16PAU303A	PRINCIPLES OF AUDITING	L	T	P	C
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COURSE OBJECTIVES

- To impart the students knowledge about the principles and practices in Auditing
- To make the students to know about the Types of Audit and Vouching transaction

LEARNING OUTCOME

Principles of Auditing represent the Auditing concepts, Qualification of an Auditor, Types of Audit, Vouching, and Audit Report. It provides the basic knowledge about the Auditing Principles and Practice.

UNIT I

Introduction to Auditing: Definition - General objectives of auditing - Advantages and limitations of auditing - Auditing and investigation - Qualification of an Auditor.

UNIT II

Types of Audit: Continuous Audit - Final Audit - Interim Audit - Balance Sheet Audit - Merits and Demerits - Audit procedure - Planning of Audit - Audit programme - Audit note book - Audit working papers – Internal control - Internal check - Internal checks as regards cash - wages - sales etc - Position of external auditors to Internal Audit.

UNIT III

Vouching: Vouching of cash transactions - Trading transactions - Impersonal ledger – Definition - Nature and Scope of Internal Auditing - Auditor position - Auditors Duty Regarding Depreciation - Reserves and Provisions.

UNIT IV

Company Audit - Appointment and removal of auditor - Rights and duties of company auditors - Liabilities - Audit of share capital and share transfer.

UNIT V

Audit report - Contents and types - Auditors decision regarding the purchase and sale of asset - Audit of Computerized Accounts - Electronic Auditing.

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand& Company, New Delhi.

REFERENCES

1. Saxena, R.G. Kuriakose, K.K. Venugopal. S, (2012), *Auditing Theory and Practicals*, Himalaya Publishing House, Mumbai.
2. Saxena. (2009), *Principles and practices of Auditing*. Himalaya Publishing House, Mumbai.
3. Kamal Gupta, (2010), *Contemporary Auditing*, Tata McGraw-Hill Publishing Company Ltd, New Delhi.
4. M.S Ramaswamy, (2010), *Principles and Practices of Auditing*, Vikas Publishing House Pvt Ltd, New Delhi.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University Established Under Section 3 of UGC Act 1956)
Coimbatore – 641 021.

LECTURE PLAN

DEPARTMENT OF COMMERCE

Staff Name : **Ms.N.Saranya**

Subject Name : **Principles of Auditing** **Subject Code** : **16PAU303A**

Academic Year : **2017- 2018** **Class** : **II B.Com – PA**

Semester : **III** **Batch** : **2016-2019**

UNIT I

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT Materials
1.	1	Introduction to Auditing	R2:1
2.	1	Overview of auditing	R1:1-5
3.	1	Features of an Auditing	R1:1-5
4.	1	Primary Objectives of auditing	R1:4 -7
5.	1	Secondary Objectives of auditing	R1:8 -11
6.	1	Advantages of auditing	R1:2 – 3, W1
7.	1	Limitations of auditing	R1:6 -7 W2
8.	1	Auditing and Investigation	R2 : 490 -493
9.	1	Investigation	R2 : 490 -493
10.	1	Qualification of Auditor	R2:495
11.	1	Qualities of an Auditor	R2:495
12.	1	Independence of Auditor	R2-535-536
13.	1	Auditors duties and responsibilities	R2-537
14.	1	Roles and Responsibilities	R2-537
15.	1	Recapitulation and discussion of important Questions	
Total No. of hours planned for unit one			15

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand& Company, New Delhi.

REFERENCES

1. Saxena, R.G. Kuriakose, K.K. Venugopal. S, (2012), *Auditing Theory and Practicals*, Himalaya Publishing House, Mumbai.
2. Saxena. (2009), *Principles and practices of Auditing*. Himalaya Publishing House, Mumbai.

WEBSITE

1. W1:baf.co/advantages and limitations of audit /
2. W2: accounting – simplified.com

UNIT II

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT Materials
1.	1	Continuous Audit	T:15
2.	1	Final Audit	T:18
3.	1	Balance sheet Audit	T:21
4.	1	Merits and demerits of Balance sheet	W3
5.	1	Audit Procedure	W4
6.	1	Planning of Audit	W4
7.	1	Audit Programme	T:39
8.	1	Audit note Book	T:43
9.	1	Audit Working Papers	T:44
10.	1	Internal Control	W5
11.	1	Internal Check	T:52
12.	1	Internal check regards as Cash, Wages, Sales etc	T:53
13.	1	Position of External auditors to Internal audit	W6
14.	1	Revenue Audit & Concurrent Audit	W4&W7
15.	1	Recapitulation and discussion of important Questions	
Total No. of hours planned for unit two			15

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand & Company, New Delhi.

REFERENCES

1. Saxena, R.G. Kuriakose, K.K. Venugopal. S, (2012), *Auditing Theory and Practicals*, Himalaya Publishing House, Mumbai.
2. Saxena. (2009), *Principles and practices of Auditing*. Himalaya Publishing House, Mumbai.

WEBSITE

1. W3:www.education.blurbit.com
2. W4: www.smallbusiness.chorn.com
3. W5: en.wikipedia.org
4. W6: www.elearning.sol.du.ac.in

UNIT III

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT Materials
1.	1	Vouching	T: 50
2.	1	Vouching of Cash Transactions	T:52
3.	1	Vouching of Cash book	T:54
4.	1	Credit side of Cash book	T: 56
5.	1	Vouching of trading transactions	T:76
6.	1	Duty of auditor in connection with credit purchases	T:77
7.	1	Duty of auditor in connection with credit purchases	T:77
8.	1	Vouching Impersonal ledger	T:96
9.	1	Outstanding Assets and Liabilities	T:97
10.	1	Internal Auditing – Nature	W4 & W7
11.	1	Internal Auditing –Scope	W7
12.	1	Auditor Position	W4
13.	1	Auditors duty regarding Reserves and Provisions	R1:190-191
14.	1	Auditors duty regarding Deprecation	R1:186
15.	1	Recapitulation and discussion of important Questions	
Total No. of hours planned for unit three			15

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand & Company, New Delhi.

REFERENCES

1. Saxena, R.G. Kuriakose, K.K. Venugopal. S, (2012), *Auditing Theory and Practicals*, Himalaya Publishing House, Mumbai.
2. Saxena. (2009), *Principles and practices of Auditing*. Himalaya Publishing House, Mumbai.

WEBSITE

1. W4: www.smallbusiness.chorn.com
2. W7: www.caclubindia.com

UNIT IV

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT Materials
1.	1	Appointment of Company Auditor	T: 220
2.	1	Removal of Auditor	T: 224
3.	1	Remuneration of auditor	T: 225
4.		Expenses of auditor	T: 225
5.	1	Rights of an Auditor	T: 229
6.	1	Duties of an Auditor	T: 233
7.	1	Liabilities of an Honorary Auditor	T: 512
8.	1	Liabilities of an Local auditor	T: 516
9.	1	Liabilities of auditor for branch audit	T: 515
10.	1	Liability of company Auditor	T: 502
11.	1	Audit Report	T: 252
12.	1	Audit of share capital	T: 265
13.	1	Share capital Audit	T: 265
14.	1	Share transfer Audit	T: 266
15.	1	Recapitulation and discussion of important Questions	
Total No. of hours planned for unit four			15

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand & Company, New Delhi.

UNIT V

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT Materials
1.	1	An overview of auditor's Report	T:337
2.	1	Importance of Audit report	
3.	1	Contents of the Audit report	T:338
4.	1	types of audit report	T:339
5.	1	Auditors decision regarding Purchase of asset	R1:195
6.	1	Auditors decision regarding sale of asset	R1:197
7.	1	Audit of Computerized Accounts	W1
8.	1	Electronic Auditing	W1
9.	1	Classification of Reserves	R:203
10.	1	Basic Principles Stock in trade	T:136
11.	1	Secret Reserves with regards to Auditors	R1:205
12.	1	Recapitulation and discussion of important questions	
13.	1	**Revision :** Discussion of ESE question papers	
14.	1	Discussion of ESE question papers	
15.	1	Discussion of ESE question papers	
Total No. of hours planned for unit five			15

TEXT BOOKS

1. B.N.Tandon, (2014), *Principles of Auditing*, S.Chand & Company, New Delhi.

REFERENCES

1. Saxena, R.G. Kuriakose, K.K. Venugopal. S, (2012), *Auditing Theory and Practicals*, Himalaya Publishing House, Mumbai.
2. Saxena. (2009), *Principles and practices of Auditing*. Himalaya Publishing House, Mumbai.

WEBSITE

W1:baf.co/advantages and limitations of audit /

UNIT-I

SYLLABUS

Introduction to Auditing: Definition - General objectives of auditing - Advantages and limitations of auditing - Auditing and investigation - Qualification of an Auditor.

Origin of Auditing

During the 18th century industrial revolution brought in large scale production, steam power, improved facilities and better means of communication. This resulted in the origin of Joint stock form of organizations. Shareholders contribute capital of these companies but do not have control over the day to day working of the organisation. The shareholders who have invested their money would naturally be interested in knowing the financial position of the company. This originated the need of an independent person who would check the accounts and report the shareholders on the accuracy of the accounts and the safety of their investment.

The Indian Companies Act, 1913 defined the qualification, power, duties and procedure of appointment of the Auditor. The audit of Joint Stock Company made compulsory by this Act. Educational qualification certificate were issued by the central and state governments to those who undergone the prescribed course. In the year 1949, Chartered Accountants Act was passed. Companies act 1956 further elaborated the provisions related to the auditing and accounts of the companies. Now a person to do the auditing must be qualified as per the standards of the Institute of Chartered Accountants of India.

Definition

Auditing Means, the vertification of accounting and financial records with a view to determine accuracy and reliability. The word “audit” is derived from the Latin word “audire” which means to “to hear”.

Spicer and Pegler defined the Audit as, “As an examination of the books, accounts and vouchers of a business, as will enable the auditor to satisfy himself that the balance sheet is properly drawn up, so as to exhibit a true and fair view of the state of affairs of the business and whether the profit and loss account gives a true and fair view of profit or loss for the financial period, according to the best of his information and explanation given to him and as shown by the books”

.

Objectives of Auditing

Primary Objectives: To determine and judge the reliability of the financial statement and the supporting accounting records of a particular financial period is the main purpose of the audit. As per the Indian Companies Act, 1956 it is mandatory for the organizations to appoint a auditor who, after the examination and verification of the books of account, disclose his opinion that whether the audited books of accounts, Profit and Loss Account and Balance Sheet are showing the true and fair view of the state of affairs of the company's business. To get a true and fair view of the companies' affairs and express his opinion, he has to thoroughly check all the transactions and relevant documents of the company made during the audited period. Which will help the auditor to report the financial condition and working result of the organization. While carrying out the process of audit, the auditor may come across certain errors and frauds. But detection of fraud or errors are not the primary objective of the audit. They are come under the secondary objectives of audit.

Audit also disclose whether the Accounting system adopted in the organization is adequate and appropriate in recording the various transactions as well as the setbacks of the system.

Secondary Objectives:

In order to report the financial condition of the business, auditor has to examine the books of accounts and the relevant documents. In that process he may come across some errors and frauds. We may classify these errors and frauds as below:

1 Detection and prevention of Errors

2. Detection and prevention of Frauds.

Detection and prevention of Errors: Following types of errors can be detected in the process of auditing.

1. Clerical Errors
2. Errors of Principle

Clerical Errors: Due to wrong posting such errors may occur. Money received from Microsoft credited to the Semens's account is an example of clerical error. Even though the account was posted wrongly, the trial balance will agree. We can classify clerical errors as below:

i. Errors of Commission

ii. Errors of Omission

iii. Compensating Errors.

i. Errors of Commission: These errors are errors caused due to wrong posting either wholly or partially of in the books of original entry or ledger accounts or wrong totaling, wrong calculations, wrong balancing and wrong casting of subsidiary books. For example Rs. 5000 is paid to Microsoft for the supply of windows program and the same is recorded in the cash book. While posting the ledger the Microsoft's account is debited by Rs. 500. It may be due to the carelessness of the accountant. Most of these errors of commission are reflected in the trialbalance and can be identified by routine checking of the books.

ii. Errors of Omission: When there is no record of transactions in the books of original entry or omission of posting in the ledger could lead to such errors. Sales not recorded in the sales book or omission to enter invoices in the purchase book are examples of Errors of Omission. Errors due to entire omission will not affect the trial balance. Errors due to partial omission will affect the trial balance and can be detected.

iii. Compensating Errors are errors committed in such a way that the net result of these errors on the debit side and credit side would be nullify the net effect of the error. For example, Ram's account which was to be debited for Rs. 5000 was credited for Rs. 5000 and similarly, Sita's Account which was to be credited for Rs. 5000 was debited for Rs. 5000. These two mistakes will nullify the effect of each other. Unless detailed investigation is undertaken such errors are difficult to locate as both the sides of the trial balance are equally affected.

2. Errors of Principle: While recording a transaction, the fundamental principles of accounting is not properly observed, these types of errors could occur. Over valuation of closing stock or incorrect allocation of expenditure or receipt between capital and revenue are some of the examples of such errors. Such errors will not affect the trial balance but will affect the Profit and Loss account. It may occur due to lack of knowledge of sound principles of accounting or can be committed deliberately to falsify the accounts. To detect such errors, the auditor has to do a careful examination of the books of account.

Detection and Prevention of frauds: To get money illegally from the organization or from the proprietor frauds are committed intentionally and deliberately. If it remain undetected, it could affect the opinion of the auditor on the financial condition and the working results of the organization. Therefore, it is necessary for the auditor to exercise utmost care to detect such frauds. It can be committed by the top management or by the employees of the organization. Frauds could be of the following types:

1. Misappropriation of cash

2. Misappropriation of goods

3. Falsification or Manipulation of accounts

4. Window dressing

5. Secret Reserves

Misappropriation of Cash: Since the owner has very limited control over the receipt and payments of cash, misappropriation or defalcation of cash is very common specially in big business organizations. Cash can be misappropriated by various ways as mentioned below:

a. Recording fictitious payments

b. Recording more amount than the actual amount of payment

c. Suppressing receipts

d. Recording less amount than the actual amount of payment.

There should be strict control over receipts and payments of cash known as "Internal check system" to prevent such frauds. The auditor should check the Cash Book with original records, bills register , invoices, vouchers, counterfoils or receipt books, wage sheets, salesman's diary, bank statements etc. in order to discover such frauds.

Misappropriation of goods: Companies handling with high value goods are pray to this kind of misappropriation. Without proper records of stock inward and stock outward, it is difficult for the auditor to find out such fraud. Periodical and surprise checking of stock and maintaining the proper record of inward and outward movement of stock can reduce the possibility of such fraud.

Falsification or manipulation of accounts: In order to achieve certain specific objectives, accounts may be manipulated by those responsible persons who are in the top management of the organization. They prepare accounts such a manner that they disclosed only a fake picture not the true picture. Some of the ways used in manipulating the accounts are as follows:

1. Inflating or deflating expenses and incomes
2. Writing off of excess or less bad debts.
3. Over-valuation or under-valuation of closing stock.
4. Charging excess or less depreciation
5. Charging capital expenditures to revenue and vice-versa
6. Providing for excess or less doubtful debts.
7. Suppressing sales and purchase or showing fictitious sales and purchases etc.

Window dressing: is the way of presenting the financial data in a much better position than the original position. It is known as window dressing. Some of the reasons for doing window dressing are as follows:

1. To win the confidence of share holders

2. To obtain further credit

3. To raise the price of shares in the market by paying higher dividend so that shares held may be sold

4. To attract prospective parters or shareholders.

5. To win the confidence of shareholders.

Secret Reserves: In secret reserves, accounts are prepared in such a way that they disclose worse picture than actually what they are. The objectives of preparing accounts in this way are:

1. To conceal the true position from the competitors.
2. To avoid or reduce the tax liability

3. To reduce the price of shares in the market by not paying dividend or paying lower dividend so that the shares may be bought at a much lower price.

It is very difficult to detect such frauds since these frauds are committed by those persons in the organizations who are at the top positions like directors, managers, financial controllers etc. To detect these kind of frauds, the auditor must be vigilant and should make searching inquiries to arrive at the true position.

Advantages of Audit

1. Audited accounts are readily accepted by Government authorities like Tax authorities and Central banks.

2. By auditing the accounts Errors and frauds can be detected and rectified in time.

3. For accessing finance from financial institutions like Banks, previous years audited accounts are evaluated for determining repayment capability.

4. Regular audit of account create fear among the employees in the accounts department and exercise a great moral influence on clients staff thereby restraining them from commit frauds and errors.

5. Audited accounts facilitate settlement of claims on the retirement/death of a partner.

6. In the event of loss of property by fire or on happening of the event insured against, Audited accounts help in the early settlement of claims from the insurance company.

7. In case of Public Company where ownership is separated from management, auditing of accounts reassure the shareholders that accounts have been properly maintained, funds are utilized for the right purpose and the management have not taken any undue advantage of their position.

8. To determine the value of the business in the event of purchase or sales of the business, audited account will be the treated as the base for the evaluation.

9. The audit of accounts by a qualified auditor also help the management to understand the financial position of the business and also it will help the management to take decision on

various matters like report in internal control system of the organization or setting up of an internal audit department etc.

10. If the accounts have been audited by an independent person, disputes between the management and labor unions on payment of bonus and higher wages can be settled amicably.

11. In the event of admission of a new partner, audited accounts will facilitate the formation of terms and conditions for joining the new partner. Last 3 years audited accounts will give a general idea about the growth and financial position of the business to the new partner.

Disadvantages of Audit

1. The payment of audit fees brings extra cost burden to the organization.

2. During an audit the auditor requires the attention several company staff and therefore causes disruption.

3. Limitations of Audit

1. An audit does not assure future viability of the organization audited

2. An audit does not assure the effectiveness and efficiency of management.

3. Auditors express opinion and therefore does not give total assurance of the true fair presentation of annual reports.

Investigative Audit

This is an audit that takes place as a result of a report of unusual or suspicious activity on the part of an individual or a department. It is usually focused on specific aspects of the work of a department or individual. All members of the campus community are invited to report suspicions of improper activity to the Director of Internal Auditing Services on a confidential basis.

An investigative audit is the same as a forensic audit. In forensic auditing, accountants with specialized knowledge of both accounting and investigation seek to uncover fraud, missing money, negligence and/or malfeasance. When fraud or theft is uncovered, the investigative auditor compiles evidence and is often asked to testify if the individual responsible for the theft is eventually prosecuted.

