine the Rough Cash Book or the Diary and compare it with cash book.
3. Control over use of Receipt Book: Another point to be noted by the auditor in these connections is to see whether receipts books are kept under proper control.
4. The method of depositing daily receipts into the bank should be examined. The use of Pay-in-Slip Book should invariably be made for this purpose.

1. CASH SALES:

The auditor should examine the effectiveness of the system of internal check in operation in regard to cash sales. He should thoroughly check the carbon duplicates of cash memos with the summarizes of cash sales. Further, he should compare well the abstracts of the salesman with the cash analysis of the receiving cashier and then, should check up the book. He can scrutinize the general cash book with the summarises prepared by the cashier.

2. RECEIPTS FROM DEBTORS:

The cash received from debtors can be vouched with reference to the counterfoils of the receipts issued to them. Thus, the counterfoils are the only proper documentary evidence available for the purpose.

There is a fraudulent practice on the part of cashier to misappropriate or misuse cash through the process of teeming and lading, i.e., not entering cash in the cash book received from a debtor and entering it only when a similar amount received from another debtor and so on. Such practice are common and the auditor can check them with reference to the rough cash book and counterfoils of the Pay-in Slips.

3. BILLS RECEIVABLE:

All details about bills receivables can be available in the bills receivable book. The receipts for bills receivables can be in two ways:

1. Receipts from bills discounted: The bills receivable which have been discounted an have not matured at the date of the balance sheet, the cash so received should be properly entered in the cash book.
2. Receipts from bills matured: The cash receipts for the bills receivable in respect of which the amount has been received on the date of maturity should be checked by comparing the bills receivable books with the cash book and the pass book.

4. INCOME FROM INTEREST AND DIVIDEND

If interest is received on account of fixed deposits in the bank, such income should be vouched with the bank pass book. If the interest comes from securities, then vouching of such cash receipts, counterfoils of receipts ma be checked.

For receipts of dividend, three voucher, viz., counterfoils, dividend warrants and letters received alongwith the cheques,should be seen. The auditor should ensure that all such income whether received or accrued has been accounted for in the books and shown in the balance sheet.

5. SALE OF INVESTMENT

Investments are usually sold through brokers. Hence, the broker's sold note should be examined to vouch the amount received from the sale of investments.

6. RECEIPTS FROM HIRE PURCHASE

The hire purchase agreement should be examined in detail so as to ascertain the duration of the agreement, the amount of instalments and the total number of instalments payable by the close of the period the accounts of which are under audit.

7. RENT RECEIVED

If the rent-rolls are maintained, the same should be examined and compared with the cash book. The lease deeds and agreements should be examined to ascertain the amount of rent, the due date and the provision regarding repairs. The counterfoils of rent receipts issued to tenants should be checked. It agents are appointed to collect rent, the accounts or statements submitted by them should be carefully checked.

8. COMMISSION RECEIVED

Counterfoils of receipts should be compared with the particulars entered in the cash book. If commission is received in respects of goods received on consignment, the amount of commission should be vouched with reference to the copy of the account sale sent to the consignor.

9. INCOME FROM SALE OF FIXED ASSETS

Whenever fixed assets, such as land, building, machinery, furniture, etc, are sold, correspondence is made with the parties who are willing to purchase them. If it is made through a broker, the broker's sold note should be seen otherwise the auctioneer's note should be examined. If a sale deed has been executed, it may also be examined by the auditor.

10. INSURANCE CLAIMS MONEY

Insurance claims money received from an insurance company against a claim should be checked by making reference to the correspondence between the company and the amount rendered by the insurance company to the client.

11. SUBSCRIPTIONS

The income received on account of subscriptions can be vouched with the help of the register of subscriptions and the counterfoils of the receipts.

HOW WOULD YOU VOUCH CASH PAYMENTS?

VOUCHING OF CASH PAYMENT or CREDIT SIDE OF THE CASH BOOK

1. CASH PURCHASE:

The auditor should see that goods paid for have actually been received. He should examine the entries in the cash book with the help of cash memos receipted invoices issued by suppliers and also goods inward book or stock ledger.

2. PAYMENT TO CREDITORS

Payment to creditors may be vouched with the receipts issued by the creditors. Money due to them can be compared with the accounts of the creditors, and for goods received, the invoices can be referred to. Before passing an entry as correct, he should refer to minutes, contracts and other documentary evidence in support of it.

3. WAGES:

The vouching of wage payment is one of the most important duties of the auditor. He should first of all assess the operation of an efficient and effective system of internal check. If the system is good, possibilities of errors or fraud are minimized. He has to satisfy himself in regard to this system so far as it relates to the maintaining of wage records, preparation of wage sheets and payment of wages.

Vouchers – Wage Records, Job Cards, Wage Sheets etc.

4. SALARY

The auditor should check the salary book and then, compare it with the entries in the cash book. He should examine the salary book, the auditor should refer to the appointment letters, agreements and minutes.the entire procedure has to be thoroughly examined by the auditor.

5. BILLS PAYABLE:

The bills honoured and returned by the payees should be examined together with the bills payable book. If the payments are made through the bank, the pass book should be checked and reference may also be made to the statement received from the bank.

6. PURCHASE OF LAND AND BUILDING

If the asset is purchased through an auctioneer, the auctioneer’s accounts should be checked. If the property is purchased through a broker, the broker’s note should be examined. The agreement for purchase is the proper document of any evidence in support.

7. PURCHASE OF PLANT AND MACHINERY

A reference to the invoice and the receipt obtained from the supplier can be of much help to the auditor in vouching purchase of plant and machinery to see that price has been paid.

8. PURCHASE OF INVESTMENTS:

Payments for the purchase of investments should be vouched with reference to the broker’s bought note. The actual investments can also been examined. If they are purchased through the bank, the pass book may be examined.

9. PATENTS AND COPYRIGHTS

The agreement of purchase may be examined for the patent and copyright and the receipt in taken of having paid the amount should also be examined. If the purchase is effected through an agent, his commission should also be capitalized.

10. PAYMENT UNDER HIRE PURCHASE AGREEMENT

The vouching of the payment made for hire purchase should be done by examining the agreement and the receipt so received can be a good evidence for it.

11. TRAVELING EXPENSES

The vouchers should contain details as the name and designation of the person, particulars of journey, amount of fare, amount of boarding and lodging expenses and other expenses. The receipts obtained from those receiving payments should be scrutinized.

12. ADVERTISING

If the amounts spent on advertising are substantial, the auditor should see that adequate controls have been kept on the expenditure. Usually, it is preferable to see that financial records run parallel to the statistical records and with the aid of such records, the budgeted and actual expenditure pertaining to a period can be comparable.

13. INTEREST ON LOAN

The term of loan should be studied and it should be seen that the rate of interest does not differ from the one given in the loan agreement. If interest is payable on debentures, the debentures interest books should referred to. If the interest is payable through the bank, the pass book and interest register should be examined.

14. DIVIDEND:

The payment of dividend can be examined with the help of dividend warrants returned. If the payment is made through the bank, dividend warrants and pass book may be compared.

15. DIRECTOR'S FEES

To vouch payment of director's fees, the director's minute book, the attendance register and the receipts obtained from directors for this payment should be examined.

16. COMMISSION

The conditions relating to the payment of commission should be examined with reference to the agreements between the clients and the agents.

17. PAYMENT OF TAXES

To vouch the payment of taxes, the auditor should made reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.

18. BANK CHARGES

To vouch bank charges such as commission, interest on overdraft and loan, etc., the bank pass book should be examined.

19. INSURANCE:

For payment made on account of insurance premiums, the receipts from he insurance company and the policy itself may be examined.

20. PETTY CASH BOOK

To vouch the petty cash payments, the auditor should examine the petty cash book which is dealt with in detail in the pages that follow. However, he can check petty cash payments by reference to the requisition slips and petty cashier's receipts.

21. POSTAGE

The auditor should compare the postage book with the cash book and petty cash book and count the stamp in hand. He should see that postage includes only the postal expenses connected with the business and not with any private account.

WHAT IS MEAN BY VERIFICATION?

Verification is a process by which an auditor satisfies himself about the accuracy of the assets and liabilities appearing in the Balance Sheet by inspection of the documentary evidence available. Verification means proving the truth, or confirmation of the assets and liabilities appearing in the Balance Sheet.

Thus, verification includes verifying:-

1. The existence of the assets
2. Legal ownership and possession of the assets
3. Ascertaining that the asset is free from any charge, and
4. Correct valuation

According to the 'statement of auditing practices' issued by ICAI, "the auditor's object in regard to assets generally is to satisfy that:

1. They exist,
2. They belong to the client,
3. They are in the possession of the client or the persons authorized by him,
4. They are not subject to undisclosed encumbrances or lien,
5. They are stated in the balance sheet at proper amounts in accordance with sound accounting principles, and
6. They are recorded in the accounts.

DEFINE THE TERM VERIFICATION.

Spicer and Pegler have defined verification as, "it implies an inquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets".

WHAT ARE POINTS TO BE CONSIDERED IN VERIFICATION?

While conducting verification following points should be considered by the auditor:-

1. Existence: The auditor should confirm that all the assets of the company physically exist on the date of balance sheet.

2. Possession: The auditor has to verify that the assets are in the possession of the company on the date of balance sheet.

3. Ownership: The auditor should confirm that the asset is legally owned by the company.

4. Charge or lien: The auditor has to verify whether the asset is subject to any charge or lien.

5. Record: The auditor should confirm that all the assets and liabilities are recorded in the books of account and there is no omission of asset or liability.

6. Audit report: The auditor has to report whether the management has conducted physical verification of fixed assets and stock and the difference, if any, between the physical inventory and the inventory as per the book.

7. Event after balance sheet date: The auditor should find out whether any event after the date of balance sheet has affected any items of assets and liabilities.

EXPLAIN THE SCOPE OF VERIFICATION.

Verification includes information on the following:-

1. That the assets were in existence on the date of the balance sheet.
2. That the assets had been acquired for the purpose of business only.
3. That the assets had been acquired under a proper authority.
4. That the right of ownership of the assets vested in the organization.
5. That the assets were free from any charge.
6. That the assets were properly valued and disclosed in the balance sheet.

Explain Classification of Assets.

Fixed Assets:

Fixed assets are those which are acquired for permanent equipment and not for resale in the ordinary course of business. Fixed assets should be valued at cost price less total depreciation in their value by consumes. There are to be valued at original or historical cost less total depreciation written off up to the date of the balance sheet. They are valued at what is known as a 'going concern value' or 'conventional value' or 'taken value'.

Floating Assets or Current Assets:

Floating assets re those are acquired for resale or produced for the purpose of sale or converting them in to cash, stock, work- in -progress, bills receivable etc. They are value the date of the balance sheet at original or historical cost price or the market price whichever is the lower, as they are held with a view to converting them into cash.

Wasting Assets:

Wasting assets are those fixed assets which are depleted gradually or exhausted in the process of working, such as a mine, a quarry, an oil well, etc. Distinction between the decrease in the value of a fixed asset and a wasting asset must be clearly understood though both of them are fixed assets.

Intangible Assets:

Intangible assets are those assets which cannot be seen or touched, e.g., goodwill, copyright, patents, trade marks. In his examination of such assets the auditor should determine the following:

1. The basis on which such assets were originally valued.
2. The reasonableness and adequacy of the amortization programme or the write- off procedure.
3. Fair and adequate balance sheet presentation.
4. The accuracy, completeness and proper control of the income arising form the ownership of such an asset as leasehold and patents.
5. He must also determine whether such assets represent some benefit or privilege at the date of the balance sheet.
6. He should see that such assets are recorded on a basis consistent with generally accurate accounting principles.
7. He must see that such assets are shown properly and fairly in the financial statements.

How Should Verification and valuation of Different Kinds of Assets of A Company?

1. Cash in Hand:

The auditor should visit the business house at the close of the financial period or on the following morning and actually count the cash in hand and compare it with the balance in hand as shown by the cash book. This should be done in the presence of the cashier and if there is any shortage his certificate should be obtained.

2. Cash at Bank:

To verify cash at bank, the auditor should examine the Bank pass Book and compare it with the balance as shown by the bank column of the cash book. The auditor should also see that the 'cheques outstanding' and 'cheques not yet collected' are genuine and not made up in order to conceal the deficiency. If some of these cheques are more than six months old, he should make inquiries.

3. Loans:

a. **Loans against Security of Land and Property:** The auditor has not only to examine the loan account in the ledger, but he has to examine the documents relating to the security, promissory note or bond, acknowledgements by the parties.
b. **Loans against mortgage of Land and Property**: If the land or property has been mortgaged, the auditor should examine the mortgage deed. He should examine the title deeds relating to the property. He should enquire the rate of interest and the date on which it is payable. He should see that the mortgage is duly registered. He should see whether has the power to mortgage the property and borrow money.
c. **Loans against Security of Stock and Shares**: The auditor should get a list of such stock and shares which have been held as security. He should see that such shares are transferred to his client. He should inspect such shares and see that they do not belong to his client. The auditor should get a written acknowledgement from the borrower regarding the amount of loan on the date of the balance sheet or examine the agreement.
d. **Loans against Security of Goods:** Where loan has been advanced against a Godown keeper's receipt, such a receipt should be examined. He should see that the warehouse rent has been paid by the borrower. He should examine the inspector's report from time to time regarding the quantity of goods.
e. **Loans against Insurance Policy:** Last receipt for the payment of the premium paid should be examined. The auditor should see the notice of assignment of the policy has been given to the insurance company.
f. **Loans against Personal Security:** In case the loan has been granted against the personal security, the auditor should make an inquiry regarding the financial position of the surety as the value of such as security depends on his financial position. He should also see that no charge in the terms of loan has been made as such a course will discharge the security and the client loses that security.