Forensic accountants focus on investigative accounting and providing litigation support. Investigative accounting involves skills that regular accountants do not usually possess. For example, a forensic accountant is trained to introduce evidence in court, answer questions from attorneys while on the witness stand and understand courtroom rules and procedure.

Investigative auditing firms are staffed with these professionals. If your business requires an investigative audit, there are distinct advantages and disadvantages to involving a third party.

Disadvantages

If indeed you have an accountant trained in investigative auditing on staff, it makes sense to use your own forensic accountant in the investigative auditing process. The positive side of this is that it gives you more control over the dissemination of information. It is typically harder to control dissemination of information when an outside firm is involved. Another disadvantage is cost-related. Hiring an investigative auditing firm is typically far more expensive than using your own investigative accountant.

Advantages

The advantages of bringing in a third-party firm are numerous. Investigative auditing firms employ accountants who do this work on a regular basis. As such, they know what to look for. Another advantage is impartiality. An outside investigative auditor -- who has no personal or professional relationship with your employees -- is likely to conduct the audit in an impartial manner. This is important, as these investigations can lead to criminal prosecution. Thus, relying on an internal accountant to find fraud or theft might place him in an uncomfortable situation, which can affect morale.

Objectives of Investigation

The common objectives of investigation are listed below:

1) Proposed purchase of business.

2) Proposed sale of business.

3) Reasons for low profitability.

4) Cause of high employee turn over.

5) Reliability of business data.

6) Proposed investment in particular securities.

7) Suspected fraud.

8) Joining in existing partnership business.

9) Borrowing funds.

10) Lending funds.

11) Proposed purchase of controlling shares in a company.

12) Suspected misfeasance against directors.

13) Detection of undisclosed income for tax purposes.

14) Suspected misappropriation by trustees.

Techniques of Investigation

An investigation can be defined as an enquiry commissioned by a client for some purpose of his. The scope of enquiry, the range of possible clients and the number of purposes can be very large. We shall therefore confine ourselves to the most common types of investigations that the professional accountant may be called upon to do.

Common types of investigations:

a) Acquisition of companies;

b) Purchase of business;

c) Prospective investments;

d) Admission of new partners;

e) Prospective lending;

f) Fraud;

g) Systems breakdown;

h) Company Acts investigations;

Under this heading we shall also consider, prospectuses and profit forecasts.

Investigations may be needed whenever facts are in doubt or in dispute or where knowledge is required. Anybody can commission an investigation and you will find that companies, individuals, financial institutions and banks, local authorities, the tax authorities can all commission various investigations.

Investigations: The Stages

All investigations are carried out in the same way, therefore the student must remember this section of this chapter.

Stage 1:

You must always obtain precise written instructions from the client. This must incorporate a very clear view of the aims of the investigation, the scope of the investigation, the degree of the detail required, the degree of secrecy to be observed, the person to whom the accountant must address

his report. At this level, consideration must be given to the resources the client is ready to utilise and the cost of the job, both in terms of money and time.

Stage 2: Professional courtesies

Professional etiquette requires that if investigations are carried out in the affairs of organizations to which the accountant is not the auditor then the auditors must be communicated with. This is to observe the usual courtesies and to obtain their cooperation.

Stage 3: Organization of the investigations

This involves the accountant assessing the aims of the investigation, estimating the time to be taken and the likely costs and ensuring that the appropriate staff will be available.

Stage 4: Obtaining the background information

This is particularly important in investigations in acquisition of business. It involves gathering as much background information as possible about the object of the investigation, the size of the industry and its structure, history since commencement, the future prospects, the relevant legislation affecting that industry, investment information and relevant accounting ratios. This information is usually available from published sources such as government statistics, trade associations and the financial statements.

Stage 5: Gathering preliminary information

This information has to be gathered on the subject to be investigated. This information includes the location of the subject, its products, its range of services and its share of the market, key personnel, major accounting control systems and past reports.

Stage 6: Preparing the report outline

A report that meets the needs of many accounting investigations is as follows:

Part A: Introduction whereby we have references to the instructions given. The object of the investigation must be apparent from the introduction. **Part B:** A summary of the instructions must be given.

Part C: A statement of the precise objectives of the investigation and the report.

Part D: A statement of the scope of investigation stating the time period and the area covered.

Part E: A statement of the documents used. If it is necessary to reproduce any of these documents this is usually done in an appendix.

Part F: An outline of the work actually done, again it may be necessary to put some of this material in an appendix.

Part G: A summary of the information obtained.

Part H: Further information which could be of use to the client but does not flow from the investigation proper.

Stage I: Recommendations of the accountant. In giving recommendations, the accountant must always ensure that:

a) He gives information from which the client can draw his own conclusions

b) Avoid presenting information in such a way that the clients' judgement is influenced

c) If information is based upon assumptions, then the accountant must state the assumptions in full and substantiate them if possible

d) Make no forecasts

e) If you are giving opinions, estimates or forecasts, then the accountant must state who made them and what qualifications they had to making them

f) The recommendations are practical

g) The investigation has been comprehensively completed.

h) The report is drafted and discussed with the client

i) The final report is submitted

(1) Where it appears to the Central Government that there is good reason so to do, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company, for the purpose of determining the true persons
(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company ; or

(b) who are or have been able to control or materially to influence the policy of the company.
(1A) Without prejudice to its powers under this section, the Central Government shall appoint one or more inspectors under sub-section (1), if the Company Law Board, in the course of any proceedings before it, declares by an order that the affairs of the company ought to be investigated as regards the membership of the company and other matters relating to the company, for the purpose of determining the true persons

(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company ; or

(b) who are or have been able to control or materially to influence the policy of the company.

(2) When appointing an inspector under sub-section (1), the Central Government may define the scope of his investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to matters connected with particular shares or debentures.

(3) Subject to the terms of an inspector's appointment, his powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant to the purposes of his investigation.

(4) **[Omitted, vide The Companies (Amendment) Act, 2000].**

(5) For the purposes of any investigation under this section, sections 239, 240 and 241 shall apply with the necessary modifications of references to the affairs of the company or to those of any other body corporate :

Provided that the said sections shall apply in relation to all persons (including persons concerned only on behalf of others) who have been, or whom the inspector has reasonable cause to believe to be or to have been,

(i) financially interested in the success or failure, or the apparent success or failure, of the company, of any other body corporate whose membership or constitution is investigated with that of the company ; or

(ii) able to control or materially to influence the policy of such company, body corporate, as they apply in relation to officers and other employees and agents of the company, of the other body

corporate, as the case may be :

Provided further that the Central Government shall not be bound to furnish the company or any other person with a copy of any report by an inspector appointed under this section or with a complete copy thereof, if it is of opinion that there is good reason for not divulging the contents of the report or of parts thereof ; but in such a case, the Central Government shall cause to be kept by the Registrar a copy of any such report, or as the case may be, of the parts thereof, as respects which it is not of that opinion.

(6) The expenses of any investigation under this section shall be defrayed by the Central Government out of moneys provided by Parliament, unless the Central Government directs that the expenses or any part thereof should be paid by the persons on whose application the investigation was ordered.

ADDITIONAL POINTS

QUALIFICATION OF AUDITOR

1. Audit Helps To Detect And Prevent Errors And Frauds

An auditor's main duty is to detect errors and frauds, preventing such errors and frauds and taking care to avoid such frauds. Thus, even though all organizations do not have compulsion to audit, they make audit of all the books of accounts.

2. Audit Helps To Maintain Account Regularly

An auditor raises questions if accounts are not maintained properly. So, audit gives moral pressure on maintaining accounts regularly.

3. Audit Helps To Get Compensation

If there is any loss in the property of business, insurance company provides compensation on the basis of audited statement of valuation made my the auditor. So, it helps to get compensation.

4. Audit Helps To Obtain Loan

Specially financial institutions provide loan on the basis of audited statements. A business organization may obtain loan considering the audited statement of last five years. So, an organization should make audit compulsory to obtain loan.

5. Audit Facilitates The Sale Of Business

Valuation of assets is made by the auditor. On the basis of valuation of assets and liabilities, businessman can sell his business. It helps to determine the price of business.

6. Audit Helps To Assess Tax

Tax authorities assess taxes on the basis of profit calculated by the auditor. In the same way sales tax authority calculates sales tax on the basis of sales shown in the audited statement.

7. Audit Facilitates To Compare

An auditor instructs an accountant in the same way which helps to compare books of accounts of current year with the accounting of the previous year. So, comparing the accounts of current with previous years helps to detect errors and frauds.

8. Audit Helps To Adjust Account Of Deceased Partner

Valuation of all the assets and liabilities of the business is made by the auditor while auditing books of account. Such valuation helps to clear the amount of deceased partner.

9. Audit Helps To Present A Proof

If any case is filed against the auditor regarding negligence, auditor can present audited report as a proof to settle such case. So, it helps to present proof to settle such cases.

10. Audit Provides Information About Profit Or Loss

A businessman wants to know profit or loss of his business after a certain period of time. So, the owner of the business can get information about profit or loss after auditing the books of accounts.

11. Audit Helps To Prepare Future Plan

All the audited statements remain true and correct. Such true and correct account helps to prepare for the future plans.

12. Audit Helps To Increase Goodwill

Auditing shows the profitability and financial position of an organization which creates faith of public over the business. Thus, auditing helps to increase goodwill of an organization.

13. Audit Helps To Amalgamate The Company

Sometimes, same nature of organization may be amalgamated. Auditing makes valuation of assets and liabilities which helps to amalgamate the company. Purchaser of the company can accept such business organization on the basis of valuation made by the auditor.

Qualities and Qualifications of an Auditor

An efficient auditor must possess certain general qualities besides statutory qualification, so that he can carry out his work efficiently and smoothly. The qualities of an auditor as classified below.

1. Professional Qualification i.e., Statutory Qualification.
2. Professional Qualities i.e., Personal Qualification.
3. Personal Qualities i.e., General Qualities.

They are detailed below:

Professional Qualification | Statutory Qualification of an Auditor

In the case of sole trading concern and partnership the law has not prescribed any qualification for an auditor. However in the case of auditors of joint stock companies, the auditor must be a Chartered Accountant within the meaning of Chartered Accountant Act, 1949.

He must pass Chartered Accountant (C.A) examination conducted by the Institute of Chartered Accountants of India (ICAI). To be entitled to practice, a chartered accountant should obtain a certificate of practice from the council of the ICAI on payment of a prescribed annual fee. There are two categories of members of the ICAI such as – Associates, and Fellows.

A person is regarded as an **Associate Member of the Institute** when his name is entered in the Members Register maintained by the Institute. This entitles him to use the letters A.C.A. after his name.

An associate in continuous practice in India for at least five years under any other associate who has been a member of the Institute for five years and possesses such qualifications as prescribed by the Council of the Institute can be enrolled as a **Fellow of the Institute** and is entitled to use the letters F.C.A. after his name.

Professional Qualities | Personal Qualification of an Auditor

The professional qualities required for auditors are many and are of varied in nature. They are required for the successful performance of audit work. They are as follows:

The auditor must have a complete and thorough knowledge of the principles, theory and practice of accountancy. The auditor must be familiar with the different system of

UNIT – II

SYLLABUS

Types of Audit: Continuous Audit - Final Audit - Interim Audit - Balance Sheet Audit - Merits and Demerits - Audit procedure - Planning of Audit - Audit programme - Audit note book - Audit working papers – Internal control - Internal check - Internal checks as regards cash - wages - sales etc - Position of external auditors to Internal Audit.

Types of Audit:

Audit is an appraisal activity undertaken by an independent practitioner (e.g. an external auditor) to provide assurance to a principal (e.g. shareholders) over a subject matter (e.g. financial statements) which is the primary responsibility of another person (e.g. directors) against a given criteria or framework (e.g. IFRS and GAAP). Main types of audit engagements and services include:

- External Audit
- Internal Audit
- Forensic Audit
- Public Sector Audit
- Tax Audit
- Information System Audit
- Environmental & Social Audit
- Compliance Audit
- Value For Money Audit

External

External audit, *also known as financial audit and statutory audit*, involves the examination of the truth and fairness of the financial statements of an entity by an external auditor *who is independent of the organization* in accordance with a reporting framework such as the IFRS. Company law in most jurisdictions requires external audit on annual basis for companies above a certain size.

The need for an external audit primarily stems from the separation of ownership and control in large companies in which shareholders nominate directors to run the affairs of the company on their behalf. As the directors report on the financial performance and position of the company, shareholders need assurance over the accuracy of the financial statements before placing any reliance on them. External audit provides reasonable assurance to the owners of the company that the financial statements, as reported by the directors, are free from material misstatements. External auditors are required to comply with professional auditing standards such as the International Standards on Auditing and ethical guidelines such as those issued by IFAC in order to maintain a level of quality and trust of all stakeholders in the auditing exercise.

Internal

Internal audit, *also referred as operational audit*, is a voluntary appraisal activity undertaken by an organization to provide assurance over the effectiveness of internal controls, risk management and governance to facilitate the achievement of organizational objectives. Internal audit is performed by employees of the organization who report to the audit committee of the board of directors as opposed to external audit which is carried out by professionals independent of the organization and who report to the shareholders via audit report.

Unlike external audit, whose scope is primarily restricted to matters that concern the financial statements, the scope of work of an internal audit is very broad and can encompass any matters which can affect the achievement of organizational objectives. Internal audit is typically centered around certain key activities which include:

- Monitoring the effectiveness of internal controls and proposing improvements
- Investigating instances of fraud and theft
- Monitoring compliance with laws and regulations
- Reviewing and *verifying where necessary* the financial and operating information
- Evaluating risk management policies and procedures of the company
- Examining the effectiveness, efficiency and economy of operations and processes

Forensic

Forensic Audit involves the use of auditing and investigative skills to situations that may involve legal implications. Forensic audits may be required in the following instances:

- Fraud investigations involving misappropriation of funds, money laundering, tax evasion and insider trading
- Quantification of loss in case of insurance claims
- Determination of the profit share of business partners in case of a dispute
- Determination of claims of professional negligence relating to the accountancy profession

Findings of a forensic audit could be used in the court of law as expert opinion on financial matters.

Public Sector

State owned companies and institutions are required by law in several jurisdictions to have their affairs examined by a public sector auditor. In many countries, public sector audits are conducted under the supervision of the auditor general which is an institute responsible for strengthening public sector accountability and governance and promoting transparency.

Public sector audit involves the scrutiny of the financial affairs of the state owned enterprises to assess whether they have been operated in way which is in the best interest of the public and whether standard procedures have been followed to comply with the requirements in place to promote transparency and good governance (e.g. public sector procurement rules). Public sector audit therefore goes a step further than the financial audit of private organizations which primarily focuses on the reliability of financial statements

Audits of public sector companies are becoming increasingly concerned with the efficiency, effectiveness and economy of resources used in state organizations which has given way for the development of value for money audits.

Tax audits are conducted to assess the accuracy of the tax returns filed by a company and are therefore used to determine the amount of any over or under assessment of tax liability towards the tax authorities.

In some jurisdictions, companies above a certain size are required to have tax audits after regular intervals while in other jurisdictions random companies are selected for tax audits through the operation of a balloting system.

Information System

Information system audit involves the assessment of the controls relevant to the IT infrastructure within an organization. Information system audits may be performed as part of the internal control assessment during internal or external audit.

Information system audit generally comprises of the evaluation of the following aspects of information system:

- Design and internal controls of the system
- Information security and privacy

- Operational effectiveness and efficiency
- Information processing and data integrity
- System development standards

Environmental & Social

Environmental & Social Audits involve the assessment of environmental and social footprints that an organization leaves as a consequence of its economic activities. The need for environmental auditing is increasing due to higher number of companies providing environment and sustainability reports in their annual report describing the impact of their business activities on the environment and society and the initiatives taken by them to reduce any adverse consequences.

Environmental auditing has provided a means for providing assurance on the accuracy of the statements and claims made in such reports. If for example a company discloses the level of CO_2 emissions during a period in its sustainability report, an environment auditor would verify the assertion by gathering relevant audit evidence.

Compliance

In many countries, companies are required to conduct specific audit engagements other than the statutory audit to comply with the requirements of particular laws and regulations. Examples of such audits include:

- Verification of reserves available for distribution to shareholders before the declaration of interim dividend
- Audit of the statement of assets and liabilities submitted by a company at the time of liquidation
- Performance of cost audit of manufacturing companies to verify the cost of production in order for a regulator to determine the maximum price to be allowed *after allowing a reasonable profit margin* to companies operating in a sensitive sector (e.g. pharmaceuticals industry)

Value For Money

Value for money audits involves the assessment of the efficiency, effectiveness and economy of an organization's use of resources.

Principles of auditing

Value for money audits are increasingly relevant to sectors which do not have profit as their main objective such as the public sector and charities. They are usually performed as part of internal audit or public sector audit.

Audit programme

After the conclusion of preliminary survey, the auditor has a fair idea of the audit objectives and the control systems. At this stage the audit programme should be made providing the proposed procedures, budgeting and basis for controlling the audit. It outlines the steps to achieve the objectives of the audit within the defined scope The audit programme will prevent the auditor from going off the scope pursuing irrelevant items and help in completing the audit project in an efficient manner.

Things to be considered while preparing audit programme

- Needs of potential users of the audit report.
- Legal and regulatory requirements
- Management controls
- Significant findings and recommendations from previous audits that could affect
- the current audit objectives. Also determine whether corrective action has been
- taken and earlier recommendations implemented.
- Potential sources of data that could be used as audit evidence and consider the
- validity and reliability of these data.
- Consider whether the work of other auditors and experts may be used to satisfy
- some of the audit objectives.
- Provide sufficient staff and other resources to do the audit
- Criteria for evaluating areas under audit.

Continuous Audit

Continuous audit or a detailed audit is an audit which involves a detailed examination of books of account at regular intervals i.e. one month or three months. The auditor visits clients at regular intervals during the financial year and checks each and every transaction. At the end of the year auditor checks the profit and loss account and the balance sheet. A continuous audit is not of much use to small firm as its accounts can be audited at the end of the financial year without much loss of time.

Business where continuous audit is applicable:

* Where it is desired to present the account just after the close of the financial year, as in the case of a bank.

* Where the volume of the transactions is very large.
* Where the statements of accounts is required to be presented to the management after every month or quarter.
* Where no satisfactory system of internal check is in operation.

Advantages Of Continuous Audit

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 a 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

In spite of the above-mentioned advantages of a continuous audit, there are certain drawbacks of such and audit which are as follows:

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. Queries 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.

Interim Audit

An audit which conducted in between the two annual audits with a view to find out interim profits to enable the company to declare an interim dividend is known as Interim Audit. It is a kind of audit which is conducted between the two periodical or balance sheet audits.

Objectives Of Interim Audit

1. To know profit or loss of interim period.
2. To distribute interim dividend.
3. To get loan on the basis of interim account.
4. To get information about the financial position of interim period.

Advantages Of Interim Audit

1. Interim audit is good where the publication of the interim figure is necessary.

2. Then final audit can be completed very soon, if there has been an interim audit.

3. Errors and frauds can be detected more quickly during the final audit.

4. There is moral check on the staff of the client as the accounts are checked, say after three or six months in the interim audit.

Disadvantages Of Interim Audit

1. Figures may be altered in the accounts which have already been audited.
2. It will mean that the audit staff will have to prepare notes when they finish the interim audit.
3. Interim audit is an additional work because final audit must be conducted after conducting this audit too.

Distinguish between Interim Audit and Continuous Audit

1. Fee :-
Interim audit : The fee of interim audit is low.
Continuous audit : The fee of continuous audit is high.

2. Legal Position :-
Interim audit : The interim audit is not compulsory by law.
Continuous audit : Continuous audit is compulsory by law.

3. Objectives :-
Interim audit : Interim audit checks and determines the profit or loss for the particular period.
Continuous audit : Continuous audit shows the true and fair view of the financial statement.

4. Scale Of Business :-

Interim audit : Interim audit is conducted for the both large scale and small scale business.

Continuous audit : Continuous audit is conducted only for large scale business.

5. Scope :-

Interim audit : In interim audit there is no detailed checking of accounts.

Continuous audit : In continuous audit there is a detailed checking of accounting records.

6. Verification :-

Interim audit : Verification of assets and liabilities are done when interim audit is conducted.

Continuous audit : In continuous audit it is done when balance sheet is prepared.

7. Period Of Audit :-

Interim audit : Interim audit period is upto the particular date.

Continuous audit : Continuous audit period is for one whole year.

8. Interest Of The Third Party :-

Interim audit : In case of interim audit third party has no interest.

Continuous audit : In case of continuous audit third party may be interested.

9. Trial Balance :-

Interim audit : Preparation of trial balance is compulsory in interim audit.

Continuous audit : It is not compulsory in continuous audit.

10. Report :-

Interim audit : The report of interim audit is presented at the end of the interim audit.

Continuous audit : Continuous audit report is presented at the end of the accounting period.

Classes of Audit

An official whose job it is to carefully check the accuracy of business records. An auditor can be either an independent auditor unaffiliated with the company being audited or a captive auditor, and some are elected public officials. The term is sometimes synonymous with "comptroller."

Auditors are used to ensure that organizations are maintaining accurate and honest financial records and statements.

The general definition of an audit is a planned and documented activity performed by qualified personnel to determine by investigation, examination, or evaluation of objective evidence, the adequacy and compliance with established procedures, or applicable documents, and the effectiveness of implementation. The term may refer to audits in accounting, internal controls, quality management, project management, water management, and energy conservation.

Auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.The purpose is then to give an opinion on the adequacy of controls (financial and otherwise) within an environment they audit, to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal Control

The whole system of controls, financial or otherwise established by MANAGEMENT in order to:

1. Carry on the business in an orderly and efficient manner
2. Ensure adherence to management policies
3. Safeguard the business assets
4. Safeguard the completeness and accuracy of records.

An internal control system is a collection of controls or "internal controls". Two things are worthy of note here. Firstly it is management's job to install and maintain these internal controls. Secondly many internal controls set up by large companies are impractical for small companies. Managers of small companies have less need to depend on internal controls for the reliability of records because of their personal involvement in the day to day operations. There are eight types of internal controls:

1.Organisation controls lines of reporting authority

2.Segregation of duties

It is important that the same person is not responsible for the recording and processing of a complete transaction. The three elements of a transaction which need to be carried out by different people are:

- Authorization
- recording
- custody of the assets

3.Physical controls

Custody of assets. An example of this might be a petty cash tin used to store office cash.

Authorization and approval

An example of this might be the approval of a new customer to take away goods on credit terms after completion of a successful credit control check.

5. Arithmetical and accounting

An example of this might be the monthly bank reconciliation. This is done so as to be able to ensure completeness and accuracy of the cash book records. Every month the entries are checked to the bank statements.

6.Personnel

Ensure that the business does not pay for work not done and only pays for work which is authorized and at the correct rate and which is undertaken competently and with integrity.

7.Supervision

The supervision of the day to day transactions for instance by a supervisor or senior.

8.Management

The overall management of business operations. Internal audit is an example of this type of control

These major types of internal controls must be present in all the transaction cycles:

- Purchases and creditors
- Sales and debtors
- Cash in the bank and in hand
- Wages and salaries
- Stock
- Fixed assets
- Investments

Internal check

An internal check is a part of internal control. Internal check is the process of arrangement of duties of various staffs of a business in such way that work is automatically checked by the next staff while performing their duties. Frauds which are committed by a staff are automatically detected and corrected by the staff. So, it helps a lot in the work of final audit. For example, a staff record the expenditure in a book and another staff posts them into ledger, another staff checks and verifies the ledger and payment is made by another staff. So, the work of one staff is checked by the staff while performing their works so that errors and frauds committed by one staff are detected and prevented by the another staff.

Objectives Of Internal Check

Following are the objectives of internal check system:

1. To eliminate the frauds and errors which may be committed by the staffs.

2. To prevent misappropriation of cash or stock.

3. To ensure the reliability of information produced by the accounting system.

4. To detect errors and frauds promptly which helps to minimize their effects in long term.

5. To exercise moral pressure over the staffs.

Evaluate criteria of good Internal check

Internal check means that checks imposed on such a way on day to day transactions that work of one person is checked by other person automatically. In this way the chances of fraud and errors minimizes. Because the mistake made by one person is checked by the other.

Matters relating to allocation of powers, division of work and methods of recording transactions are included in the internal check.

Auditory' duty:

Auditor's position with regard to internal check is as under.

Expansion:

First of all an auditor should satisfy himself about the working of proper internal check/control system. He should examine carefully the system of internal check before deciding the scope of work he would do.

In case of satisfactory system:

If the auditor is satisfied about the effectiveness of internal control them he should check hire efficiency and its existence by checking various items from different places. After it he may pay more attention or care to other important parts of this work.

Unsatisfactory case:

If the auditor feels that internal control system is not satisfactory then he should check those accounts where errors are likely to exist. If the internal control system cannot conform or satisfy to the auditor the he should report the client in writing.

Some sections are inadequate:

If auditor feels that overall system is satisfactory but certain sections of the system appear to be inadequate then he should inform the client about the dangers. The auditors should also give suggestions that how weaknesses can be removed if he is asked by the client.

Audit Note Book

A note book which is prepared by the audit staff to note down all the uncleared queries which s/he may find in the course of audit and requires further clarification and explanation is known as audit note book. Audit note book contains information regarding day-to-day work performed by the audit staff on any particular date. Notes about all types of errors, difficulties and uncleared queries or points to be discussed with the auditor or clients and the points which are to be incorporate in the report are noted down.

Contents Of Audit Note Book

1. The nature of the business carried on and the important documents relating to the constitution of the business, i.e. Memorandum Of Association, Articles Of Association (in the case of limited companies) and Partnership Deed (in the case of partnership firm) and other legal documents.

2. The name of the client and the audit year.

3. A list of books of accounts in use.

4. Names of principal officers, their duties and responsibilities.

5. Particulars of the accounting and financial system followed and the internal check in operation in the business.

6. Details regarding accounting and financial policies followed in the business.

7. A copy of the audit program.

Special Matters To Be Recorded In The Audit Note Book

1. Routine queries not cleared, i.e., missing receipts and vouchers etc.

2. Details of mistakes and errors discovered.

3. The points raised during the course of audit, to which the attention of the auditor must be drawn, i.e. failure of the company to comply with the provisions of the Companies Act or of the Memorandum of Association and other legal requirements.

4. Extracts from minutes books and contracts and other correspondence with various government agencies, financial institutions, debtors, creditors etc.

5. The points to be incorporate in the audit report.

6. The points which needs further explanation and clarification e.g., a change in the basis of valuation of finished stocks or in the computation of depreciation, etc.

7. Date of commencement and completion of the audit.

Objectives Of Audit Note Book

Audit note book is prepared with the following objectives:

1. To know about the nature of business i.e regarding provision of memorandum, articles of association etc.

2. Not to leave any errors and frauds which helps to make audit more effective and efficient.

3. To make the future audit work easier. Auditor can get information regarding nature of business from previous audit note book.

4. To check the list of debtors and creditors so that false list can be detected.

5. To know about the facts where clarification and explanation are essential.

6. To present as proof by the auditor to get clearance over the cases if auditor has been accused for misfeasance and negligence.

7. To assure the audit of major function or items of the business where there are chances of frauds and errors

Working Papers

Audit working papers are the documents which record all audit evidence obtained during financial statements auditing, internal management auditing, information systems auditing, and investigations. Audit working papers are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant auditing standards. They show the audit was:

- Properly planned;
- Carried out;
- There was adequate supervision;
- That the appropriate review was undertaken; & finally and most importantly;
- That the evidence is sufficient and appropriate to support the audit opinion.

The Institute of Internal Auditors, a global professional audit standards body, has issued practice advisory 2330-1 stating the goals of audit working papers are to:[1]

- Document the planning, performance, and review of audit work;
- Provide the principal support for audit communication such as observations, conclusions, and the final report;
- Facilitate third-party reviews and re-performance requirements; and
- Provide a basis for evaluating the internal audit activity's quality control program.

Audit working papers are the property of the auditor. In order to keep professional ethic, it cannot discover to third party without consent of the client unless limited specified situations mentioned in ISA 230 Documentation and required by law, the examples are court order, for public interest and so on.

Prepared by N.SARANYA , Department of Commerce

UNIT –III
SYLLABUS

Vouching of cash transactions - Trading transactions - Impersonal ledger – Definition - Nature and Scope of Internal Auditing - Auditor position - Auditors Duty Regarding Depreciation - Reserves and Provisions.

Vouching

Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc.

The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called "Vouching". Vouching is a technical term which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction. Simply stated, vouching means a careful examination of all original evidence i.e invoices, statements, receipts, correspondence, minutes and contracts etc. with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible, that no entries have been omitted in the books of accounts. Therefore, vouching is the act of testing the truth of entries appearing in the primary books of accounts. It is initial for auditing.

Objectives Of Vouching

Main objective of vouching is to find out the regularity or irregularity of transactions, frauds and errors. Regularity means maintaining record and performing the work compliance with the rules, regulation and law. But irregularity means doing the work crossing to the line of rules, regulation and laws. Some of the major objectives of vouching are given below:

1. To Detect Errors And Frauds

All transactions are to be supported by evidence. Each document should be proved by authorized authority. With the help of vouching we can detect errors and frauds by verifying each transaction. Planned fraud can be detected through vouching.

2. To Know The Truth Of Account

Each and every transaction is checked and ratified on the basis of support document. So, we can easily know the truth of account.

3. To Find The Unrecorded Transactions

Each and every transaction is checked and ratified on the basis of document. Vouching helps to find out the unrecorded or missing transactions. If any voucher is found unrecorded, auditor can suggest to record such transactions.

4. To Know That All The Transactions Are Authorized

If the transactions are made on the consent of concerned authority, such transactions are known as authorized transactions. If transactions are not authorized, such transactions can be fictitious transactions. So, such fictitious transactions ca be found with the help of vouching.

5. To Know That Only the Business Transactions Are Recorded

Sometimes, transactions are performed for individual purpose but payment is made out of business. Such transactions should not be recorded in account of business. If such transactions are recorded, we can find it with the help of vouching. To know the real profit or loss of business, such transactions are to be separated.

Voucher

„Voucher" is the original documentary evidence in support of any payment or receipt of money by the business. It would be with the help of the voucher that the accuracy of entry can be checked. Voucher alone can tell us about the nature and sources of the transaction, its value and authority. It substantiates the book entries and confirms their reality. Such evidence may be primary and collateral. Certain Vouchers provide primary evidence while others constitute collateral evidence.

The following may be a few of the examples of vouchers for certain transactions:

1) Cash Received – Counterfoils of Receipts issued, Contracts, Minutes, Correspondence, Confirmation of balances by Debtors etc,

2) Cash Paid – Original receipts from Payees, Invoice Bills, Demand Notes, Wages Books, Salaries Books, Contracts, Correspondence, Confirmation by Creditors etc,

3) Purchases – Invoices, Books, Copies of Orders, Correspondence etc.

4) Sales – Copies of Invoices, Orders Record, Goods Outward Book, Correspondence etc. similarly, evidence can be had with regard to transactions like Purchases and Sales Returns, Bills Receivable and Payable and Journal Entries.

All vouchers relating to business transactions should be carefully preserved and properly filed.

Vouching the of cash book

1) To verify that all the receipts and payments have been properly recorded.
2) To verify about the cash at the bank and in hand.
3) To know or understand that all receipts are accounted for.
4) To prove that no fraudulent have been made

Vouching the debit side of cash book:

1. Examination of internal system:

In case of receipts side the auditors has to depend upon the internal checks and external documentary evidence. He should examine the weak points of the internal check system and pay the special attention on the weak point.

2. Compare counterfoil with cashbook:

The auditor should checks the received cash with the counterfoil. He should also verify that unused receipt books are kept under lock and key or not.

3. Sale of assets:

The auditor should check the money received from the sale of assets and vouch it with reference to the correspondent of contract and other available evidence.

4. Terms of discount:

Auditor should verify that the terms and conditions on which discounts are given to the debtors. He should also examine a few items, on their base.

5. Receipts of rent:

When the Rent received it should be vouched with the rent agreement and counterfoil receipts.

6. Cash sale:

In this regard or consider auditor should compare the daily sale, statement of cashier and salesman with the bank statement.

7. Verify commission:

Auditor should check the account of commission with the accounts of the parties from whom commission has been received. The rate of agreement and commission must be checked verified.

8. Profit from investment:

Auditor should touch the profit from the investment with the counterfoil of dividend warrants and financial journals.

9. Bills receivable:

The amount received against the bill receivable should be vouched with reference to the bills receivable books. Inquires must be made against those bills, which are for the receipts of money, but against which the amount has not been received.

10. Bad debits dividend:

Receipts from debtors who become bank rupt should be vouched with the dividend warrants received from the official receiver, total debt, rate per rupee payable as dividend and correspondence exchanged between the debtor or the official receiver and the client should be examined.

11. Insurance claim money received:

Amount received in represent of a claim from an insurance company should be vouched with correspondence exchange with the insurance company, the amount rendered by the company, the original claim actually lodged.

12. Sale of securities:

Broker sold note should be vouched. The fact that sale is “ex-dividend” or “cum-dividend should carefully be examined. Minutes of the boards of directors if any should also be examined.

13. Miscellaneous receipt:

For vouching miscellaneous receipt resort be made to correspondence, contracts, or any other document which will be produced for proving the support of transaction involved in respect of the miscellaneous receipts.

14. Opening balance:

It should be verified with the balance shown in the auditor"s balance sheet of the previous years.

Vouching Credit side of cash book

1. Checking of internal system:

With reference to cash payments, auditor should analyze the internal check system and keep in view the weak points while auditing.

2. Inspection of wages and salaries:

The auditor should inspect the certified wages sheet and also test a few items for his satisfaction. He should also compare the contract and the appointment orders with the salaries.

3. Petty cash checking:

Auditor should examine the petty cash in hand and verify the balance of petty cash with cashbook.

4. Checking of payable bills:

The auditor should examine these bills with the returned bill. If these are paid through bank then passbook should be checked.

5. Checking of revenue and expenditure:

The auditor should prove that proper allocation has been made between capital, revenue and expenditure.

6. Creditors payments:

Auditor should also verify or examine the record and documentary evidence about the payments made to the creditors.

7. Detection of any missing entry:

Auditor should be very careful is examining the various payments. He should find out the missing or irregular entry by proper checking of vouchers.

8. Checking of cash purchase:

Auditors should check the name of the payees in the cash book against their entries. He should also note the dates on vouchers.

9. Checking of cash purchase:

These should be vouched with cash memos of the suppliers. For acquiring satisfaction that good have actually been received. The good received notes (GRN) good inward book etc should be examined. Allocation to the head of account debited should be verified.

Vouching of Trading Transactions

Trading transactions include, purchases, sales, purchase return, sales return, on the basis of consignment, hire purchase, sale or return, etc. Before commencing vouching and verification of the trading transactions, the auditor has to examine the effectiveness of the internal control systems in book keeping, compliance of accounting principles; and maintenance of stock records.

The internal control system in book-keeping shall ensure, that sales and closing stock are not overstated and purchases and opening stock are not understated. That discounts allowed/received are duly recorded. Adequate provisions are made for losses, depreciation and bad debts.

The internal control system should ensure that expenses of capital and revenue nature are correctly identified. Expenses pertaining to the accounting period are debited to the profit and loss account on accrual basis and outstanding expenses are disclosed in the liabilities side of the balance sheet. The prepaid expenses are duly disclosed in the assets side of the balance sheet. That the closing stock is shown at the correct value and there is no discrepancy in valuing the closing stock and a uniform method of valuation of closing stock is followed consistently.

The efficient system of internal checks ensures that all goods received and delivered are entered in the stock register and the chances of discrepancies are few and far between. Purchase department should be an independent unit, free from the task of receiving, storing and dispatching of goods. Purchase department should function in constant consultation with the sales departments, regarding the nature of demand, the quantity and quality of goods demanded, etc. purchase department should also be aware of the availability of various goods and their prevailing rates

Vouching of Impersonal ledger

Impersonal accounts refer to real accounts and nominal accounts which are related to trading account, profit and loss account and balance sheet. So, if there are any errors in such accounts, they will affect adversely to the report and financial statements which are to be signed by the auditor. Checking of such accounts is known as audit of impersonal ledger. It does not only assure the correctness and reliability of nominal accounts but also helps to detect the errors which remain in personal accounts. Such audit is conducted with the help of cash book, journal and subsidiary books.

Following works are to be performed for the audit of impersonal ledger:

1. Cash transactions are to be checked on the basis of cash book or journal.

2. Other impersonal transactions are to be recorded on the basis of sufficient evidences. An auditor has to check whether it is recorded on the basis of evidence or not.