4. Bills Receivable:

The auditor should examine the Impersonal ledger or Bills Receivable Book with the bills receivable on hand. Some of the bills might have been sent out for collection in which case an inquiry should be made from the bank. While examining the bills, the auditor should see that they are properly drawn, stamped, duly accepted and that they are not overdue. In case there is any doubt about the payment of the bill on the due date, sufficient provision be made.

5. Investments:

If there are a large number of investments, as in the case of banks and insurance companies, the auditor should ask for a schedule of investments held by his client. The schedule should give full particulars of the investments, e.g., name of investment, the cost price, the market price, book value, date on which the investment was acquired, rate of interest payable and the dates of the payment on interest, tax deducted and so on and compare these with the records in the books of his client.

Valuation of Investments: Having verified the existence of the investments the auditor should now proceed to find out whether they are properly valued at the date of the balance sheet. The basis of the valuation of investments in the balance sheet will, to a large extent, depend upon the purpose for which they are held. If they are held by Trust Company, the object of which is to earn dividends and interest and distribute such dividends and interest amongst the shareholders, such investments are to be treated as fixed assets and, therefore, even permanent fall in their value may be ignored, of course, subject to Articles of Association and the Memorandum of Association of the trust Company.

6. Stock-in-hand:

The correctness of the profit and loss account of a concern depends, to a great extent, upon the correctness of the value of the stock of goods in hand at the close of the period. The auditor has, therefore, not only to verify the existence of the stock in hand but he has also the see that it is valued according to certain accepted principles of accountancy. The auditor should insist upon the maintenance of stock book, if it has not already been maintained.

Method of costing:

The auditor must have definite idea about the cost price and the market price in order to value the closing stock properly. The following are the different methods of finding out the cost price of the stock of goods:

1. Unit cost method or actual cost method.
2. Average Cost method.
3. First in, First out (FIFO) Method.
4. Last in, First out (LIFO) Method.
5. Base Stock Method.
6. Standard Cost Method.

Verification and Valuation of Stock:

1. Physical verification of Stock:
2. Attendance of auditor during physical verification of stocks.
3. Examination of records.
4. Verification and confirmation: From third party.
5. Ensuring the ownership over the Stock.

Valuation of Stock:

The auditor should see that the goods are properly valued. For the purpose of finding out the cost price, he will have to refer to the original invoices, cost accounts and market prices, which can be ascertained, form the financial papers, etc. he should see that the basic principles regarding the valuation of the stock are correctly followed.

7. Fixed Assets:

The usual method of the valuation of fixed assets is the cost price less deprecation. It has been suggested that during the inflationary period, the replacement cost method should be followed while valuing the assets on the balance sheet date.

8. Books Debts:

The auditor should see that the debts as shown in the balance sheet are recoverable. If they are doubtful, provision should be made for them. If they are bad, i.e., they are irrecoverable, they should not shown on the assets side. If the auditor does not pay attention to these points, the balance sheet which he certifies to show a “true and fair view” may be wrong and he might be held liable for damages.

9. Endowment Policies:

The auditor should physically inspect the policies and see that the premium payable has been paid and that the policy has not lapsed.

10. Patents Rights and Trade Marks:

If the client holds large number of patents or trade marks the auditor should ask him to prepare a schedule giving : The description of patent, registered numbers, the dates on which they were acquired, the unexpired period. The auditor should examine the receipts for the payments of the fees. He should also see that the renewal fee has been paid each year at the right time.

11. Copy Right:

Copy Right must be revalued at the date of balance sheet. If the publication does not command any sale, the copyright should be written off.

12. Furniture and Fixtures:

The auditor should verify this item with the help of invoices. Any addition made during the year should be verified in the usual way. Any expenses incurred in the purchase of these assets should be debited to the Furniture account. The auditor should see that proper depreciation is provided and that the net figure is shown in the balance sheet.

13. Plant and Machinery:

This item is also verified by reference to the original invoices, correspondence, etc. The auditor should see that plant and machinery is properly depreciated.

14. Loose Tool:

The auditor should examine the list of the loose tools. He should see that the list has been certified by a responsible officer.

15. Property- Leasehold and freehold:

The auditor is not competent to examine the title deed relating to a property. In such a case he should insist upon the client to get a certificate regarding their validity from the solicitor. A certificate form an architect, surveyor or an engineer will also serve the purpose of the valuation of the property. The property may be (a) Freehold property (b) Lease hold property. In both case the auditor should examine the title deeds relating to the property.

16. Goodwill:

Goodwill is defined as the assessed value of the reputation of a business or as the difference between the purchase price and the net assets which are purchased and the excess amount so paid, represents the goodwill acquired by the business. It is intangible asset. It value depends upon the earning capacity of the business and fluctuates accordingly. In case the Directors have debited the profit and loss account and credited the amount to the goodwill account, the auditor should object to this step especially when the action taken is likely to prejudice the interest on any class of shareholders. He should mention this fact in his report to the shareholders if such a step has been taken.

How Should Verification of Liabilities of a Company?

General: Verification of liabilities is also as important as the verification of assets. If the liabilities are overstated or understated the balance sheet shall not represent a true and fair view of the state of affairs of company. Similarly the profit and loss account will be incorrect. The verification of the liabilities is much easier than their valuation.

Verification and valuation of Different Kinds of Liabilities:

1. Capital:

Although capital is not the liability of a company, still it should be verified to enable an auditor to give a certificate in regard to the correctness of the balance sheet. The auditor should examine the Memorandum of Association and the Articles of Association of the company. He should also examine the Cash Book, Pass Book and Minutes Book of the Board of Directors to find out the number and different classes of shares issued.

2. Reserve Accounts and Funds:

For the audit of these two items, the auditor should examine the Minutes Books of directors meeting.

3. Debentures and Mortgage:

The auditor should enquire in to powers of the company to borrow money.

4. Trade Creditors:

The auditors should ask for schedule of the creditors and check it with the purchase ledger which in its turn may be checked with the books of original entry with the Purchase invoices, Credit Notes, Goods Inward Books, Return Outward Book, Bill Payable Book, and Cash Book. The Auditor should see that all Purchase during the year have been included in the purchases and especially purchases made at the close of the year.

5. Bills Payable:

The auditor should verify this item form Bills payable Book and the Bills Payable Account. The Bills payable already paid should be checked from the Cash Book and examine the returned bills payable. To see the genuineness of the bills payable in hand on the date of balance sheet, the auditor should check the cash book of the succeeding year as to whether any payment has been made in respect of such bills.

6. Outstanding Expenses:

The auditor should get a certificate from a responsible official to see that all expenses for the current year are included and the payment for each expenses such as interest, discounts, salaries have not been paid are included.

7. Loans:

Reference may be made to the agreement and correspondence for getting the loan. If interest on the loan has not been paid, he should see that it is shown as a liability. In case of bank overdraft, the agreement with the bank and the security offered should be examined.