3. Special attention should be given while checking transfer entries because it effects the final accounts.
4. Totals and balances of impersonal ledger should be ratified with the balance shown in trial balance.
5. Opening balance of impersonal ledger should be verified with the audited account of previous year.

6. Auditor should thoroughly check the totals of the various other books of original entry and also the postings of their totals of the impersonal ledger

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Internal Auditing

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Nature of Internal Audit

The following are the nature of internal audit:

1. **Independent**: The internal auditor should work independently. The word independent implies that the audit work should be free from any sort of restrictions that may have a significant impact on the scope and effectiveness of the review process and on the reporting of the findings and conclusions. Therefore, the internal audit work is detached from regular day-to-day operations of the organization.
2. **Appraisal**: The word appraisal implies a critical evaluation and assessment of the existing controls and operations of the business enterprise. The internal auditor should appraise them on the basis of appropriate criteria.
3. **Established**: The management should organize an independent internal audit department and duties should be specifically assigned to the department.
4. **Examine and Evaluate**: The terms of examination and evaluation describe the two fold functional roles and responsibilities of the internal auditor. Firstly the internal auditor should make an examination and enquiry for fact finding. Secondly he should make a judgmental evaluation after thorough examination.
5. **Activities of the Organization**: Internal audit aims at conducting a systematic examination of records, procedures and operations of an organization. The internal auditor should carefully examine the controls established inside the organization. In this sense internal audit can be described as ***Control Over Other Controls***. Controls are essential for every organization. In the absence of controls, it would be impossible for any organization to protect its assets, rely on the records and perform its functions successfully. The internal auditor examines the effectiveness of each control system and traces out the deficiencies in each system.
6. **Service**: Internal audit is a service to the whole organization. The internal auditor is an employee of the organization. His services can be availed at any time of emergency. His advice

can be obtained on any matter or point significant from the business and strategic point of view. His services can also be effectively utilized by other employees from the top to bottom. Any employee can consult him in solving the day-to-day problems.

7. **To the Organization**: The primary concern of an internal auditor is the phase of business activity where he can render any service to the management not only top management but all other managerial as well as operating staff. Therefore, the internal auditor should be an expert in all branches of business. In this respect, the internal auditor is superior to the financial auditor and even the cost auditor. His services are very useful to all the employees throughout the organization at all times. The terms '*To the Organization*' also signifies that internal audit is a total concept of service having a broad meaning and connotation.

Scope or Functions of Internal Auditing

Internal audit involves five major functions or areas of operation. They are as below:

1. **Reliability and Integrity of Information**: The internal auditor should review the reliability and integrity of financial and operating information and examine the effectiveness of the means used to identify, measure, classify, and to report such information.
2. **Compliance with Policies and Procedures**: The systems and procedure also.have considerable impact on the operation of the business enterprise. The internal auditor should gauge the effectiveness and impact of such systems and report thereon.
3. **Safeguarding the Assets**: The internal auditor should review the existing system for safeguarding the assets and if necessary should verify the existence of such assets.
4. **Economical and Efficient Use of Resources**: The internal auditor should also appraise the economy and efficiency with which the resources are employed. Further the internal auditor should identify the conditions, which would prevent the economical use of resources. They are as follows:
    1. Under utilization of capacity.
    2. Non-productive work.
    3. Procedures, which are not cost, justified.
    4. Over staffing or under staffing.
5. **Accomplishment of the Established Objectives and Goals**: The internal auditor should make a review of the operations or programmes of the enterprise and should ascertain whether the results are not inconsistent with the established goals and objectives of the enterprise. He should also ascertain whether the programmes are carried out as per plan.

Auditors Position

Internal auditors are not responsible for the execution of company activities; they advise management and the Board of Directors (or similar oversight body) regarding how to better execute their responsibilities. As a result of their broad scope of involvement, internal auditors may have a variety of higher educational and professional backgrounds.

Internal auditors work for government agencies (federal, state and local); for publicly traded companies; and for non-profit companies across all industries. Internal auditing departments are led by a Chief Audit Executive ("CAE") who generally reports to the Audit Committee of the Board of Directors, with administrative reporting to the Chief Executive Officer (In the United States this reporting relationship is required by law for publicly traded companies).

Auditor's Duty Regarding Depreciation

The Auditor cannot be held responsible for estimating the working life of an asset; it is the job of an expert valuer.

- A company can adopt different methods for different type of assets provided that the methods are adopted consistently over the years.
- If a company opts to choose new depreciation methods, then depreciation should be recalculated applying new methods from the date on which the asset is put to use for the first time. The difference of amount of depreciation as charged with old rate and the amount calculated from new rate should be debited to profit and loss account in case of loss and difference should be credited to general reserve in case of profit.
- According to Schedule II of the Companies Act, if asset is sold or discarded during the year, depreciation will be charged on pro-rata basis up to date of sale or discard. Similarly, depreciation will be charged on pro-rata basis, in case of addition to fixed asset.
- Account must disclose method of depreciation.
- Depreciation must be according to provisions of Companies Act and Income Tax Act.
- If depreciation is charged more than prescribed rate, Auditor should examine whether it is based on some professional and technical advice.
- Depreciation should be charged on revalued amount, if there is revaluation of assets.

Auditor's Duties towards Provisions and Reserves:

An auditor should see that specific reserves or provisions are created to cover all possible contingencies and are adequately provided for. He should verify these items carefully and discuss the matter with the management in case of any doubt. He should also get a certificate from a high official about adequate provision for all contingencies. Inadequate provisions, if not rectified, should be reported to clients.

Creation of general and special reserves is generally a matter of discretion for the management. Bond vs. Barrow Haematite Steel Co. case clearly established the principle that, subject to provisions in the Articles, directors have full authority to create any reserve they think necessary before recommending distribution of dividend and that no shareholder could challenge such authority.

Sub-section (2A) of Section 205 of the Act, however, requires that no dividend can be declared or paid by a company out of profits for any financial year except after transfer to reserve of such percentage of profit not exceeding 10, or voluntary transfer of more than 10 per cent under certain circumstances, as prescribed by the Companies (Transfer of Profits to Reserves) Rules, 1975. The auditor should see that reserves are created out of genuine surplus profits and, as per statutory provisions mentioned above in the case of a company, and that they are properly dis-closed in the balance sheet.

An auditor should also satisfy himself about disclosure in the profit and loss account of provisions and reserves and also withdrawals there from, if any, as per Part II, Clause 3(viii) and (ix), of Schedule VI to the Companies Act, 1956.

UNIT IV

Company Audit - Appointment and removal of auditor - Rights and duties of company auditors - Liabilities - Audit of share capital and share transfer

Concept and Meaning of Verification

Verification means proving the correctness. One of the main work's of auditor is verification of assets and liabilities. Verification is the act of assuring the correctness of value of assets and liabilities, title and their existence in the organization. An auditor should be satisfied himself about the actual existence of assets and liabilities appearing in the balance sheet is correct. If balance sheet incorporates the incorrect assets, both profit and loss account and balance sheet do not present true and fair views.

Thus, verification means to confirm the truth or accuracy and to substantiate. It is a process by which the auditor satisfies himself not only about the actual existence, possession, ownership and the basis of valuation but also ensures that the assets are free from any charge. While verifying the assets, an auditor should consider the following points:

* Ensuring the existence of assets.
* Acquiring the assets for business.
* Ensuring the proper valuation of assets.
* Ensuring that the assets are free from any charge.

Concept And Meaning Of Valuation

Valuation is the act of determining the value of assets and critical examination of these values on the basis of normally accepted accounting standard. Valuation of assets is to be made by the authorized officer and the duty of auditor is to see whether they have been properly valued or not. For ensuring the proper valuation, auditor should obtain the certificates of professionals, approved values and other competent persons. Auditor can rely upon the valuation of concerned officer but it must be clearly stated in the report because an auditor is not a technical person.

An auditor should consider the following points regarding the assets while making valuation of assets:

* Original cost

* Expected working life
* Wear and tear
* Scrap value

Verification is concerned with:

1.The existence of Actual items of assets and Liabilities.

2.Ownership and possession of the assets

3.Proper Classification and Valuation of both Assets and Liabilities.

According to Spicer & Peglar," Verification of Assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets"

So Verification of Assets may be said to form an opinion in respect of the following:

1.Existence of the Assets

2.Ownership of Assets

3.Possession of the Assets, whether actual or constructive

4.Proper valuation of the Assets

5.Proper presentation

Verification of Liabilities:

1.Balances in Creditors,

2.All liabilities have been disclosed.

3.All liabilities are properly valued.

4.Proper classification of Liabilities.

Valuation of Assets & Liabilities.

It is the value of which an item is stated in the balance sheet as per the GAAP.

Normally assets are valued as under.

1.Cost 2.Market Value 3.Cost of replacement 4.Realizable Value 5.Book Value 6.Break Up or Scrap Value 7.Going Concern Value.

Methods of Stock taking:

1.Unit Cost 2.Average Cost 3.FIFO 4.LIFO 5.Base Stock 6.Adjusted Price 7.Standard Cost 8.HIFO

Difference between Vouching & Verification:

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Methods of Stock taking:

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2.Average Cost

3.FIFO

4.LIFO

5.Base Stock

6.Adjusted Price

7.Standard Cost

8.HIFO

Difference between Vouching & Verification:

1. Nature of work	Vouching	It examines the entries relating to transactions
	Verification	It examines the assets & liabilities in the balance sheet
2. Time	Vouching	It is done throughout the year
	Verification	It is done at the end of the year
3. Basis	Vouching	It is based on documentary examination
	Verification	It includes personal as well as documentary examination
4. Valuation	Vouching	Vouching does not include valuation
	Verification	It includes valuation

Difference between Vouching & Verification & Valuation:

1. Meaning	Vouching	It consists of comparing entries in the books of accounts
	Verification	It proves the existence, ownership & title
	Valuation	It certifies the correct value of Asset & Liability

Importance of Verification And Valuation Of Assets And Liabilities

Assets and liabilities are very important aspects of business. Balance sheet is prepared on the basis of them and an auditor should prove the true and fairness of information provided by balance sheet. So it is very important for an auditor. Its importance can be highlighted as follows:

1. To Show the Actual Financial Position

Balance sheet is prepared to show the actual financial position of a business. If proper valuation is not made, such balance sheet does not provide true and fair information. So, to provide information about the real financial position, verification and valuation of assets are essential.

2. To Know The Real Position Of Profit And Loss

Depreciation and other expenses on assets will be incorrect if proper valuation of assets is not made. So, to calculate the actual amount of profit and loss, proper valuation of assets and liabilities is necessary.

3. To Increase Goodwill

Proper valuation gives fair information about profitability and financial position of a business. So, people can get information which creates positive attitude towards company. Positive attitude of public increases goodwill.

4. To Assure Shareholders

Valuation and verification provide actual information about assets and liabilities to the shareholders which assure the safety of their investment.

5 Easy For Sale

At the time of sale of the company, it can be sold at the price which is enlisted in the balance sheet, but the assets whose valuation is not made need valuation before selling the company.

6. Easy To Get Loan

Company discloses the balance sheet proved by auditor for public knowledge which increases the trust of the company. Financial institutes provide loan easily to such companies.

7. Easy To Get Compensation

Whenever the loss occurs due to any incident, insurance company provides compensation on the basis of valuation of assets. So, the company can easily get compensation. Auditors position in verification and valuation of assets and liabilities

Verification means „proving the truth", or „confirmation". The student is warned at this stage not to confuse verification with vouching the expenditure in connection with the acquisition of asset. One of the most important duties of an auditor in connection with the audit of the accounts of a concern is to verity the assets and liabilities appearing the in the balance sheet. He has not only to examine the arithmetical accuracy and bona fide of the transactions in the books of account by vouching only, as has already been explained inone of the previous chapters, but he has also to see that the assets as recorded in the balance sheet actually exits. The fact that there is an entity regarding the purchase of an asset and which entry has been found to be correctly recorded, is not a proof that the assetis in the possession of the concern at the date of the balance sheet.

The verification of assets involves the following four points:

1.Comparing the ledger account with the balance sheet.

2.Verifying the existence of the assets on the date of the balance sheet.

3.Satisfying that they are free from any charge or mortgage

.4.Verifying their proper value.

5.Assets were acquired for the business.

Having satisfied himself that a particular asset does exits either by actual inspection orotherwise and that is free any charge, he has to proceed further to find out whether the asset s are properly valued.

Problem in the valuation of Assets:

The accuracy of the balance sheet and the estimated profits of a concern depend upon thecorrect valuation of the assets and liabilities. The valuation of the assets made by theproprietors or officials of the company or the firm. The auditor has simply to applycertain tests regarding the valuation of the assets. He is entitled to rely upon thecertificates of competent persons such as valuers, surveyors, etc. If he does so he mustmention this fact in his report. He cannot be expected to possess the technical knowledgeto find out the value of the assets. Under such conditions, he should also refer to theinvoices to find out the price at which such assets were acquired. Of course, he cannot guara ntee the correctness of the valuation of the assets. The assets should be valued as for a going concern concept. Therefore, the assets arevalued taking into consideration the following:Their original cost, the probable working life of the assets, the wear and tear of the assets, break-Up value of the assets, and the chances of the assets becoming obsolete.

The duty of the auditor in such a case to see that the basis of valuation and the calculations are correct and that all contingencies are provided for.

2 Valuation of Assets during Inflationary Period:

A problem which confirms an auditor is as to how to value the assets during the Inflationary period, e.g.

1.Valuation of stock is not sufficient to meet the cost of replacing the same quantity of stock.

2.The depreciation charges based on the historical cost of fixed assets will notprovide sufficient amount required to meet the cost of replacing those assets if they are needed to be replaced later on.

3.If depreciation is provide on the historical cost of the assets and similarly if thestock in trade is also valued accordingly, the profits shown by the profit and loss account will not reflect an increase or decrease in terms of the purchasing power of the money.

To solve the above problems, the following suggestion have been made:

1. The fixed assets should be valued at replacement cost.
2. The fixed assets should be written up according to the market price of the assets prevailing on the balance sheet date.
3. The stock-in -trade should be valued at the market price and depreciation should be provided on the value of the stock so arrived at.
4. The index method of adjusting the accounts to reflect the changes in the purchasing power of money should be followed.

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 are those assets which 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 valued at 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 from 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.

Auditor's Position as Regards the Valuation of Assets:

From the above discussion it must have been clear to the reader that the correctness of the profit and loss account and the balance sheet depends to a great extent on the correct valuation of the assets which is, however, a difficult problem. As has been pointed out above, the auditor is not a valuer or a technical hand to estimate the value of an asset. He has to depend a great extend on the valuation by directors, partners, experts, surveyors, etc. But does it mean that he is absolved from his liability if assets are overvalued by the directors, etc, and if he entirely depends upon them? Doer he guarantees the absolute correctness of the balance sheet under such circumstances? The answer is no. He must see that the assets are valued according to certain principles of accountancy. In certain case, the market value of assets is available, e.g., in case of investment, when he shouldsee that the assets are valued accordingly. The auditor has to see whether the valuation isaccordingly to the accepted principles of accountancy.

Verification and Valuation of Stock:

Physical verification of Stock: Attendance of auditor during physical verification of stocks.
Examination of records.
Verification and confirmation: From third party.
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 lessdeprecation. It has been suggested that during the inflationary period, the replacement costmethod 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 arerecoverable. If they are doubtful, provision should be made for them. If they are bad, i.e., theyare irrecoverable, they should not be shown on the assets side. If the auditor does not payattention 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 trademarks 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 renewalfee 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 publicationdoes 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, Patterns, and Dies:

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

15. Property:

The auditor is not competent to examine the title deed relating to a property. Insuch a case he should insist upon the client to get a certificate regarding their validity from thesolicitor. 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 asthe difference between the purchase price and the net assets which are purchased and the excessamount so paid, represents the goodwill acquired by the business. It is intangible asset. It valuedepends upon the earning capacity of the business and fluctuates accordingly. In case theDirectors have debited the profit and loss account and credited the amount to the goodwillaccount, 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 tothe shareholders if such a step has been taken.

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 thecompany. He should also

examine the Cash Book, Pass Book and Minutes Book of the Boardof 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.

Depreciation

Depreciation expense is calculated utilizing either a straight line depreciation method or an accelerated depreciation method. The straight line method calculates depreciation by spreading the cost evenly over the life of the fixed asset. Accelerated depreciation methods such as declining balance and sum of years digits calculate depreciation by expensing a large part of the cost at the beginning of the life of the fixed asset.

Depreciation is defined as an accounting methodology which allows an organization to spread the cost of a fixed asset over the expected useful life of that asset. The cost of the fixed asset immediately comes out of the cash account of the organization and is entered as an asset for the organization. At the end of each period of the useful life of the asset a part of the cost is expensed. This amount is added to the accumulated depreciation for the asset. The net value of the asset on the books of the organization is the asset account less the accumulated depreciation account.

A fixed asset is considered depreciable if it will wear out or become obsolete over a period of years. The period of years is called the life or the useful life of the item. The life that is assigned to an item will depend on industry standards, management standards, and governmental regulations. Generally, depreciable items include buildings, manufacturing equipment, office equipment, and vehicles. Land is not considered a depreciable item as it does not wear out or become obsolete.

Some fixed assets may be expected to have a market value at the end of their useful life. This expected value is called the salvage value. Some organizations set this value on a per asset basis, some use a percentage of the purchase price, some assume that all assets will have zero salvage value, and some use a combination of these methods.

Organizations usually set a price at which a fixed asset is considered depreciable. Any asset purchased at less than the set price is immediately expensed. This eliminates the need to track every waste basket, stapler, hammer, wrench, desk lamp, etc. Some organizations set this as low as $100.00. Other organizations set it at $10,000.00 or more. Once this limit has been set it should be adhered to and should not be reset every year.

Objectives of providing Depreciation

The main objectives of providing depreciation are as follows:-

1. To ascertain true profit of the business.
2. To show the proper value of assets.
3. To retain the capital Intact.
4. Provision of depreciation is a statutory need for the business.

Life span of an asset to a business rests primarily, on the purpose of its acquisition and secondary, on its nature. An item acquired for immediate consumption or sale is a short-lived asset and that meant for prolonged use, is long lived asset, though both produce revenues. Whereas the former asset expires within one year of its acquisition, the latter asset lasts longer. Hence almost entire expenditure on a short lived asset becomes an expense and is matched against current year's revenue.

But the position is otherwise with a long-lived asset which wears out or depreciates over a long period. Accordingly, the outlay of a fixed asset is spread over several years and annually only a fraction thereof expires. Simply, this fraction, called expired cost or depreciation, is charged against current revenues and the rest, termed as expired cost, is carried forward for future expiration.

"Depreciation may be defined as the permanent decrease in the value of an asset due to use and/or the lapse of the time." -Terminology of Institute of Cost and Management Accountants, England

"Depreciation is the permanent and continuous diminution in the quality, quantity or value of an asset." -Pickles

"Depreciation may be defined as measure of the exhaustion of effective life of an asset from any cause during a given period." -Spicer and Pegler

"Depreciation is' the gradual and permanent decrease in the value of an asset from any cause."-Carter

Causes of Depreciation

Depreciation may be of two types :-

(1) Internal-Depreciation which occurs for certain inherent normal causes is known as internal depreciation. The causes of internal depreciation are :

(1.1) Wear and Tear-An asset declines on account of continued use e.g. building, plant, machinery etc. such decline depends upon quantum of use of an asset. If a factory works double-shift instead of single shift, depreciation on plant and machinery will be doubled. It is obvious that such loss is unavoidable. An asset may be kept in proper working conditions through repairs for the time being, but it can not be done so permanently: At one time the asset will become unfit for repairs, when it will no longer be suitable.

(1.2) Depletion-Some assets decline in value proportionate to the quantum of production, e.g. mines, quarry etc. With the raising of coal etc. from coal mine, the total deposit reduces gradually and after some time it will be fully exhausted. Then its value will be nil.

(2) External-Depreciation caused by some external reasons is called external depreciation.

The causes of external depreciation are:

(2.1) Obsolescence

Some assets, though in proper working order, may become obsolete. For example old machine becomes obsolete with the invention of more economical and sophisticated machine, whose productive capacity is generally higher and cost of production is lesser. In order to survive in the competitive market the manufacturer must install new machine replacing the old one.

(2.2) Passage of time

Some assets diminish in value on account of sheer passage of time, even though they are not used e.g. lease hold property, patent rights, copy rights etc.

(2.3) Accidents

Assets may be destroyed by abnormal reasons such as fire, earth quake, flood etc. In such a case the destroyed asset may be written-off as loss and a new one purchased.

Necessity of providing Depreciation

The necessity of providing Depreciation arises for the following reasons:

(1) Ascertainment of true profit or loss-Depreciation is a loss. So unless it is considered like all other expenses and losses, true profit/loss cannot be ascertained. In other words, depreciation must be considered in order to find out true profit/loss of a business.

(2) Ascertainment of true cost of production-Goods are produced with the help of plant and machinery which incurs depreciation in the process of production. This depreciation must be considered as a part of the cost of production of goods. Otherwise, the cost of production would be shown less than the true cost. Sale price is normally fixed on the basis of cost of production. So, if the cost of production is shown less by ignoring depreciation, the sale price will also be fixed at a low level resulting in loss to the business;

(3) True Valuation of Assets-Value of assets gradually decreases on account of depreciation. If depreciation is not taken into account, the value of asset will be shown in the books at a figure higher than its true value and hence the true financial position of the business will not be disclosed through Balance Sheet.

(4) Replacement of Assets-After some time an asset will be completely exhausted on account of use. A new asset then be purchased requiring large sum of money. If the whole amount of profit is withdrawn from business each year without considering the loss on account of depreciation, necessary sum may not be available for. buying the new assets. In such a case the required money is to be collected by introducing fresh capital or by obtaining loan by selling some other assets. This is contrary &0sound commercial policy.

(5) Keeping Capital' Intact-Capital invested in buying an asset, gradually diminishes on account of depreciation. If loss on account of depreciation is not considered in determining profit/ loss at the year end, profit will be shown more. If the excess profit is withdrawn, the working capital will gradually reduce, the business will become weak and its profit earning capacity will also fall.

(6) Legal Restriction-According to Sec. 205 of the Companies Act, 1956 dividend cannot be declared without charging depreciation on fixed assets. Thus in "Case of joint stock companies charging of depreciation is compulsory.

Auditor‟s duty with regard to depreciation

1. Companies Act provides only minimum rates. The company can charge depreciation at a higher % also. (or it means lesser life).
2. The company can adopt different methods for different type of assets provided the same is consistently followed.
3. Change in method of depreciation should be with retrospective effect and only if it is

required by statute or accounting standard or if it results in better presentation.
4. The accounts must disclose the methods which have been used to calculate depreciation.
5. Low-value items may be fully depreciated provided this is disclosed appropriately in the accounts.
6. Depreciation should be calculated from the date when the asset is ready to use.

Reserves and Provisions

Reserve is the part of the capital of a company, other than the share capital, largely arising from retained profit or from the issue of share capital at more than its nominal value. Reserves are distinguished from Provision in that for the latter there is a known diminution in value of an asset or a known liability, whereas reserves are surpluses not yet distributed and, in some cases (e.g., share premium account or capital redemption reserve), not distributable. The directors of a company may choose to earmark part of these funds for a special purpose.(e.g., a Reserve for obsolescence of plant). However, reserves should not be seen as specific sums of money put aside for special purposes as they are represented by the general net assets of the company. Reserves are subdivided into Retained earnings (revenue reserves), which are available to be distributed to the shareholders by way of dividends, and capital reserves, which for various reasons are not distributable as dividends, although they may be converted into permanent share capital by way of a bonus issue.

Provision is an amount set aside out of profits in the accounts of an organisation for a known liability(even though the specific amount might not be known) or for the diminution in value of an asset. Common examples include Provision for Bad debts, Provision for depreciation and also provision for accrued liabilities.

Definition of reserves are amounts appropriated out of profits, which are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist at the date of the balance sheet or retained by way of providing for any known liability. (Clause 1(x) of Part 1 of the 5thSchedule to CO, 1984.) Another definition given by the AICPA is, “the use of the term reserve is limited to indicate that an undivided portion of the asset is being held or retained for general or specific purpose. Reserves refer to retained profits or surpluses. In a not-for-profit entity, these are described as accumulated funds. Reserves may be distributable (revenue reserves) or non-distributable (capital reserves). (Cima Official Terminology) Amounts set aside from profits in company accounts for an unspecified purpose. Reserves are part of retained earnings i.e. undistributed profits and belong to the ordinary shareholders of the company. (International Dictionary of Finance by Graham Bannock & William Manser).

Definition of provisions refer to liabilities of uncertain timing or amount. A provision should be recognized when and only when: an enterprise has present obligation (legal or constructive) as a result of past event; it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation. (Source: IAS 37para 10 and 14) Provisions are amounts charged against revenue to provide for the following: Depreciation, renewals or diminution in the value of assets A known liability, the amount whereof cannot be determined with substantial accuracy A claim, which is disputed A possible obligation (a contingent liability) is disclosed but not accrued. However, disclosure is not required if payment is remote. [IAS 37.86] In rare cases, for example in a lawsuit, it may not be clear whether an entity has a present obligation. In those cases, a past event is deemed to give rise.

to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date. A provision should be recognized for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the entity should disclose a contingent liability, unless the possibility of an outflow of resources is remote. [IAS 37.15]C. Measurement of provisions. The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, that is, the amountthat an entity would rationally pay to settle the obligation at the balance sheet date or totransfer it to a third party. [IAS 37.36]This means: Provisions for one-off events (restructuring, environmental clean-up, settlement of a lawsuit) are measured at the most likely amount. [IAS 37.40] Provisions for large populations of events (warranties, customer refunds) are measured at a probability-weighted expected value. [IAS 37.39] Both measurements are at discounted present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability. [IAS 37.45 and 37.47]In reaching its best estimate, the entity should take into account the risks anduncertainties that surround the underlying events. [IAS 37.42]If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized as a separate asset, and not as a reduction of the required provision, when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognized should not exceed the amount of the provision. [IAS 37.53]

In measuring a provision consider future events as follows: Forecast reasonable changes in applying existing technology [IAS 37.49] Ignore possible gains on sale of assets [IAS 37.51] Consider changes in legislation only if virtually certain to be enacted [IAS 37.50]D. Use of provisions should only be used for the purpose for which they were originally recognized. They should be reviewed at each statement of financial position date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources will be required to settle the obligation, the provision should be reversed. [IAS37.61]E. Disclosure of provisions

Reconciliation for ƒ each class of provision: [IAS 37.84] Opening balance ƒ ƒ Additions Used (amounts charged against the provision) ƒ ƒ Unused amounts reversed Unwinding of the discount, or changes in ƒ discount rate Closing balance. ƒAuditor"s responsibility in respect of provisions. Provisions should be reviewed at each statement of financial position date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed. (Para 8, IAS 37)A provision should be used for expenditure for which the provision was originally recognized.(Para 9, IAS 37)The assessment of the adequacy or otherwise of a provision is one of the most difficult judgments we have to make in audit. The quality of audit evidence varies in this regard.

This area of work therefore requires the close attention of the manager and audit partner. The method used to verify each provision made in the accounts varies considerably, depending on the nature of the provision. Both understatement and overstatement must be considered. For each provision or group of provisions, an auditor should carry out the following steps:1. Prepare or obtain a schedule showing opening and closing balances2. Analyze the movements in the year3. Review, with supporting evidence, the adequacy of the closing provision and consider whether it is, in fact, necessary4. Review the appropriateness of previous years‟ provisions in the light of subsequent movements whether all provision consumed for last year‟s envisaged expenses5. Consider the need for written confirmation of representations made by management6. Assess the competence of the personnel responsible for calculating the closing balance of all provisions under audit.7. Check approval of such provisions by a competent authority8. Identify the areas of potential liability from the following sources: Audit files Client correspondence Reviews of minutes of meetings Discussions with management9. Verify provisions for losses on forward foreign exchange or commodity transactions10. Verify provisions for warranty and repair claims11. Obtain confirmations, in a letter of representations from management that the auditors have been informed of all pending legal actions and that in management‟s opinion adequate provision and disclosures have been made.12. Re-measurement of provisions [IAS 37.59] Review and adjust provisions at each balance sheet date If an outflow no longer probable, provision needs to be reversed.

G. Reserves versus provisions Reserves Provisions 1. It is an appropriation of profit. Hence, 1. It is a charge against profit. It is it is created by debiting statement of debited to statement of retained earnings. comprehensive income. 2. A reserve is created for an unknown 2. A provision is made for a known liability. liability. 3. Creation of provisions is a must as 3. Creation of reserves depends upon these are meant for meeting known the financial policy of the firm. liabilities. 4. The provisions are usually 4. The reserve is shown in the balance deducted from the concerned sheet of a company under the head assets in the asset side of the “Reserves and Surplus.” statement of financial position. 5. Provision can never be utilized for 5. Past reserves can be utilized for dividend payment. Only excess distribution of dividend. provision written-back can be utilized for dividend utilization. 6. It is possible to create revenue reserve only if the company earns 6. Provisions are possible to be made profit. If there is a loss, a reserve even if there is loss as it is a charge cannot be created as it is an against profit. appropriation of profit. 7. Creation of reserves is discretionary 7. Creation of provision is a must and and the auditor need not devote the auditor should qualify his report much time for the verification of if adequate provisions are not reserves. made. 8. A reserve is always reserve till it is fully utilized. Even if it is more than 8. Provision in excess of requirement the requirement, it will not change its can be treated as reserve. nature.

H. Classification of reserves 1. Revenue reserves 2. Capital reserves Definition of revenue reserve Revenue reserve means a reserve that is normally regarded as available for distribution through the profit and loss account, including general reserves and other specific reserves created out of profit and un-appropriated profit i.e. credit balance of statement of comprehensive income after appropriation for the period to the date of statement of financial position. (Clause 2(v) of Part 1 of 4th Schedule to the CO, 1984.)It represents profits that are available for distribution to shareholders held for the time being for any one or more purposes for example supplement divisible profits in years, to finance an extension of business, or to generally strengthen the financial position of the company. A revenue reserve shall include: General reserve Dividend equalization reserve Other reserves created out of profit Un-appropriated profits/ retained earnings. Auditor‟s responsibility in respect of revenue reserve 1. Since the creation of this reserve is not a must, the auditor has no duty to report on the creation, adequacy or inadequacy of such a reserve. 2. He may advise the management on the desirability of creation and maintenance of such reserve in the best interest of the business.

J. Definition of capital reserve. It represents reserves which are created out of capital profit. Capital profits are those profits, which do not arise in the normal course of the business. So a capital reserve is created out of the profits of the following nature: Profits earned on sale of fixed assets at a price in excess of ƒ written down value (WDV) Profit on revaluation of all ƒ assets/liabilities Profit earned prior to incorporation of the ƒ company Profit on reissue of forfeited shares ƒ Premium on ƒ issue of shares or debentures Profits on redemption of debentures ƒ Amount utilized out of profits to redeem redeemable preference ƒ sharesA capital reserve can be utilized for the following purposes:1. For issuing bonus shares, if the Articles of Association so provides2. For writing-off various types of fictitious or intangible assets. A capital reserve includes: Capital redemption reserve ƒ Capital ƒ repurchase reserve account Share premium account ƒ Profit ƒ prior to incorporation Any reserve regarded free for distribution ƒ by way of dividend (Clause 2(ii) of Part 1 of 4th Schedule to the CO, 1984)

K. Auditor‟s responsibility in respect of capital reserves 1. The auditor should examine that the capital reserve is created out of capital profits only. 2. If the management is giving dividend out of capital reserve, then he should ensure that it is permitted by the Articles of Association of the company. 3. The auditor should ensure that reserves are appropriately classified in accordance with the provisions of CO, 1984, and the companies own constitution, for instance revenue and capital reserves must be classified separately. 4. Check movements during the year to the supporting evidence and confirm authorization with board minutes 5. Ensure that the movements in the reserves do not contravene the requirements of CO, 1984 and company‟s own constitution. For instance, the share premium account can only be utilized for the following purposes: in ƒ paying up bonus shares to be issued as fully paid to write-off ƒ preliminary expenses of the company to write-off expenses, ƒ commission or discount on any issue of shares or debentures of the company. Capitalization of reserves Capitalization of reserves must not be confused with capital reserves. It is a different concept. Capitalization of reserves is the process of retaining any capital or revenue reserve permanently by issuing bonus shares. It is one of the methods of internal financing for the growth and expansion of the business and is popularly known as the ploughing back of the profits.

M. Capital reserves versus capitalization of reserves Following are the differences between

capital reserve and capitalization of reserves: Capital reserves Capitalization of reserves 1. Capital reserve is created out of 1. Capitalization of reserve is done capital profits only i.e. gain on sale of either out of capital or revenue fixed assets, gain from reserve. mergers/acquisitions etc., etc. 2. Capitalization of reserve 2. Capital reserve does not increase the increases the amount of capital of the company. company‟s capital. 3. Capitalization of reserve is 3. Capital reserve is created by any type possible only out of some of capital profit when they arise. specific reserves. 4. Capitalization of reserves does 4. Creation of capital reserve is not increase the assets of the receive profit of the company, though in kind, but in case of necessity, shares can be converted into cash by selling them in the market. Advantages from the point of view of the company: The company can keep its shareholders happy ƒ without impairing the financial position and liquidity of the company. Creditors can feel more protected due to increase in ƒ share capital.
accompanied by an increase in asset company. Only there is a sort of the company.
reorganization of capital structure of the company.

N. Advantages of capitalization of reserves π Following are advantages from the point of eliminated and the statement of financial position can be presented in a more meaningful way.O. Auditor‟s responsibility in respect of capitalization reserve An auditor can frame his audit work in the light of following guidelines: 1. Bonus shares can be issued out of free reserves created out of genuine profits or securities premium only. 2. Reserves created out of revaluation of assets have not been utilized for the purpose of capitalization. 3. The company has not defaulted in payment of interest and principle in respect debentures and public deposits.

4. There has been provision in the Articles of Association authorizing the company to issue bonus shares 5. The extended capital after the issue of bonus shares has been within the limit of the authorized capital of the company 6. In addition to the above guidelines, the auditor will also check the accounting entries to ensure himself that they have been passed properly in the books of accounts. Reserve fund If amounts equal to a reserve are invested in outside securities, the reserve will be named as reserve fund. If there are no specific investments, it cannot be called a reserve fund but merely a reserve. Reserves can be retained in the business as a part of working capital or invested outside the company in marketable securities. Fund in relation to any reserve, shall be used only where such a reserve is represented by specifically earmarked investments or other assets realizable at not less than the amount of the reserve. (Clause 1(v) of Part 1 of 5th Schedule to CO, 1984.)The term reserve fund is used to describe a reserve only when the amount of reserve is invested outside the business of the company and it is represented by readily realizable assets. It means that it has a separate legal existence. Board of trustees takes care of such funds. Their income is separately reported in the separate accounts which are audited separately and reported to the said board. The auditor should see that the reserve fund has been distinctly shown in the statement of financial position and the fund is represented by readily realizable assets. Sinking fund A sinking fund is a specific type of fund which is created for the redemption of a long-term debt or for the replacement of an asset in future. This fund is created by the regular investment of an amount, which will accumulate along with the compound interest earned thereon to make available a certain amount of money at the end of a stated period.

R. Creation of sinking fund Sinking fund investment method Sinking fund policy method.

Brief description of each method is as follows: Sinking fund - Investment method. Under this method, a predetermined amount is debited to a profit and loss account atthe end of a year and credited to sinking fund account. The aforementioned amount is taken out of business and invested in readily saleable securities. When the period of the fund expires, the investments are sold and the amount so realized is utilized for the conceived purposeπ Sinking Fund - Policy method. Under this method, a policy for the period is taken up and the premium on the policy is debited to the profit and loss account. At the end of the policy period, the amount received is utilized in the conceived purposes. Auditor‟s responsibility in respect of sinking fund The auditor should ensure that the reserve fund created has been separately shown in the statement of financial position. He has to ensure that the purpose for which the fund is created has been clearly indicated. He should also see that the creation of sinking fund for any specific purpose is authorized by Articles of Association of the company. He should also ensure that proper entries have been passed in the books of accounts to record the creation and utilization of the fund. Secret/ hidden reservesThe existence of secret reserves in a company‟s statement of financial position means that stockholder‟s equity is understated because assets are understated or liabilities are overstated. When the secret reserves exist, the financial position of the company is better than what appears.