8. Contingent Liability:

The auditors should consider the circumstance and the situation about the occurrence of that type of liabilities.

UNIT IV

What is Audit?

An audit is an unbiased examination and valuation of the financial statements of an organization to form an independent opinion.

Who is an Auditor?

An auditor is a person who is assigned the job to audit the financial statements of a company. He is appointed under section 252 of the Ordinance by a company to audit its financial statements. The preparation and presentation of financial statements is the responsibility of management of the company and auditor is only responsible for audit of financial statements and giving an opinion on the fairness of the financial statements.

WRITE SHORT NOTES ON APPOINTMENT OF FIRST AUDITORS OF A COMPANY?

1. Appointment by Board: Sec.224 (5) specifies that the Board of Directors can appoint the First Auditor(s) of a Company.

2. Time of Appointment: The appointment shall be made by the Directors, within 1 month from the date of incorporation of the Company.

3. Tenure of Office: The First Auditor(s) shall hold office till the conclusion of the first AGM.

4. Failure: If the Board fails to appoint the First Auditor(s) within one month of registration, the Company in General Meeting is empowered to make the appointment.

5. Members' Power of Removal: The Company may, at a general meeting, remove such an Auditor or all or any or them and appoint another or others in his or their place, on a nomination being made by any member of the Company. For this purpose, notice should be given to the members of the Company, not less than 14 days before the date of the meeting.

6. Provision in Articles: An Auditor cannot be appointed as First Auditor(s) simply because his name has been stated in the Articles of Association.

7. Intimation: The Company need not send any statutory intimation to the First Auditor(s), of their appointment within 7 days. Notice of appointment can be sent in the ordinary course of business within reasonable time.

8. Acceptance: The First Auditor(s) are themselves not required to inform the ROC about their acceptance or refusal of such an appointment.

WRITE SHORT NOTES ON APPOINTMENT OF AUDITOR BY SPECIAL RESOLUTION?

1. Special Resolution: Sec.224A of the Act states that Special Resolution is required for appointing or reappointing at each AGM, the Auditor in the case of a Company in which not less than 25% of the Subscribed Share Capital is held, whether singly or in any combination by :

- **a.** A Public Financial Institution or a Government Company or the Central Government or any State Government, or
- **b.** Any financial or other institution established by a Provincial or State Act in which a State Government holds not less than 51% of the Subscribed Share Capital, or
- **c.** A Nationalised Bank or an Insurance Company carrying on general insurance business.

2. Omission by Company: Where a Company referred to above omits or fails to appoint an Auditor(s) by a special resolution in its AGM, the Central Government shall have the power to appoint a person to fill the vacancy u/s 224(3).

3. 25% Holding:

- **a.** For determining 25% holding, the material date shall be the date of the AGM in which the special resolution is required to be passed.

b. In cases where the holding is less than 25% on the date of notice, but exceeds 25% as on the date of

AGM, it is advisable for the Company to:

i. Adjourn the meeting, issue another notice to the members for appointment of Auditors by special resolution and pass the special resolution at the adjourned meeting, or

ii. Omit or pass over the item on the agenda regarding the appointment of Auditor.

WRITE SHORT NOTES ON APPOINTMENT OF AUDITORS BY SHARE HOLDERS?.

1. Appointment: Under Sec.224 (1), every Company shall, at each Annual General Meeting, appoint an Auditor(s). Appointment in a General Meeting of the Company means appointment by the Shareholders of the Company.

2. Certificate from Auditor: Before appointment or reappointment at the AGM, the Company shall obtain from the Auditor(s), a certificate to the effect that the appointment, if made, will be within the ceiling limits specified u/s 224(1B).

3. Tenure of Office: The Auditor shall hold appointment from the conclusion of that AGM (in which he is appointed) till the conclusion of the next AGM.

4. Intimation: The Company shall give intimation of appointment to the concerned Auditor within 7 days of the appointment.

5. Intimation to Previous Auditor: The appointed Auditor shall communicate to the Previous Auditor about the appointment and enquire whether there is any professional reason why the appointment should not be accepted. This forms part of the Chartered Accountant's Code of Conduct.

6. Acceptance: The Auditor, on receipt of the intimation from the Company about his appointment, is required to send a written communication to the ROC in eForm 23B within 30 days of the receipt of intimation stating whether he has accepted or refused to accept the appointment.

WHEN CAN THE CENTRAL GOVERNMENT EXERCISE IT POWERS TO APPOINT AUDITORS OF A COMPANY?

1. Sec. 224(3) of the Act provides that where at the AGM, no Auditors are appointed or reappointed, the Central Government may appoint a person to fill the vacancy.

2. Under Sec. 224(4), the Company shall give notice of the fact within 7 days to the Central Government, of its power becoming exercisable.

3. If the Company fails to give such notice, the Company and every Officer of the Company who is in default shall be punishable with fine. which may extend to Rs.5,000.

4. Where a Company is required to appoint an Auditor at an AGM by passing a special resolution, but omits or fails to pass such resolution due to any reason, it shall be deemed that no Auditor has been appointed by the Company at its AGM, and the provisions of Sec.224 (3) of the Act will be attracted. [Sec.224A(2)]

WRITE SHORT NOTES ON THE APPOINTMENT OF AUDITORS OF GOVERNMENT COMPANY?

1. Government Company [Sec.617]: A Government Company means any Company in which not less than 51% of the PaidUp Share Capital is held:

a. By the Central Government, or

b. By any State Government or Governments, or

c. Partly by the Central Government and partly by one of more State Governments.

It includes a Company, which is a Subsidiary of a Government Company as above defined.

2. Appointment [Sec.619]: The Auditor of a Government Company shall be appointed or reappointed by the Comptroller and Auditor General of India.

3. Sec.619B Companies: Sec.619B deals with any Company in which not less than 51% of the PaidUp Share Capital is held by one or more of the following or any combination there of:

a. The Central Government and one or more Government Companies,

b. Any State Government or Governments and one or more Government Companies,

c. Central Government, one or more State Governments and one or more Government Companies.

d. Central Government, one or more Corporations owned or controlled by the Central Government,

e. Central Government, one or more State Governments and one or more Corporations owned or controlled by the Central Government,

f. One or more Corporations owned or controlled by the Central Government or the State Government,

g. More than one Government Company. The Auditors of Companies specified u/s 619B shall be appointed or reappointed by the C&AG of India.

4. Remuneration: Remuneration of Auditors of Government Companies shall be fixed by the Company in General Meeting or in such manner as the Company in General Meeting may determine.

QUALIFICATIONS & DISQUALIFICATIONS TO BE APPOINTED AS AN AUDITOR.

Qualifications:

1. Chartered Accountant

a. The person proposed to be appointed as an auditor should be a qualified Chartered accountant as per the Chartered Accountants Act, 1949.

b. If a partnership firm is proposed to be appointed as an auditor then all the partners practicing in India shall be qualified chartered accountants as per the chartered accountant's act, 1949.

c. In case a partnership firm is appointed any partner may act in the name of the firm.