They are the reserves which are not shown on the face of statement of financial position. Obviously, if secret reserves are created then a statement of financial position cannot reveal the true and fair view of the company‟s statement of financial position. And, therefore, can be subject of audit objection, if noted. The actual financial position of the company can be better than what is revealed on the face of statement of financial position. Following are the few ways by which secret reserves are created:1. Charging capital expenditure as revenue expenditure.2. Providing for excessive/more depreciation on fixed assets.3. Making excessive provision for bad and doubtful debts.4. Writing down the goodwill to a nominal value.5. Under-valuation of stock-in-trade.6. Omitting some assets from the face of the statement of financial position.7. Showing contingent liabilities as real/actual liabilities.8. Showing fictitious liabilities or over-valuation of the liabilities.9. Making an excessive provision for contingencies or by continuing to carry forward provisions when they are not required.10. Ignoring the permanent appreciation in the value of assets.11. Suppression of sales.12. Inflating purchases.13. Using the last-in, first-out inventory method in periods of rising price levels.14. Showing an asset as a contingent asset.15. Crediting revenue receipts to an asset e.g. Rent received credited to Building Account.

Reasons for creating secret reserves. Following are the reasons for which management creates secret reserves: 1. Meet any extraordinary loss in future without disclosing the fact to the shareholders i.e. showing the consistent profitability 2. Strengthen the financial position of the company 3. Mislead the competitors about the financial position of the company 4. Evade income tax and wealth tax 5. Manipulate share price for some ulterior motives 6. Regulate steady payment of dividend 7. Sometimes, secret reserves may arise themselves. For instance, assets might increase in value permanently or there may be a permanent diminution in a particular liability. They are not brought on books immediately. Of course valuation will take place once in a year or more. Auditor‟s responsibility in respect of secret reserves. The auditor is required to report on the truth and fairness of the company‟s financial state of affairs. If secret reserves were created during the year under audit, the true and fair view will not be possible for the auditor to report, irrespective of the purpose positive or negative underlying creation of such reserves. So the position of the auditor in the case of secret reserves detection is quite clear. He has to exercise reasonable skill and due care in detecting all the cases of secret reserve creation and advise the management to rectify the accounts by dissolving these secret reserves. If the advice is not followed immediately, he should qualify the audit report. And if the auditor fails to detect the secret reserves or deliberately ignores their existence in the statement of financial position, he can be criminally persecuted along with the management in the court of law. Even a provision in the Articles of Association forbidding the auditor from disclosing the fact of secret reserves is ultra vires and invalid as was held in the case of Newton vs. Birmingham Small Arms Co Ltd. In these judicial pronouncements, it is noted that although creation of secret reserve was permitted by the Articles of Association, its disclosure was made obligatory.

V. Specific reserves These are the reserves created for some definite purpose to be served in future out of profits of the company. The purpose of creating reserves can be pre-defined in Articles or by the decision of the Board. Also some of the specific reserves may be required to be created under contractual obligations or legal compulsion. An example of the former would be the fund for redemption of debentures and the example of the latter would be the development rebate reserve, which is compulsory to be created, if the advantages of the development rebate are to be enjoyed from income tax liability. Such reserves take on the character of capital reserves. Following are some of the purposes of creating such reserves:

1. Debenture redemption reserve:

2. Capital redemption reserve: for redemption of preference shares

3. Dividend equalization reserve: to enable the company to pay dividend at a stable rate in different years irrespective of the amount of profit earned

4. Foreign project reserve

5. Staff welfare reserve fund: Workers Profit Participation Fund (WPPF)W. Auditor‟s responsibility in respect of specific reserves Since the creation of these reserves is specified and they appear on the face of balance sheet, therefore, the auditor must verify its adequacy and ensure that it is not used for any purpose other than that for which it is created. So, the auditor has to take the following steps ensure the justification of existence of these reserves in the balance sheet of a company.

1. Examining Articles of Association. The auditor should study the articles to examine whether there is any provision for creation of specific reserves.

2. Reviewing directors‟ meeting minute books Scanning the minute books for all the meetings of the directors for the decisions taken for the creation of specific reserves and to ensure that the reserves have been created according to the decisions taken in those meetings.

3. Examining the statement of financial position. The auditor should ensure himself that the specific reserve created has been shown in the statement of financial position according to the requirements of the 4th or 5thschedule to the CO, 1984.4. Reading the legal documents. He will also examine the related documents e.g. the debenture trust deed, the tax audit file etc., to ensure that adequate provision has been created according to the legal requirements and the amount created, if utilized, has been utilized according to the legal provisions.

Classification of Reserves

Classification of reserves can be done in this manner:

1. Open reserves

Open reserves may be defined all reserves which shows in the balance sheet. Every person or public can know such reserves of company. Those reserves provide full information to shareholders about which amount has gone to reserves or why they are not getting all amount of **dividend**. **This** type can also divide in sub parts

a) Capital reserves

Capital reserves are main type of open reserves. It is not created out of profit of company. This reserve is not used for distributing the dividend to shareholders of company. The main sources of these reserves are following:-

- profit earned prior to incorporation
- Premium on the issue of shares and debentures.
- Profit on reissue of forfeited shares
- Profit set aside for the purpose of redemption of preference shares.
- Profit on sale of undertaking or part of it.
- Surplus on revaluation of assets and liabilities.

b) Revenue reserves

Revenue reserves are that part of open reserves which are created out of profit of company. It is showed in profit and loss appropriation account .It can be used for dividend to shareholders. There are following benefits of revenue reserves:-

- Extension of business
- Set off unknown losses of business.
- Used to create strength in the financial position of business.
- To make stability in the dividend rate.

These revenue reserves can also divide into two parts.

i) general reserves

ii **) Specific reserves** = Specific reserves includes dividend equalization reserve, debenture redemption reserve , staff reserve. Investment fluctuation reserve, taxation reserve and contingency reserves.

2. Secret Reserves

Secret reserves may be defined as that type of reserves which is not shown in final account of company. **Means** it has neither been shown in profit and loss appropriation account nor in balance sheet. These reserves can easy created by showing less value of assets and more value of liabilities in balance sheet. If a company has created such secret reserves for the benefits of company, it will be surely strong his financial position. These secrete reserves can be created by following ways:

- showing heavy depreciation value
- Showing the less value of goodwill and closing stock of business.
- Secrete of sale value of business.
- Showing heavy liabilities which is not of company.
- Showing capital expenses as revenue expenses.
- Grouping of free reserves with creditors.
- Current asset not shown in balance sheet.

3. Other Reserves

i) Foreign currency translation reserve

This reserve is made on the estimation of loss of translating from foreign currency to domestic currency. When a company is dealing more than one country, at that time this reserve is needed for keeping money separated for adjustment of currency differences due to difference in the rates applied. It is shown in the liability side of company.

Secret Reserves

A reserve which maintained to strengthen the financial position of the business without disclosing it in the book is known as secret reserve. Secret reserve is hidden reserve which is not disclosed by the balance sheet. Secret reserve is also known as internal reserve. It is created by showing the figure of net profit less than actual. Its existence makes the financial position of the business better than what the balance sheet is disclosing. Generally, it is maintained by bank, Insurance and other financial institutions.

A secret reserve is created in any of the following ways:

* By depreciating the fixed assets at excessively high rates.

* By undervaluing the current assets.

* By eliminating the assets altogether from the books.
* By over-valuing the liabilities.
* By showing contingent liabilities as real assets.
* By creating excessive amount of reserve for future contingencies.
* By treating capital expenditure as revenue reserve.
* By ignoring accrued income or treating income as liability.

Objectives And Advantages Of Secret Reserve

The following are the objectives and advantages of secret reserve:

* Secret reserve helps in strengthening the financial position of the business.
* Secret reserve gives the sense of financial stability to the shareholders and creditors by equalizing the rate of dividend.
* Secret reserve helps in eliminating unhealthy competition by not showing true profit to the competitors.
* Secret reserve provides additional working capital.

Disadvantages Of Secret Reserve

The following are the disadvantages of secret reserve

* The existence of secret reserve is known to the management only and not to the real owners or shareholders.
* Secret reserve makes the information of financial statements false and inaccurate.
* Secret reserve may be the strong cause of loosing trust and confidence of the shareholders and outsiders.
* Secret reserve may cover up the inefficiency and fraud committed by the managers and directors

Duty of an Auditor in connection with Secret Reserves

He has to disclose the fact that secret reserve has been created, if it has been done so. If he does so. If he does not disclose the fact that there is a reserve of such a kind and certifies the balance sheet as showing a true and fair view of the state of affairs of the company, he would be making a false statement as some of the assets are under-valued while some of the liabilities are over-valued.

In case of companies such as banking companies, etc., the auditor should carefully enquire into the necessity of creating such a reserve. If he finds that the intention is honest and that it is in the best interest of the company to create a secret reserve, and that the amount is reasonable, he need not qualify his report. It is suggested by certain accountants that the auditor may make a statement like this in case secret reserve has been created: „the value of the assets is understand‟. No doubt such a statement will indicate the existence of a secret reserve, but the extent of the reserve will not be shown. It is argued that if the shareholders so desire, they may be eke out the information by putting questions to the directors.

„The purpose of the balance sheet is primarily to show that the financial position of the company is at least as good as there stated, not to show that it is not (or) may not be better‟. Moreover, the balanced sheet does not show the position of the company as better than what it is. If any person deals with the company, which has created secret reserve, on the basis of the balance sheet he does not suffer any loss. On the contrary, he may gain if he purchases shares on the strength of such a balance sheet as the intrinsic value shares is more than what is indicated by the balance sheet. Although from the point of view of the purchaser of the shares his argument is sound but the balance sheet does not represent the true and fair view of the state of affairs of the company.

If the auditor finds that intention of the directors is not honest, e.g., to fabricate improper dealing in the shares of the company, he must disclose the fact in his report.

It may be mentioned here that a company cannot by its articles of association restrain its auditor from reporting to the shareholders the creation of secret reserve as was decided in the case quoted above.

It must be remembered that if any part of a secret reserve is utilized by the directors to meet bad and doubtful debts, it must be shown in the balance sheet and should not be concealed from the shareholders as was decided in the case of shamdasani vs. pochkhanwala in 1927, when their lordship said: „if any part of secret reserve is availed of to meet bad and doubtful book debts, it must be revealed in the balance sheet and not concealed‟.

UNIT V

Audit report - Contents and types - Auditors decision regarding the purchase and sale of asset Audit of Computerized Accounts - Electronic Auditing

COMPANY AUDIT

A ‗joint-stock company‘ is a business entity where different stakes can be bought and owned by shareholders. Each shareholder owns company stock in proportion, evidenced by his or her shares (certificates of ownership).[This allows for the unequal ownership of a business with some shareholders owning a larger proportion of a company than others. Shareholders are able to transfer their shares to others without any effects to the continued existence of the company.

An auditor has to study the Company Law so as to familiarize himself with his rights and duties. There are provisions in the law in regard to issue of Share Capital, preparation of Memorandum of Association and Articles of Association, appointment of Director and Managing Directors, issue of Prospectus and other important matters which an auditor has to study for the successful conduct of a company‘s accounts.

Preparation by the Auditor before Audit:

The auditor should go through the following preliminaries before he begins his actual work:

1. To see that his appointment is in order;
2. Inspection of documents books and registers;
3. Inspection of contracts;
4. Study of previous year‘s Balance Sheet and Auditor‘s Report;
5. Obtaining a schedule of books and persons handling them;
6. Study of internal check system; and
7. Certificate of incorporation and commencement of business.

1. To see that his Appointment is in order:

(a) If he is appointed as the first (newly appointed) auditor of the company by the Board of Directors, he should ask for a copy of the resolution by the Directors authorising his appointment.

(b) If he is appointed in place of a retiring auditor, he should enquire from the retiring auditor whether due notice was served and the provisions of section 225 were complied with or not. It would be a breach of professional etiquette if he does not enquire from him in writing about the circumstances which led to his removal.

(c) If he is appointed by the shareholders at the Annual General Meeting, he should obtain a copy of the resolution. He should inform the Registrar within 30 days of the receipt of the appointment letter in writing that he has accepted or refused to accept the appointment. He should ensure that proper notice or nomination was given, otherwise his appointment will be invalid.

The auditor should correspond in writing with the previous auditor, informing the latter of the fact of his appointment.

(d) If he is appointed to fill a casual vacancy caused by the death of the previous auditor, he should obtain a copy of the resolution passed by the Directors so as to ensure that his appointment is valid.

(e) Under section 224(6) of the Companies Act, a General Meeting of the shareholders should be called to appoint a new auditor in place of the auditor who has resigned. Thus, the vacancy caused by the resignation has to be filled by the company in a General Meeting and not by the Board of Directors.

The auditor should see that his appointment is regular under such circumstances. He should, however, enquire from the auditor who has resigned, about the circumstances in which he has resigned and then decide whether he should accept the appointment or not.

2. Inspection of Documents, Books and Registers

Documents:

1. Memorandum- (1) Under the provisions of section 13 of the Companies Act, the Memorandum of every company shall state:

(a) the name of the company with _Limited' as the last word of the name in the case of a public limited company and with _Private Limited' as the last words of the name in the case of a private limited company;

(b) The State in which the registered office of the company is to be situated;

(c) In the case of a company in existence immediately before commencement of the Companies (Amendment) Act, 1956, the objects of the company.

(d) In the case of a company formed after such commencement -

(1) The main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

(ii) Other objects of the company not included in Sub-section (i); and

(e) In the case of companies (other than trading corporations), with objects not confined to one State, the States to whose territories the objects extend.

(2) The Memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.

(3) The Memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributors among themselves, such amount as may be required, not exceeding a specified amount.

(4) In the case of a company having a Share Capital:

(a) Unless the company is an unlimited company, the Memorandum shall also state amount of Share Capital with which the company is to be registered and the divisions thereof into shares of a fixed amount;

(b) No subscriber of the Memorandum shall take less than one share; and

(c) Each subscriber of the Memorandum shall write against his name the number of shares he takes.

Under section 17, a special resolution has to be passed for alteration of Memorandum so as to change the place of its registered office from one State to another or with respect to the objects of the Company and the alteration shall not take effect until and except in so far as it is confirmed by the Company Law Board on petition.

Such an alteration has to be registered within three months from the date of the order and be filed by the company with the Registrar as provided by section 18 of the Act.

Auditor's Duty:

The auditor should proceed in the following way in examining the Memorandum of Association:

(1) He should very carefully examine the _Object Clause' of the Memorandum to ensure that the company is carrying on the work as specified.

(2) He should check the _Capital Clause' and see that the issue of share capital is within the _Authorised Capital'.

(3) If the Authorised Capital has been increased according to law, it should be verified and traced out.

(4) If the Memorandum has been altered, it should be seen that such an alteration has been made within the provisions of sections 17 and 18 of the Companies Act.

2. Articles of Association:

Under section 26, every company is required to have the Articles of Association. The Articles of Association of a company limited by shares may adopt all or any of the regulations of Table A in Schedule I.

The Articles of Association contain regulations to control the internal administration of the company, viz., regulation for day-to-day work, relationship between its members, their rights and responsibilities, etc. Since the Articles of Association are framed by the company for its use, they may be altered by a special resolution as and when necessary, subject to the provisions of the Companies Act and to the conditions contained in its Memorandum.

According to section 30, the Articles will be printed and divided into paragraphs, numbered consecutively and signed by each subscriber of the Memorandum of Association (who shall add his address, description and occupation, if any) in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

As quoted earlier, a special resolution subject to the provisions of this Act and to be conditions contained in its Memorandum, has to be passed to alter the Articles of Association when such an alteration has been approved by the Central Government under section 31.

A printed copy of the Articles should be filed by the company within one month of the date of receipt of the order of approval.

Thus, the Memorandum of the company, its articles, if any, and the agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager, shall be presented to the Registrar of the State in which the registered office of the company is situated as provided by section 33.

Under section 36, Memorandum and Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles.

All monies payable by any member to the company under the Memorandum or Articles shall be a debt due from him to the company.

Auditor's Duty:

The auditor should examine the Articles of Association of the company for the following matters:

(i) Issue of Share Capital.

(ii) Calls on shares.

(iii) Calls in advance.

(iv) Calls in arrears.

(v) Forfeiture and re-issue of shares.

(vi) Transmission of shares.

(vii) Payment of commission of shares.

(viii) Rights of various classes of shareholders.

(ix) Appointment, remuneration, rights and duties of Managing Director or Manager.

(x) Appointment, remuneration, qualification shares, rights and duties of Directors.

(xi) Alteration of Share Capital.

(xii) Dividends and Reserves.

(xiii) Borrowing powers of the Company and Directors, etc.

(xiv) Appointment, rights and duties of the auditor.

(xv) Accounts and Audit of the Company.

(xvi) Underwriting of Shares.

(xvii) Meetings and their procedure.

(xviii) How to inform Shareholders.

(xix) Voting Powers of the Shareholders.

(xx) Payment of interest out of capital.

(xxi) How far Table A has been followed in framing the Articles of Association?

The auditor should go through the Articles very carefully and see specially that the regulations contained are in accordance with the law. He should further see that for alteration of the Articles, section 31 has been followed.

It is to be noted that if a company has not adopted its own Articles, Table A of the Companies Act will be applicable.

In the case of Leeds Estate Building and Investment Society Ltd. vs. Shepherd (1887), it was held that an auditor has no defence with him to say that he could not see the Articles of Association when he knew of their existence.

3. Prospectus:

Matters to be stated and reports to be set out in Prospectus are given in section 56 of the Companies Act. A Prospectus is issued with the objective of inviting public to purchase the share of the company. Ordinarily, all matters dealt with above in the Articles of Association are found in the Prospectus.

Auditor's Duty:

The auditor should examine the Prospectus for the following matter:

(i) Amount of capital to be issued, classification of shares and right of shareholders attached therewith,

(ii) Amount payable on allotment and calls,

(iii) Amount of minimum subscription,

(iv) Particulars of any contract entered into with the vendors for the purchase of business,

(v) Amount payable for underwriting commission on shares or debentures,

(vi) Amount of preliminary expenses paid or payable,

(vii) Qualifications, remuneration, etc. of Directors,

(viii) Appointment, remuneration, etc. of Managers.

(ix) Particulars of any material contracts entered into within two years of the date of issue of the prospectus.

Books and Registers:

Under section 209 every company shall keep at its registered office proper Books of Account with respect to:

(a) All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(b) All sales and purchases of goods by the company;

(c) The assets and liabilities of the company; and

(d) In the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed if such class of companies is required by the Central Government to include such particulars in the Books of Account.

All or any of the Books of Account may be kept at such other place in India as the Board of Directors may decide. When the Board of Directors so decides, the company shall, within seven days of the decision, file with the Registrar a notice in writing giving the full address of that other place.

Where a company has a Branch Office, whether in or outside India, the company shall be deemed to have complied with the provisions given above, if proper Books of Account relating to the transactions effected at the Branch Office are kept at that office and proper summarized returns, made up to dates at intervals of not more than three months, are sent by the Branch Office to the company at the registered office or the other place referred to earlier.

For the purpose of sub-section (1) and (2), proper books of account shall not be deemed to be kept with respect to the matters specified therein-

(a) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions; and

(b) if such books are not kept on accrual basis and according to the double entry system of accounting.

The Books of Account and other books and papers shall be open to inspection by any Director during business hours.

The Books of Account of every company relating to a period of not less than eight years immediately proceeding the current year shall be preserved in good order. In the case of a company incorporated less than eight years before the current year, the Books of Account for the entire period preceding the current year shall be preserved.

The Managing Director or Manager is made responsible for maintaining and preserving the Books of Account. The Board of Directors of the company, if there is no Managing Director or Manager, will be responsible for maintaining the books. In default, anyone responsible will be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one thousand rupees; or with both.

1. Register of Members:

Every company will keep in one or more books a Register of its Members and enter therein the following particulars (under section 150):

(a) The name and address, and the occupations, if any, of each member;

(b) The shares held by each member, the amount paid thereon, etc;

(c) The date at which each person was entered in the register as a member; and

(d) The date at which any person ceased to be a member.

Provided that where the company has converted any of its shares into stock and has given notice of the conversion to the Registrar, the register shall show the amount of stock held by each of the members converted instead of the shares so converted which were previously held by him.

If default is made in complying with these provisions, the company and every officer of the company, who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

Register of Charges:

Under section 143, every company is required to keep at its registered office a Register of Charges and enter therein all charges on the undertaking or on any property of the company-giving in each case:

(i) A short description of property charged,

(ii) The amount of the charge, and

(iii) Except in the case of securities to bearer, the names of the persons entitled to the charges.

If any officer of the company knowingly omits, or willfully authorizes or permits the omission of any entry required to be made, he shall be punishable with fine which may extend to five hundred rupees.

3. Register of Directors, etc:

Under section 303 of the Companies Act, every company is required to keep at its registered office a register of its Directors, Managing Director, Manager and Secretary containing their names, addresses, nationality, father‘s or husband‘s name in full, occupation and his business or occupation, if any.

If default is made in complying with the provisions of this section, the company and every officer of the company, who is in default, shall be punishable which may extend to fifty rupees for every day during which the default continues.

4. Register of Directors’ Shareholdings, etc:

Under section 307, a separate register has to be maintained by every company to record the number, description and amount of any shares or debentures of the company or any other body corporate being the company‘s subsidiary or holding company, or a subsidiary of the company‘s holding company, which are held by him or in trust for him or of which he has any right to become the holder whether on payment or not.

5. Register of Contracts, Companies and Firms in which Directors are Interested:

According to section 301, every company is required to keep one or more registers in which separate particulars of all contracts or arrangements, e.g., dates of contract or arrangement, names of the parties, principal terms and conditions and the date of the meeting of the Board of Directors on which the contract is considered, will be entered.

Auditor has to see whether the register is kept as per requirements of the Act and is in order.

6. Index of Members:

Under section 151, every company having more than fifty members shall, unless the Register of Members is in such a form as in itself to constitute an index, keep an index (which may be in the form of card index) of the names of the members of the company and shall, within fourteen days after the date on which any alteration is made in the Register of Members, make the necessary alteration in the index.

The index will contain a sufficient indication to enable the entries relating to each member and will be kept at the same place at which the Register of Members will be kept.

In default, the company and every officer who is in default shall be punishable with fine which may extend to fifty rupees.

7. Register and Index of Debenture holders:

Under section 152, every company shall keep in one or more books a Register of the holders of its Debentures and enter therein the particulars relating to the names, addresses, occupations, etc., about the Debenture holders.

In default, the company and every officer of the company shall be punishable with fine which may extend to fifty rupees.

8. Register of all investments made by the company in Shares:

Under section 372(6), every company shall keep a Register of Investments made by it in shares of any other body or bodies corporate showing names of such corporate bodies in which investment has been made, date of investment, date on which body corporate came in the same group and the names of all body corporate in the same group as investing company.

9. Register of Loans:

According to section 370 of the Companies Act, every lending company shall keep a register in respect of loans made, guarantees given and the date on which the loans have been made.

10. Register of Public Deposit:

Under section 58(A), every company shall maintain a separate register in which all public deposits are to be recorded.

11. Register of Investments:

According to section 49 of the Companies Act, it is provided that ―all investments of a company shall be made and held in its own name.‖ If the company‗s nominee or director becomes on its behalf a director in another company and is required to hold qualification shares, they may be held jointly in the name of the company and such person. A separate register shall be maintained by the company for such investment.

12. Foreign Register of Members and Debenture holders:

Under sections 157 and 158, if it is authorized by the Articles of Association, a company may keep a register of members and debenture holders in the State or country outside India where they are resident. Such a register is kept in that state or country as a branch register. It is known as Foreign Register.

3. Inspection of Contracts:

Next, the auditor should examine the contracts which have been entered into between a company and other parties, e.g.

(i) Contracts with the vendors of any property.

(ii) Contracts with the brokers and underwriters.

(iii) Contracts with the promoters for the preliminary expenses, etc.

Usually, brief particulars about such contracts are given in the

The auditor should see that the Statement of Particulars is correct and transactions relating to such contracts have been properly recorded in the Books of Accounts.

4. Study of Previous Year's Balance Sheet and Auditor's Report:

When the auditor is appointed in place of retiring auditor, he should examine the Balance Sheet of the last year and also the Report of the auditor appointed last year to be familiar with any relevant matter raised by the previous auditor. He should ensure that the objections or qualifications raised in the previous Audit Report have been duly met by the company.

Besides this, he may also examine the Directors‗ Report to the members containing the recommendations of the Directors in respect of the appropriation of profits made last year. This is very important.

5. Obtaining a Schedule of Books and Persons handling them:

The auditor should, then, get a list of the persons employed to maintain accounts of the company and also of books maintained by them. This will help him in the successful conduct of the audit whenever he needs some information and explanations, and difficulties can, thus, be met easily.

6. Study of Internal Check System:

This is another significant part of an auditor‘s duty to obtain a detailed statement from the Directors of the Company about the system of the internal check in operation. This will enable him to note down the shortcomings of the accounting system and the procedure followed by the company.

7. Certificate of Incorporation and Commencement of Business:

A public limited company is not allowed to commence business unless a certificate entitling the company to commence business is granted. A private company is entitled to commence business and exercise borrowing powers immediately after incorporation. The auditor should examine the certificate and see that the company has commenced business after it is granted. Qualification of an Auditor

Audits can be classified into two groups namely: Optional Audit and Compulsory Audits. The audit which is not legally required is called optional audit which is otherwise known as private audit. The audit which is legally required is called compulsory audit which is otherwise known as statutory audit.

In case of optional audits rights, duties, liabilities, etc of auditor will be of Contractual nature. That means all those things will be determined by agreement which has got formed between auditor and client. But in case of Compulsory audits rights, duties, etc of auditor will be of Statutory nature, that means concerned act itself determines rights, duties etc of auditor. Audit of Joint Stock Companies comes under Statutory Audits. Important Sections of Auditors; The Companies Act, 1956

- Section 224: Appointment and remuneration of auditors.
- Section 224A: Auditor not to be appointed except with the approval of the company by special resolution in certain cases.
- Section 225: Provisions as to resolutions for appointing or removing auditors.
- Section 226: Qualifications and Disqualifications of the Auditor.
- Section 227: Powers and Duties of Auditors.
- Section 228: Audit of accounts of branch office of the company.

- Section 229: Signature of Audit Report.
- Section 230: Reading and inspection of auditor's report.
- Section 231: Right of auditor to attend general meeting.
- Section 232: Penalty for non compliance with Section 225 to Section 231.
- Section 233: Penalty for non compliance by auditor with Section 227 to Section 229.
- Section 233A: Power of Central Government to direct special audit in certain cases.
  Section 233B: Audit of Cost Accounts in certain cases.

Qualifications of an Auditor

According to Sec. 226 of Companies Act, Company auditor should be either Chartered Accountant or Certified Auditor.

Chartered Accountant: The members of `*Institute of Chartered Accountant of India*` are called Chartered Accountants. Their profession is regulated by Chartered Accountants Act 1949. A firm of Chartered Accountants may also conduct company audit. But every partner of such firm must be a Chartered Accountant.

Certified Auditor: The persons who are the holders of certificates issued by Central Government under Certified Auditors Rules are called Certified Auditors. They can also carry on auditing profession at anywhere in India. They are also eligible to conduct Company Audit.

Disqualifications of an Auditor

Section 226(3) of Companies Act reads about disqualifications of company auditor. The following persons are disqualified;

- Body corporate
- Officer or employee of the company
- Partner or employee of an office or employee of the company.
- Insolvent person
- Lunatic person
- A person who is indebted to the company for a sum exceeding Rs. 1000/-
- A person who has given guarantee for such sum relating to the company.
- If a person is disqualified to holiday company, automatically he gets disqualified to its subsidiaries also. In the same way if a person is disqualified to subsidiary company, he gets disqualified to related holding company also.

Various modes of appointment of Company Auditor

(*1*) Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selectionof auditors by the members of the company at such meeting shall be such as may be prescribed:

Provided that the company shall place the matter relating to such appointment for ratification by members at every annual general meeting:

Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor:

Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141:

Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.

Explanation.—For the purposes of this Chapter, ―appointment‖ includes reappointment. (*2*) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

(*a*) an individual as auditor for more than one term of five consecutive years; and

(*b*) an audit firm as auditor for more than two terms of five consecutive years:

Provided that—

(*i*) an individual auditor who has completed his term under clause (*a*) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

(*ii*) an audit firm which has completed its term under clause (*b*), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:

Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act: Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

(*3*) Subject to the provisions of this Act, members of a company may resolve to provide that—
(*a*) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or (*b*) the audit shall be conducted by more than one auditor.

(*4*) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of sub-section (*2*). *Explanation*.—For the purposes of this Chapter, the word ―firm‖ shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008.

(*5*) Notwithstanding anything contained in sub-section (*1*), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

(*6*) Notwithstanding anything contained in sub-section (*1*), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

(*7*) Notwithstanding anything contained in sub-section (*1*) or sub-section (*5*), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next thirty days; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

(*8*) Any casual vacancy in the office of an auditor shall—(*i*) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting; (*ii*) in the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days:

Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

(*9*) Subject to the provisions of sub-section (*1*) and the rules made there under, a retiring auditor may be re-appointed at an annual general meeting, if—(*a*) he is not disqualified for re-appointment;(*b*) he has not given the company a notice in writing of his unwillingness to bere-appointed; and (*c*) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

(*10*) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

(*11*) Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

REMOVAL OF AUDITOR

In my last Article we have provided the procedure for Appointment of Auditor under Companies Act- 2013. Under my this article am trying to give procedure for Removal Auditor.

The Ministry has taken a big step by notifying 183 major sections of Companies Act, 2013 w.e.f. 01.04.2014 out of which the provisions relating to Audit & Auditors is of utmost importance for all the Chartered professionals out there. This article contains the provision relating to Removal of Auditors.

Section- 140 of Companies Act talks about Removal of Auditor: – This section corresponds to Section 225 of the Companies Act. The Section seeks to provide for the provisions for removal of auditor before the expiry of his term.

The Board of Directors of the company has no power to remove an auditor (Individual or Firm) appointed by the company in General meeting before the expiry of his term.

Removal by Special Resolution and previous approval of the Central Government: [Sec 140(1)]: Sub-Section (1) provides that the removal of an Auditor before the expiry of his term requires-

ü The previous approval of Central Government (CG). Form of Application will be made in form-ADT-2. Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration ffices and Fees) Rules, 2014. [Rule 7(1) of the Companies (Audit and Auditor) Rules, 2014} (Attached in form GNL-2).

ü The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a SPECIAL RESOLUTION of the company,

ü Before taking any action, the auditor concerned shall be given a Reasonable Opportunity Of Being Heard.

ü The application to Government shall be filed within 30 days from the date of resolution of the Board along with fees;

ü The company need to hold General Meeting (EGM) within 60 (Sixty) days of the approval of Central government.

v Removal of Auditor by Special Resolution will be considered as Special business for Section-102.

v Here, a long-term relationship is built for 5 years, since removal before 5 years would be considered as removal before the expiry of his term. And for removal before the expiry of an auditor‘s term requires strict formalities to be followed.

Form ADT – 2 require following information:

ü Details of the application clearly indicating the grounds for seeking removal of auditor.

ü Whether the accounts have been qualified during last three years (if yes, give details) ü Details of opportunity given to auditor concerned for being heard

ü Whether any civil or criminal proceedings are pending between the company and the concerned officers. Yes / No. If yes, give complete details.

ü Date of appointment of the concerned auditor and SRN of notice of his appointment and period for which the auditor was appointed.

ü Whether any special notice has been received for removal of auditors. Yes or No. If yes, the date of receipt of notice and the percentage of capital held by the members giving such notice or percentage of the number of members in case of company limited by members.

ü Whether all due audit fee has been paid to the concerned auditors. If no mention the amount of arrears.

ü Details of other services been rendered by such auditors to the company.

ü Pendency of Audit i.e, number of financial years for which audit is pending.

ü Stage of accounts of the company for each of such financial year i.e, yet to be approved by the Board or approved by the Board but yet to be handed over to auditors or approved by the Board, handed over to auditors but audit not yet completed or audit completed, draft report not yet given by the auditors.

ü Whether there is any dispute with regard to the Books of Accounts in the possession of auditors but not delivered back to the company. Yes or No.

Remuneration and expenses of an Auditor

The remuneration of the auditors of a company :

(a) in the case of an auditor appointed by the Board or the Central Government, may be fixed by the Board or the Central Government, as the case may be; and

(b) in the case of an auditor appointed under section 619 by the Comptroller and Auditor-General of India, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

(c) subject to clause (a), shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

For the purposes of this sub-section, any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression " remuneration ".

Expenses of an Auditor

Expenses of an auditor can be mentioned as:

Expenses incurred while doing audit work

Travelling for Audit purpose

Expense incurred on any project regarding Auditing

Accommodation expenses on behalf of audoiting

Rights of an Auditor

According to section 227 (1) of the Companies Act, 1956, a company auditor has the following rights:

1. Right of Access to Books of Accounts:

Every auditor of a Company has a right of access at all times to the books of accounts and vouchers of the company whether kept at the head office of the company or elsewhere.

Thus, the auditor may consult all the books, vouchers and documents whenever he so likes. This is his statutory right. He may pay a surprise visit without informing the Directors in advance but in practice, the auditors inform the Directors before they pay their visits.

2. Right to obtain Information and Explanations:

He has a right to obtain from the Directors and officers of the company any information and explanation as he thinks necessary for the performance of his duties as an auditor.

This is another important power in the hands of the auditor. He will, however, decide as to which information or explanations he thinks necessary to obtain. It the Directors or officers of the company refuse to supply some information on the ground that in their opinion it is not necessary to furnish it, he has a right to mention the fact in his report.

3. Right to Correct any Wrong Statement:

The auditor is required to make a report to the members of the company on the accounts examined by him and on every Balance Sheet and Profit and Loss Account and on every other document declared by this Act to be part of or annexed to the Balance Sheet or Profit and Loss Account which are laid before the company in General Meeting during his tenure of office. The Directors have a duty to prepare them and present them to the auditor.

The auditor cannot require but advise the Directors to amend their system of maintaining accounts if it is faulty. If his suggestions are not carried out, he has a right to refer the matter to the members. If the method of accounting is inadequate, he must state the fact in his report that proper books of accounts have not been kept by the company.

4. Right to visit Branches:

According to section 228, if a company has a branch office, the accounts of the office shall be audited by the company's auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226.

Where the Branch Accounts are not audited by a duly qualified auditor, the auditor has a right of access at all time to the books, accounts and vouchers of the company and thus, may visit the branch, if he deems it necessary.

5. Right to Signature on Audit Report: Under section 229, only the person appointed as auditor of the company, or where a firm is so appointed, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

6. Right to receive Notice and other Communications relating to General Meeting and attend them:

Under section 231 an auditor of a company has a right to receive notices and other communications relating to General Meeting in the same way as a member of the company. He is also entitled to attend any General Meeting which he attends or any part of the business which concerns him as an auditor.

According to the power of the auditor, he may make any statement or explanation with regard to the accounts as he may desire. He need not, however, answer any questions.

Ordinarily, it is not necessary for the auditor to attend every General Meeting, but it will be good for him to attend meetings in the following circumstances:

(a) When his report contains important qualifications directly affecting the management, so that his remarks may not be misunderstood or misinterpreted.

(b) When he has received a notice from the company that someone else is going to be proposed for appointment as auditor of the company at the Annual General Meeting.

(c) When he has been specially asked by the management to be present.

7. Right of being indemnified:

Under section 633, an auditor (being an officer of a company), has a right to be indemnified out of the assets of the company against any liability incurred by him defending himself against any civil and criminal proceedings by the company if it is proved that the auditor has acted honestly or the judgement delivered is in his favour.

8. Right to have Legal and Technical Advice:

He has a right to seek the opinion of the experts and, thus, take legal and technical advice. This is necessary to give his opinion in his report. (Re. London and General Bank Case, 1895).

He has a right to receive his remuneration provided he has completed the work which he undertook to do.

Duties of an Auditor:

I. According to the Companies Act:

1. To Enquire:

The duties of an auditor have been extended by the insertion of sub-section (1A) of section 227 under the Companies (Amendment) Act 1965 which is reproduced below: With prejudice to the provision of sub-section (1), the auditor shall enquire:

(a) Whether loans and advances made by a company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members.

(b) Whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company.

(c) Where the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the assets of the company, as consists of shares, debentures and other securities have been sold at a price less than at within they were purchased by the company.

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

(e) Whether personal expenses have been charged to revenue account.

(f) Whether it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in account books and the Balance sheet is correct, regular and not misleading.

2. Under section 227 (2, 3, 4 and 5), the duties of the auditor which relate to his report are given hereunder:

The Report:

The auditor shall report to the shareholders on the accounts examined by him. The report so submitted shall contain the following:

(a) Whether, in his opinion, the Profit and Loss Account referred to in his report exhibits a true and fair view of the profit or loss.

(b) Whether, in his opinion, the Balance Sheet referred to in his report is properly drawn up so as to exhibit a true and fair view of the state of affairs of the business according to the best of the information and explanations given to him as shown by the books of accounts.