2. Restricted state auditor's: The holder of a certificate in previous PartB states entitling him to act as an auditor of companies.

Disqualifications:

1. Sec.226(3): The following persons are disqualified for appointment as auditors of a company:

a. A body corporate.

b. An officer or an employee of the company.

c. A partner or an employee of an officer or employee of the company.

d. Indebtedness:

i. A person who is indebted to the company for more than Rs.1,000 Or

ii. Who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for more than Rs. 1000.

iii. When a firm is indebted to the company, each partner of the firm also is deemed to have been indebted to the company and vice versa is also correct.

e. Security: A person holding any security of that company. (For the purposes of this Sec., security means an instrument which carries voting rights).

2. Subsidiary/Holding: A person is not eligible for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's subsidiary or holding company or of any other subsidiary of the same holding company. (Sec.226(4)).

3. Vacation: If an auditor, after his appointment, become subject to any of the disqualification specified in 1 & 2 points, he shall be deemed to have automatically vacated his office.

4. Partnership firm: If any of the partners in a partnership firm is subject to any of the above disqualifications then that partnership firm will be disqualified from being appointed as an auditor of that particular company.

WRITE THE CO.'S ACT PROVISIONS RELATING TO AUDITORS REMUNERATION?

1. Fixed by: The remuneration shall be fixed by (Sec.224(8)):

a. By the directors When the appointment is made by it.

b. By the C.G. When the appointment is made by it and

c. By the shareholder's:

i. When the appointment is made by shareholders.

ii. When the appointment is made by C&AG (For government & deemed govt. co.'s).

For this purpose, the expression "remuneration" should be deemed to include any sums paid by the company in respect of auditor's expenses.

2. Same meeting: The act does not require that the remuneration should be fixed at the same meeting at which the appointment is made. It may be fixed at a subsequent meeting.

3. Retiring auditor: Where a retiring auditor is reappointed, if no resolution is passed fixing his remuneration his old remuneration will continue for.

4. Additional work: Where in addition to the normal audit work, the auditor is also required to undertake any other work, he is entitled to receive an extra remuneration. This additional remuneration will be decided by the directors.

5. Disclosure: It shall be disclosed in the P&L Account as below (Part II of Schedule VI):

- **a.** As auditor.
- **b.** As adviser or consultant in respect of :
  - **i.** Taxation matters.
  - **ii.** Company law matters.
  - **iii.** Management services.
- **c.** In any other manner.

WHAT ARE THE RIGHTS/POWERS OF AN AUDITOR?

1. Right to receive information and explanations:

- **a.** According to Sec.227(3), the company auditor has to state in his report, whether he has received necessary information and explanations for the purpose of audit.
- **b.** It is not possible for the auditor to draw conclusions without obtaining proper explanations and information.
- **c.** It is for the auditor to decide the matters in respect of which information and explanations are required by him.
- **d.** When the auditor is not given/provided the information required by him his only remedy would be to report the same to the shareholder's through qualification in the auditor's report.

2. Right of accessibility to the books and records:

- **a.** The auditor enjoys the right of accessibility to books and records because he has to mention in his report whether proper books and records are maintained.
- **b.** It is logical that this right is available to the auditor because the books and records form part of the evidences on the basis of which the auditor draws his conclusion.
- **c.** The books will include:
  - **i.** Books of accounts (Financial & Costing).
  - **ii.** Vouchers & supporting evidences or documents &
  - **iii.** Statutory books.
  - **iv.** Quantitative records like production, sales, stock records etc.
  - **v.** Branch books, vouchers etc.
- **d.** It is for the auditor to determine what record or document is necessary for the purpose of the audit.
- **e.** This right can be exercised by the auditor at all times – mean that Normal business hours on a working day & during the period of his office.

3. Right to visit branches:

- **a.** Since the auditor has to report on the consolidated financial statements which also include the results of the branch operations, he has the right to visit the branches to obtain information.
- **b.** Even if the branch accounts are audited by another auditor, this right is still available because it is possible that the auditor may not be getting full information from the branch auditor regarding the branch accounts.

4. Right of lien: The term lien refers to the right of possession. The auditor enjoys this right over the books of the clients if there is a fees due. The guidelines to be followed while exercising this right is:

- **a.** Documents retained must belong to the client who owes the money.
- **b.** Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the board of directors.
- **c.** Such of the documents can be retained which are connected with the work on which fees have not been paid.

5. Right to attend G.M.:

a. The auditor enjoys the right to receive notice of GM and attend GM.

b. However, he cannot participate in the discussions of the G.M.

c. The purpose is to clarify the doubts raised by the shareholders.

d. It is not his duty to attend, but it is only a right.

e. Further such a right extends only to G.M.'s and not to the board meeting's.

f. It may be advisable for the auditor to attend the meeting when any important matter has come to his knowledge subsequent to his signing the audit report, so as to bring this matter to the notice of the shareholder's.

WHAT ARE THE DUTIES OF AUDITOR?

A. Statutory & Non statutory audit: In the case of non statutory audits, the auditor's duties would depend upon the agreement between the auditor & the client. On the other hand in case of statutory audit the duties of a company auditor are given in the Companies Act itself.

B. Duties of company auditor as given under companies act are as below:

1. Sec.227(1A): Under this Sec. it is the duty of the auditor to enquire:

a. Whether loans and advances given on security have been properly secured and the terms & conditions on which they have been made are harmful to the interest of the company.

b. Whether transactions which are represented merely by book entries in fact have taken place and are harmful/prejudicial to the interest of the company. (E.g. In books purchases were recorded for. In reality no such transaction has taken place. The auditor's report should mention this fact).

c. Whether any of the assets of the company consisting of shares, debentures etc. have been sold at a price less than the cost of such shares etc. (This is not applicable to an investment company or a banking company). (This doesn't prohibit the sale below cost. If the sale is bonafide and the price is reasonable having regard to the
circumstances of the case, need not be reported.)

d. Whether loans and advances made by the company have been shown as deposits.

e. Whether personal expenses have been charged as business expenses.

f. Where it is stated in the books of accounts that any shares have been allotted for cash, then the cash has been actually so received. (DCA notification Shares allotted against a debt payable by the company shall be taken as 'shares allotted for cash').

2. Sec.227(2): Under this sec. it is the duty of the auditor to make a report whether, in his opinion the financial statements give a true & fair view:

a. In the case of the B/s of the financial position of the company at the end of the financial year &

b. In the case of the profit and loss account of the profit or loss for the year.

3. Sec.227(3): Under this sec. it is the duty of the auditor to state the following in his audit report:

a. Whether he has obtained all the information and explanations which were necessary for the purposes of his audit.

b. Whether the audit report on the financial statements of any branch office audited bya person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

c. Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts and branch returns.

d. Whether any director is disqualified under Sec.274 (1) (g). (Sec.274(1)(g) A person is disqualified from being appointed as a director, if the company in which he is a director has not filed the annual returns for any continuous 3 financial years Or has failed to repay its deposit or interest thereon on due date Or redeem its debentures on due date Or pay dividend and such failure continues for ≥ 1 year.)

e. In **bold** or in italics the observations of the auditors which have any adverse effect on the functioning of the company.

f. Whether the cess payable under Sec. 441A has been paid and if not, the details of amount of cess not so paid".

g. Whether, in his opinion, proper books of accounts, as required by law, have been kept by the company and proper returns adequate for the purposes of his audit have been received from the branches. Remember that the cost records prescribed under Sec.209(1)(d) also from part of books of accounts.

h. Whether accounts give the information required by the act in the manner so required.

i. Whether in his opinion, the balance sheet and the profit and loss account comply with the accounting standards referred to in Sec.211 (3C) of the Companies Act.

4. Sec.227 (4): Where any matters referred in Sec.'s 227(2) and 227(3) are answered in negative, it is the duty of the auditor to state the reasons for such answers in his audit report.

5. Sec.227(4A): It is the duty of the auditor to include in his report a statement on such matters as may be specified by the C.G.Called CARO, 2003 (Companies auditor's report order).

6. Other duties:

a. Duty to sign the auditor's report.

b. Duty to certify the prospectus & Duty to certify the statutory report.

c. Duty to attend audit committee meetings.

HOW CAN A CASUAL VACANCY IN THE OFFICE OF AN AUDITOR IS FILLED UP?

1. Meaning: No definition is given in the act. In the opinion of the DCA, it means a vacancy in the position of the auditor after he was validly appointed & appointment was accepted.

2. Reasons: This may arise due to death, disqualification, dissolution of the firm of auditors, removal & resignation, etc.

3. Who has to fill this?:

a. If it was due to resignation only by shareholders.

b. If it was due to other reasons By board of directors.

4. The law requiring the shareholders to fill the vacancy created by resignation will increase auditor's independence. This process will bring out facts leading to auditor's resignation to the notice of the shareholders.

5. Reappoint: If the auditor could be found to be honest, the general meeting may even request him to reconsider his decision and take appropriate steps to cure the evils, if any, in the management.

6. Duration of office: The auditor appointed to a causal vacancy shall hold office till the conclusion of the next annual general meeting.

7. Other Points:

a. When the Existing Auditors who have been reappointed at the AGM refuse to accept the appointment, it does not create a Casual Vacancy or vacancy by resignation. The Auditor's appointment has not become effective due to the refusal.

b. If the Firm is appointed as Auditor, any reconstitution of the Firm due to admission, retirement, death etc. including change of name by the Firm, will not affect the appointment as Auditor. However, when there is a total reconstruction of the Firm i.e. all the existing partners retire and new partners are admitted such reconstitution would result in casual vacancy amounting other than resignation and the Board can appoint the new reconstituted Firm.

c. A Casual Vacancy is not a vacancy created by any deliberate omission on the part of the Company to appoint an Auditor in its AGM.

STATE THE PROVISIONS OF THE COMPANIES ACT WITH REFERENCE TO REMOVAL OF COMPANY AUDITOR.

1. REMOVAL ON THE EXPIRY OF TERM OF OFFICE: Sec.225 lays down the procedure for removal of the Auditor on the expiry of his term of office, as under:

a. Special Notice: Special Notice is required for a resolution at an AGM for:

Ø Appointing as Auditor, a person other than the Retiring Auditor, or

Ø Providing expressly that the Retiring Auditor shall not be reappointed.

b. Time Period of Notice: The concerned member shall give the Company, a Special Notice about his intention to move a resolution to this effect at the ensuing AGM, at least 14 days before such meeting.

c. Circulation of Notice: On receipt of such a notice, the Company shall forthwith send a copy thereof to the Retiring Auditor as well as to the members of the Company. Special Notice is to be sent to all members of the Company atleast 7 days before the date of the AGM in terms of Sec.190(2).

d. Retiring Auditors Rights: The Retiring Auditor has the following rights:

Ø To make a representation of a reasonable length to the Company,

Ø To request that such representation be circulated among the members,

Ø To require that the representations be read out at the AGM and be heard orally at the AGM.

e. Company's Duties: Where the Retiring Auditor makes a representation in writing to the members of the Company, the Company shall, unless the representation is received by it too late for it to do so:

Ø State the fact of representations being made, in any notice of the resolution given to members of the Company,

Ø Send a copy of representation to every member of the Company to whom notice of meeting is sent.

f. Situations when representations need not be circulated: In the following situations, the representations need not be circulated to members:

i When the representations are received too late by the Company.

ii If the Central Government is satisfied, that the right of representation is being misused by the Auditor to secure needless publicity for defamatory matter, on the application made by the Company or any other aggrieved person.

g. Procedure at AGM: If a copy of the representation is not sent as the same was received too late or because of the Company's default, the Auditor may require that the representation shall be read out at the Meeting. He also has the right to be heard orally at the AGM. At the AGM, if a Special Resolution is required in terms of Sec.224A, the same should be duly passed.

h. Certificate from Appointed Auditor: Before any appointment or reappointment of Auditors is made at an Annual General Meeting, a written certificate is to be obtained from the Auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Sec.224(1B).

STATE THE PROVISIONS OF THE COMPANIES ACT IN RESPECT OF AUDIT OF ACCOUNTS OF A BRANCH OFFICE OF A COMPANY?

1. Appointment [Sec.228(1)]: The following persons are eligible for appointment as Branch Auditors:

In case of Local Branches

a. The Company’s Auditor appointed u/s 224, or

b. A person qualified for appointment as an Auditor u/s 226

In case of foreign Branches

a. The Company’s Auditor appointed u/s 224, or

b. A person qualified for appointment as an Auditor u/s 226, or

c. An Accountant duly qualified to act as an Auditor in accordance with the laws of that foreign country.

2. Appointment of persons other than Company Auditor as Branch Auditor [Sec.228(3)(a)]:

a. General Meeting: The decision to appoint any person other than the Company Auditor as Branch Auditor, should be taken at a General Meeting.

b. Appointment at Meeting or Authorisation to Board: The Company may either appoint the Branch Auditor at the meeting or authorise the Board of Directors to appoint such an Auditor, in consultation with the Company's Auditor.

3. Rights of Branch Auditor [Sec.228(3)]:

a. Audit Powers: To exercise the same powers and duties in respect of Branch Office Audit as enjoyed by the Company's Statutory Auditor in respect of the Company's Audit.

b. Reporting: To prepare a Report on the accounts of the Branch Office examined by him and to forward it to the Company's Auditor who shall deal with it in the manner required to prepare / finalise his Report.

c. Remuneration: To receive such remuneration as the Company in General Meeting or the Board may fix

4. Rights of Company Auditor [Sec.228(2)]: The Company Auditor shall have the following rights when the Branch Accounts are audited by another person:

a. To visit Branch Office, if deemed necessary for the performance of his duties, and

b. To have access at all times to the books, accounts and vouchers maintained at the Branch Office.

5. In case of Foreign Branches of Banking Companies, the Company Auditor is allowed access to such copies of and extracts from the books and accounts of the Branch, as have been transmitted to the Head Office in India.

WHAT ARE THE POWERS AND DUTIES OF A SPECIAL AUDITOR CONDUCTING A SPECIAL AUDIT?

1. Circumstances in which special audit may be ordered: May be ordered by the Central Government if it forms an opinion as to the existence of *any* of the following circumstances:

a. That the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices.

b. That the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains.

c. That the financial position of the company is such as to endanger its solvency.

2. Can shareholders apply to the Central Government for ordering special audit: Where the shareholders form an opinion as to the existence of any of the above circumstances, they may make a complaint to the Central Government. If the Central Government is satisfied about the existence of such circumstances, it may order a special audit to be conducted. But, such a complaint does not bind the Central Government to order a special audit, even if the complaint is made by all the shareholders. Thus, the power of the Central Government to order special audit is discretionary in nature.

3. No opportunity of being heard: The special audit may be ordered by the Central Government without providing an opportunity of being heard to the company.

4. Period of special audit: Special audit shall be conducted for such period as may be specified in the order.

5. Special auditor: The Central Government may appoint either the company's auditor or any other chartered accountant (whether or not he is in practice) to conduct the special audit, who shall be called as the special auditor.

6. Powers and duties: The special auditor shall have the same powers and duties as an auditor of a company has under Sec. 227.

7. Directions to furnish information: The Central Government may direct any person to furnish to the special auditor such information as may be required by him.

8. Report of special auditor:

a. The report of the special auditor shall include all the matters required to be included in an auditor's report under Sec. 227. The report shall also include a statement on any other matter which may be referred to him by the Central Government.

b. The special auditor shall make his report to the Central Government.

c. On receipt of the report of the special auditor, the Central Government may take such action on the report, as it considers necessary.

d. If no action is taken on the report within 4 months from its receipt, the Central Government shall send to the company either a copy of, or relevant extract from, the report with its comments thereon and require the company either to circulate that copy or those extracts to the members or to have such copy or extracts read before the company at its next general meeting.

UNIT V

EXPLAIN THE SPECIAL POINTS TO BE CONSIDERED WHILE AUDITING THE ACCOUNTS OF A CHARITABLE INSTITUTION.

1. Examine the constitution, rules and regulations of the Charitable Institution (or) the Trust Deed, if any.
2. See that the funds for specific purposes have been dealt with according to the rules.
3. Vouch the receipt of donations and subscriptions as shown on the debit side of the cash book with the counterfoils of the receipt book, register of subscribes, list of the donors notified in the newspapers from time to time correspondence and any other documentary evidence available.
4. Vouch the income from investments from the Investments Register and see that income tax deducted from dividends received is recovered from the income tax authorities, if the charitable institution is not liable to income tax. Vouch the receipt of rents from the properties belonging to the charitable institution, with the rent roll, agreements with the tenants, etc. and the payment with the minute book of the trustees or the managing committee regarding important payments.
5. Vouch the receipt of rents form the properties belonging to the charitable institution with the rent roll, agreements with the tenants, etc.
6. Vouch the payment with the Minute Book of the trustees (or) the managing committee regarding important payments.
7. Verify the purchase of investments by referring to the Bought Notes physically examine such investments. In case such investments are lodged the bank, get a certificate from the bank and the cash and bank balance. The accounts are drawn up in accordance with the regulations.

WHAT ARE THE SPECIAL POINTS TO BE CONSIDERED WHILE AUDITING THE ACCOUNTS OF CLUBS?

A club is not an institution, which earns trading profits. It collects sub script ions from its members and provides for their amusements. The following special points should be noted in the audit of accounts of a club.

GENERAL

1. He should examine the documents relevant to be establishment of the club.
2. He should evaluate the system of internal check and control and select the audit procedures accordingly.

INCOME:

1. See that the life membership fee is carried to Income and Expenditure account over a number of years or is treated as capital income according to-rules of **the** club.
2. Subscription from members should be vouched with the counterfoils of receipts issued to them and the Register of members.
3. He should verify whether necessary steps have been taken for the recovery of arrears of subscriptions, and whether the amount deemed as irrecoverable has been duly written off.
4. He should check whether the members as properly charges for the services provided to them for various games and sports.

EXPENDITURE:

1. In case the club owns (or) Hires any machine for amusement of its subscribers, it should be seen that there is a proper check over the removal of coins from them.
2. Expenditure on purchase of magazines and journals should be vouched with the bills from suppliers and money receipts obtained from them.
3. Salaries and yearly increments to staff should be verified by reference to service contracts, salary register, and minutes of the meetings of the managing committee.
4. He should ascertain the rates of depreciation being applied to furniture, fixture, fittings linen etc., and satisfy himself that it is adequate.
5. See that expenditure is properly allocated between capital and revenue.

6. Verify the assets, particularly stock in hand in the usual manner.

GIVE SHORT NOTE ON THE SPECIAL POINTS TO BE CONSIDERED WHILE AUDITING THE ACCOUNTS OF CINEMA THEATRES:

GENERAL:

At first, he should enquire into the system of internal check in operation so as to enable himself to be familiar with the shortcomings of the system.

INCOME:

1. He should examine the letter of his appointment to see if the scope of his responsibilities has in any way been enlarged. And carefully go through the documents relating to the setting up of the organisation such as Partnership Deed, Memorandum and Articles of association, etc., and note down the provisions relating to accounts.
2. He should ascertain if there is an effective system of internal check and control and devise his audit procedures accordingly. Whether the entrance to the cinema hall during the shows is only against printed tickets which are serially numbered and uniformly bound into books.
3. If there are tickets of different colours and bearing different numbers for each show and class, the number of tickets for each show and the same class run serially.
4. The income of cinemas is usually from the sale of tickets. The auditor should check the daily receipts as entered in the Cash Book with the daily Returns of Tickets and counterfoils of the tickets .He should ascertain whether such receipts are deposited in the bank daily or not.
5. The auditor should ensure that money received on account of advance booking has been carried over.
6. The income from advertisement on screen, slides, lobby, etc. should be vouched by reference to proper documentary evidence.

EXPENDITURE:

1. The auditor should check carefully the capital expenditure and ensure that proper distinction has been made between capital and revenue.
2. The auditor should check the payment made in counterfoils or tickets sold and see that it is being regularly paid tot eh government.
3. The auditor should check the payment made in connection with salaries, wages, electricity, etc.,
4. He should vouch the repair and renewal expenses.
5. Expenditure on repairs and maintenance of a routine nature should be checked with the bills and money receipts, and that on extensive redecoration refurbishing should be checked with the agreements with decorators expenditure being heavy, it should be treated as deferred revenue expenditure be written off over a specified period of time.
6. He should satisfy himself that a proper distinction is maintained capital and revenue items of expenditure. Salaries to staff should be vouched with the individual agreement receipts, counterfoils of cheques, etc. Payments to advertisers should be vouched with the contracts with advertisers, and bills and statements submitted by them.

MISCELLANEOUS:

1. The auditor should verify the assets including the closing stocks and see that they are properly depreciated.
2. He should also see that films, etc, are properly valued.
3. He should examine the accounting records relating to sales of tickets and hiring of films carefully.

GIVE A BRIEF ACCOUNT OF A SPECIAL FEATURE OF THE AUDIT OF EDUCATIONAL INSTITUTION.

The auditor should conduct the audit of an educational institution, whether a school, colleges (or) University, along the following lines:

PRELIMINARY:

1. He should see that the letter of his appointment as auditor is in order and whether it has enlarged in any way the scope of his examination.

2. He should examine the charter, Trust Deed (or) Regulations in the case of the school (or) college and note all the provisions. In the case of university, he should go through the act of the legislature under which the institution has been set up, as also the rules framed there under.
3. He should go through the minutes of the meetings of the Managing Committee, Governing Body (or) Executive Council of the Institution.
4. He should study and evaluate the internal check and control and see if it provides for appropriate segregation of duties and responsibilities.

INCOME:

1. Fees constitute an important source of income of an educational institution. The auditor should check the students fees register for each month (or) term with the respective class registers showing the names of the students on roll.
2. He should vouch the fees received with the counterfoils of money receipts issued to students, as also with the entries in the cash book and the fees register.
3. In the case of free studentships (or) other concessions as to fees, the auditor should examine the authorization by a responsible official.
4. He should ascertain if all the arrears of fees, including hostel dues, are recovered before the students accounts are closed.
5. He should check late payments of fees along with fines, if any, with the entries of arrears in the fees register and authorization for the payment by a responsible official.
6. In the case of free studentships or other concessions as to fees, the auditor should examine the authorization by a responsible official and see that it is consistent with the policy decision of the Managing Committee.

OTHER INCOMES:

1. He should vouch the income by way of grants-in-aid from the government (or) local body on the basis of the Memorandum (or) other correspondence with regard thereto.
2. Income from donations and subscriptions should be checked with the counterfoils of money receipts, cash book and the list of donors published with the Annual Report.
3. He should ascertain whether items of capital and revenue expenditure are properly distinguished in accordance with sound accounting practices.
4. Establishment expenses should be checked with the relevant vouchers and entries in the cash book.
5. He should test check the efficacy of the procedure as to purchase, custody and issue of materials.
6. He should see whether purchase invoices are duly passed for payment, and liabilities as to unpaid purchases are adequately provided for.
7. Investment income of an approved educational institution is not liable to income-tax.
8. He should see that contributions to provident fund by the staff are duly invested in the approved securities.

GIVE A BRIEF ACCOUNT OF THE SPECIAL FEATURES OF THE AUDIT OF HOSPITALS:
GENERAL:

1. He should examine the letter of his appointment and ascertain whether it has enlarged in any way the scope of his responsibilities.
2. He should carefully go through the Charter or Trust Deed under which the Hospital has been set up and take a special note of the provisions affecting the accounts.
3. He should examine and evaluate the system of internal check and control and devise his audit procedures keeping in view its weaknesses.

INCOME:

1. He should vouch the entries in the Patients' Bills Register with copies of bills issued.
2. He should vouch collection from patients with copies of the bills and entries in Bills Register.
3. In the case of income by way of interest/dividends, he should vouch it with shares and securities settled on the hospital as recorded in the Investment Register and dividend and interest warrants.
4. In case of legacies and donations received for a specific purpose, he should ensure that these or any income there from, as the case may be, is not applied for any other purpose.

5. Actual collection of subscriptions should be checked with Subscribers Register and the difference, whether due to arrears or advance payments, should be carried forward and properly disclosed in the annual statements.

EXPENDITURE:

1. He should ascertain whether a clear distinction has been made between capital and revenue items of expenditure.
2. Expenditure of capital nature should be duly authorized by a valid resolution of the trustees or the Managing Committee.
3. He should see that all appointments of the staff, and payment of salaries as also annual increments, are authorized by the trustees or the Managing Committee.

MISCELLANEOUS:

1. He should physically verify all investments such as shares, debentures Government bonds and certificates, and check them with the entries in the Investment Register.
2. He should verify the documents of title as regards landed property and check with the Property Register.
3. He should physically inspect at least a part of the stocks and stores at the end of the year and ensure that a proper value is placed on them.
4. It should be seen that adequate depreciation has been provided in respect of depreciable assets.

EXPLAIN THE SPECIAL POINTS TO BECONSIDERED WHILE AUDITING THE ACCOUNTS OF HOTELS:

GENERAL:

First of all, the auditor should examine the system of internal check in vogue with regard to the purchase, issue, payment etc., of provisions, stores, wines linen, etc. He should also familiarities himself with the system of book keeping in vogue in the hotel. This is very necessary.

INCOME:

1. The receipts from the travelers should be checked by reference to records made in the Cash book which should be compared with the Window.
2. For balances outstanding, the personal ledger should be examined.
3. Other receipts should be carefully examined. He should examine the system of internal check and control, particular as regards ordering, receiving and paying for provisions, wines, spirits, crockery, linen, etc., and receiving of cash and accounting for it by the waiters, cashiers etc. His audit procedures should be selected in the light of the weaknesses of the system as discovered by him.
4. Examine the Visitors Ledger and the daily totals thereof should be vouched with the Cash Book and Impersonal Ledger. Care should be taken to see that the visitors pre duly charged for items supplied to them as also those paid on their behalf.
5. Receipts on account of holding of conferences, marriages, receptions, etc., should be checked with the agreements and correspondence with the parties concerned as also counterfoils of money-receipts issued to them.

EXPENDITURE:

1. The auditor should see that proper destination has been made between the capital and revenue. It has to be ensured that heavy prices have been paid for purchases.
2. The payment of wages, salaries, etc., should be vouched.
3. The petty cash payments should be thoroughly checked.
4. The auditor should be see that the expenses incurred on planning, equipment, etc., are spread over a reasonable number of years.
5. It should be ensured that a proper distinction is made between item- revenue and capital expenditure.

6. The purchases of provisions, wines, cigarettes, etc., are against duly authorised requisitions, and test-check the purchases of period by reference to bills, money receipts and entries in the respective stock Registers.

MISCELLANEOUS:

1. He should see that all assets and liabilities are properly and distinctly shown in the balance sheet.
2. He should see that all assets have been adequate depreciated.

COMPLETED

REFERNCE BOOKS:

1. **PRINCIPLES AND PRACTICE OF AUDITING – DINKAR PAGARE.**
2. **B.N. TANDON, S. SUDHARSANAN and S. SUNDHARABABU.** ***Practical Auditing.*** S. Chand & Sons. New Delhi.
3. **SHARMA.** Auditing.