(c) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit.

(d) Whether, in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of those books, and proper returns adequate for the purpose of his audit have been received from branches not visited by him.

(e) Whether the report on the accounts of any branch office audited under section 228 by a person other than the company‘s auditor has been forwarded to him as required by (c) of sub-section (3) of that Section and how he had dealt with the same in preparing the auditor‘s report.

(f) Whether the company‘s Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns.

Where any of the matters referred to above is answered in the negative or with a qualification, the auditor‘s report shall state the reason for the answer.

Under section 227 (4A), the Central Government may, by general or special order, direct that, in the case of such class or description of companies as may by specified in the order, the Auditor‘s Report shall also include a statement on such matters as may be specified therein.

The Central Government before making any such order may consult the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949, in regard to the class or description of companies, if the Government thinks it necessary.

In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956, the Central Government has issued the Manufacturing and other Companies (Auditor‘s Report) Order, 1975 which applies to every company which is engaged in one or more of the following activities:

(1) Manufacturing, mining or processing,

(2) Supplying and rendering services,

(3) Trading, and

(4) The business of financing investment, Chit Fund, Nidhi or mutual benefit societies.

The order will not apply to banks. The order requires that the Auditor‘s Report on the accounts of every company examined by him to whom this order applies, for any financial year ending on a day on or after January 1, 1976, should contain matters specified in paragraphs 4 and 5 of the order.

The Company Law Board has now issued a fresh order viz. the Manufacturing and other companies (Auditor‘s Report) order, 1988 which has superseded the previous order of 1975.

Other Statutory Duties:

3. Under section 229, it is the duty of an auditor to sign the report prepared by him. Only a partner in the firm practicing in India may sign the Auditor‘s Report or authenticate any other document.

4. Under section 56(1), the Prospectus issued by an existing company shall contain a report from the auditor of the company regarding:

(i) Profits and losses;

(ii) Assets and liabilities of the company and its subsidiaries; and

(iii) Rates of dividends paid by the company for each of the five it is auditor‘s duty to submit his report.

5. According to section 165 (4), the auditors of the company shall, in so far as the statutory report relates to the shares allotted by the company, the cash received in respect of shares and the receipts and payments of the company, certify it as correct after the same has been certified as correct by not less than two Directors of the company, one of whom shall be a Managing Director.

(Every company shall within a period of not less than one month and not more than six months from the date from which the company is entitled to commence business, hold a General Meeting of the members which shall be called the statutory Meeting.)

6. When a company goes into its voluntary winding up and a declaration of solvency is made by its Directors under section 488 (I), such a declaration is to be accompanied by the report of the auditors of the company under section 488(2). It is the duty of the auditors to make such a report.

7. Under section 240, it is the duty of an auditor ―to preserve and to produce to an inspector or any person authorized by him in this behalf with the previous approval of the Central Government, all books and papers of, or relating to the other body corporate which are in their custody or poser and otherwise to give to the Inspector all assistance in connection with the investigation which they are reasonably able to give ―.

Under section 240(6), the auditor is treated as an agent of the company for the purpose of this section.

Auditors' Liabilities

The liabilities of auditors of a company can be studied under following heads:

a) Civil Liabilities.

Civil liabilities mean the disputes over losses caused to one party by acts of another. The civil liabilities of an auditor can be for:-

i) Negligence ii) Misfeasance

i) Liability for Negligence (under law of agency)

Auditor being agent of the Shareholders is required to carry out his duties with reasonable care and skill. If he fails to do so, he is liable to make good any loss caused to the third party.

ii) Liability for Misfeasance

The term misfeasance means breach of duty. If auditor does something wrong in the performance of his duties resulting in a financial loss to the company, he is guilty of misfeasance. For example auditor's duties are laid down in section 255 of the Companies Ordinance, 1984. If auditor does not perform his duties properly and the company suffers loss he is liable for misfeasance.

Share Capital Audit

Points to be considered for audit of share capital

A private limited company has two types of share capital: Equity share capital â€¢ Preference share capital EQUITY SHARE CAPITAL This type of share capital is that part of capital that is not a preferential. In other words it is the basic kind of capital or an ordinary share capital. PREFERENTAL SHARE CAPITAL This part of capital has the following characteristics: It carries a preferential right as to the payment of dividend over other type of capital. â€¢ It carries the preferential right as to payment of capital in case of winding up or repayment of capital over the over the other type of capital. SPECIAL POINTS IN AUDIT OF SHARE CAPITAL In case of share capital issued by the company following points merit consideration of the auditor: Authorization of the issue ― Auditor should check the minutes of the meeting of the board of directors to check the authorization of the terms of the terms of the issue of share capital. Vouching share applications ― Auditor should test check the share application forms and vouches their respective entries in the cashbook. Legal requirement â€― It should be checked that the legal requirements as laid down by the companies act, sebi and other regulatory bodies are met. Compilation requirements ― Auditor should check that various compilation requirement of various statements with the registrar of companies are met with. While doing the audit of share capital auditor should vouch the following carefully o Memorandum of association o Articles of association o Minutes of the directors meetings o Prospectus o Share application form o Letters of allotment o Letters of refund o Share registers o Cashbook o Ledger accounts. There is a form for which they pay fee to roc for increase in authorised share capital ... check form no.5.

Share Transfer Audit:

It is no part of an auditor‘s duty to check the share transactions in detail but he is usually asked to undertake the audit of share transfer for which he is paid an extra remuneration.

Its objects are:

(i) To prevent clerical errors, and

(ii) To prevent the improper issue of Duplicate Share Certificates or certified transfers (whether fraudulently or otherwise).

Under section 108, it is provided that a company shall not register a transfer of shares (or debentures of) in the company unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the company along with the certificate relating to the shares or if no such certificate is in existence, along with the letter of allotment of shares (or debentures).

Provided that where, on an application in writing made to the company by the transferee and bearing the stamp required for an instrument of transfer, it is proved to the satisfaction of the Board of directors that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee, has been lost, the company may register the transfer on such terms as to indemnity as the Board may think fit:

Provided further that nothing in this section shall prejudice any power of the company to register as shareholder or debenture-holder any person to whom the right to any shares in, or debentures of, the company has been transmitted by operation of law.

(1A) Every instrument of transfer of shares shall be in such form as maybe prescribed, and-

(a) every such form shall, before it is signed by or on behalf of the transferor and before any entry is made therein, be presented to the prescribed authority being a person already in the service of the Government, who shall stamp or otherwise endorse thereon the date on which it is so presented, and

(b) in the case of shares dealt in or quoted on a recognised stock exchange, at any time before the date on which the register of members is closed, in accordance with law, for the first time after the date of the presentation of the prescribed form to the prescribed authority under clause (a) or within (twelve) months from the date of such presentation, whichever is later;

(ii) In any other case, within two months from the date of such presentation.

(1B) Notwithstanding anything contained in sub-section (1A), an instrument of transfer of shares, executed before the commencement of section 13 of the Companies (Amendment) Act, 1965 (31 of 1965), or executed after such commencement in a form other than the prescribed form, shall be accepted by a company,

(a) in the case of shares dealt in or quoted on a recognised stock exchange, at any time not later the expiry of six months from such commencement or the date on which the register of members is closed in accordance with law, for the first time after such commencement, whichever is later;

(b) In any other case, at any time not later than the expiry of six months from such commencement.

(1C) nothing contained in sub-section (1A) and (1B) shall apply tote) any share -

(i) which is held by a company in any other body corporate in the name of a director or nominee in pursuance of sub-section (2), or as the case may be, sub-section (3), of section 49, or

(ii) which is held by a corporation, owned or controlled by the Central Government or a state Government, in any other body corporate in the name of a director or nominee, or

(iii) In respect of which a declaration has been made to the Public Trustee under section 153B, if- the company or corporation, as the case may be, stamps or otherwise endorses, on the form of transfer in respect of such share, the date on which it decides that such share shall not be held in the name of the said director or nominee or, as the case may be, in the case of any share in respect of which any such declaration has been made to the Public Trustee, the Public Trustee stamps or otherwise endorses, on the form of transfer in respect of such share under his seal, the date on which the form is presented to him, and the instrument of transfer in such form, duly completed in all respects, is delivered to the-

(a) Body corporate in whose share such company or corporation has made investment in the name of its director or nominee, or

(b) Company in which such share is held in trust, within two months of the date so stamped or otherwise endorsed:

Audit Report

The **auditor's report** is a formal opinion, or disclaimer thereof, issued by either an internal auditor or an independent external auditor as a result of an internal or external audit or evaluation performed on a legal entity or subdivision thereof (called an "auditee"). The report is subsequently provided to a "user" (such as an individual, a group of persons, a company, a government, or even the general public, among others) as an assurance service in order for the user to make decisions based on the results of the audit.

An auditor's report is considered an essential tool when reporting financial information to users, particularly in business. Since many third-party users prefer, or even require financial information to be certified by an independent external auditor, many auditees rely on auditor reports to certify their information in order to attract investors, obtain loans, and improve public appearance. Some have even stated that financial information without an auditor's report is "essentially worthless" for investing purposes.

Contents Of Audit Report

Auditor should check the books of accounts and balance sheet and need to prepare the audit report addressing to the shareholders and present it to the concerned department and to the company. Copy of such report should be sent to all the shareholders. Audit report should contain the following things.

1. Answer, clarification and explanation of furnished questions are given by the concerned authority satisfactory or not.
2. Income statement and balance sheet is prepared by the company in prescribed structure or not.
3. Accounts are maintained as per the provision of laid down rules and regulations or not.
4. Balance sheet of the company presents true and fair view of financial position or not.
5. High ranking official, representatives and staffs of the company have performed work as per the provision of rules and regulations or not; they have committed fraud or not.
6. Transactions of the company are satisfactory or not.
7. Auditor should provide suggestion if necessary.

In addition to above facts, an auditor should include other facts using his own discretion. Other facts which are to be incorporate in the report are given below:

1. An auditor should include all the facts demanded by the Company Act.
2. Auditor should include the true and fairness of books of accounts as well as facts where he is not able to satisfy himself.
3. Auditor should include all the important facts which directly affect the financial position of the company.
4. Some abnormal transactions which are found during the course of audit but they are necessary for the company should be incorporated in the audit report.
5. If financial statements like income statement and balance sheet are not maintain properly, an auditor should clearly state in the audit report.
6. An auditor should include in the report that the audit of books of account is made in detail or applying test check.
7. If there is special situation, an auditor should include it in the audit report.
8. If auditor detects any frauds and errors during the course of audit, he must include in audit report clearly stating their effect in financial statements. Like regarding valuation of stock, depreciation system demarcation of capital and revenue etc.

Types of Audit Report

An audit report is an appraisal of a small business‘s complete financial status. Completed by an independent accounting professional, this document covers a company‘s assets and liabilities, and presents the auditor‘s educated assessment of the firm‘s financial position and future. Audit reports are required by law if a company is publicly traded or in an industry regulated by the Securities and Exchange Commission (SEC). Companies seeking funding, as well as those looking to improve internal controls, also find this information valuable. There are four types of audit reports.

Unqualified Opinion

Often called a clean opinion, an unqualified opinion is an audit report that is issued when an auditor determines that each of the financial records provided by the small business is free of any misrepresentations. In addition, an unqualified opinion indicates that the financial records have been maintained in accordance with the standards known as Generally Accepted Accounting Principles (GAAP).

This is the best type of report a business can receive. Typically, an unqualified report consists of a title that includes the word ―independent.‖ This is done to illustrate that it was prepared by an unbiased third party. The title is followed by the main body. Made up of three paragraphs, the main body highlights the responsibilities of the auditor, the purpose of the audit and the auditor‘s findings. The auditor signs and dates the document, including his address.

Qualified Opinion

In situations when a company‘s financial records have not been maintained in accordance with GAAP but no misrepresentations are identified, an auditor will issue a qualified opinion. The writing of a qualified opinion is extremely similar to that of an unqualified opinion. A qualified opinion, however, will include an additional paragraph that highlights the reason why the audit report is not unqualified.

Adverse Opinion

The worst type of financial report that can be issued to a business is an adverse opinion. This indicates that the firm‘s financial records do not conform to GAAP. In addition, the financial records provided by the business have been grossly misrepresented. Although this may occur by error, it is often an indication of fraud. When this type of report is issued, a company must correct its financial statement and have it re-audited, as investors, lenders and other requesting parties will generally not accept it.

Disclaimer of Opinion

On some occasions, an auditor is unable to complete an accurate audit report. This may occur for a variety of reasons, such as an absence of appropriate financial records. When this happens, the auditor issues a disclaimer of opinion, stating that an opinion of the firm‘s financial status could not be determined.

PRINCIPLES OF AUDITING

POSSIBLE QUESTIONS

8 MARKS

UNIT 1

1. Explain Advantages and disadvantages of Auditing?
2. Write a brief note on stages of an Investigation.

3"Auditing begins where accounting ends."-Discuss.

4. Explain the objectives of auditing?
5. Distinguish between Continuous Audit and Balance Sheet Audit. What are the advantages of Continuous of Continuous Audit?
6. Define internal control. What are its principal forms? Describe its objectives.
7. "An Auditor is not a valuer", "An auditor is intimately connected with values", Comment these two statement.

8.Explain the importance of valuation and verification of assets and liabilities.

9.Write in brief on the concept of verification.

10. Explain the problems involved in valuation of Assets

UNIT 2

1. Elaborate the types of auditing.

2.Elucidate the position of External Auditors to Internal Auditors.

3. Explain about Internal check and Internal Control.

4.Write a Brief note on Audit Note Book

5. What is Vouching? How would you vouch the Trading Transactions?
6. For what purpose is the Journal utilized? How is it audited?
7. Explain the objectives of Share Transfer Audit.

8.Write in brief on Auditor's decision regarding the purchase and sale of assets.

9. Comment on Removal of Auditors.

10. Explain Share Transfer Audit and its Objectives.

UNIT 3

1. What is vouching? How would you vouch the cash book?
2. Explain in brief on Auditors duty regarding depreciation.
3. Vouching is the extension of auditing Discuss.
4. Explain about nature and scope of internal auditing.
5. Elucidate Auditors duty regarding Depreciation.
6. What is meant by “Verification of Assets”? How does it differ from the term “Valuation of Assets”?
7. Elucidate Duty of an Auditor in connection with secret reserves.
8. Explain the objectives of Vouching
9. Elaborate detection and prevention of frauds.
10. Explain falsification or manipulation of accounts.

UNIT 4

1.State the importance of verification and valuation of assets from the point of view of an auditor of a limited company.
2. Explain about Auditors decision regarding the sale of assets.
3. Explain about the classification of provisions and Auditor’s duty as regards provisions.
4. Elaborate Auditors position on valuation of assets and liabilities.
5. Describe how you would audit the share capital transaction of a newly established company.
6. Elaborate the rights of a company Auditor.
7. Elaborate the Origin of Auditing.
8. Explain the objectives of Auditing
9. Explain the differences between Internal and External Audit.

10. Write briefly the contents of Audit note book.

UNIT 5

1. Write a brief note on liabilities of a company auditor.
2. Explain in detail on Audit of share transfer.
3. Write a brief note on appointment of a company auditor.
4. Distinguish between rights and duties of company auditor
5. Discuss the techniques involved in Investigation.
6. “Accountancy is a necessity while Auditing is a luxury.” Comment.
7. Describe briefly the system of internal check suitable for a manufacturing company.
8. Explain briefly the objectives of Periodic Audit
9. Elucidate vouching of Impersonal Ledger.
10. Explain the steps involved in Internal Audit Project.

UNIT 1

Questions

Auditing standards differ from auditing procedures in that procedures relate to
The independent auditor of 1900 differs from the auditor of today in that the 1900 auditor was
The first general standard of generally accepted auditing standards which states, in part, that th
The first standard of field work, which states that the work is to be adequately planned, and ass
An independent audit aids in the communication of economic data because the audit
The first standard of field work recognizes that early appointment of the independent auditor ha
Which of the following best describes the reason why an independent auditor reports on financ
when two or more errors are committed in such a way that the result of these errors on the deb
———————are always committed deliberately and intentionally to defraud the proprietor
the main objective of ———————is to avoid or reduce the tax liability
Supporting accounting records for a particular financial period is ____________of an audit
An independent audit aids in the communication of economic data because the audit
Auditing of accounts is compulsory for_________
Which of the following is an element of quality control?
Which of the following is a quality control standard?
Independence permits internal auditors to render impartial and unbiased judgments. The best w
Which of the following is considered a major reason for establishing an internal audit function
The internal auditor's responsibility for the prevention of fraud includes all of the following exc
The primary responsibility for the adequacy of disclosure in the financial statements of a public
Due professional care requires
In the ancient period of audit was confined to _________audit and not to detect fraud
An auditor who examines the books of account with due audit care________escape liability fo
Detection of errors and frauds is _________the purview of an audit
Expression of independent opinion by the auditor on correctness and reliability of financial stat
_________of accounts refers to fraudulent manipulation or falsification of accounts
The main objective of _________is to win the confidence of shareholders
________ occurs when the distinction between revenue and capital is not strictly maintained
______occurs on account of transaction not being recorded in the books of account either whol
__________arise when an entry in a book of original record has been made twice
An__________ is an examination of accounting records
Auditing begins where _________ ends
___________ of an independent financial audit is to determine whether the financial statement
Detection of errors and frauds is an integral part of __________
The term________in accounting refers to an unintentional misstatement of financial statement
These errors arise because of mistake committed by the clerical staff means__________
The errors which counter balance each other in such a manner that there remains no difference
casting errors in the trial balance is called_________
__________ are those in which result from misapplication of or overlooking accounting pricip
The distinction between revenue and capital is not strictly maintained is called___________
When prepayments are ignored and the amount charged from the profit and loss account and c
Closing stock is not valued at cost or market price whichever is lower is called________
An intelligent vouching and ____________ of the assets and liabilities can easily detect errors
Locate errors and discover the difference in the trial balance , the auditor should take ________

Ascertain that all opening balances have been correctly brought forward in the current year boc
_________are often committed by two or more persons acting in collusion with one another
_____________ refers to fraudulent manipulation or falsification of accounts.
The accounts are prepared to indicate a much better and sound financial position of the busines
To disclose worse fiancial position of the company than actual one is called____________
Control of receipts and payments of cash can be exercised through a system is known as _____
Audited accounts are readily acceptable by _____________
The chartered accountants act was enacted in the year
Which of the following best describes the primary objective of an independent financial audit?
Transposition of figures is an error of:
Special audit of the accounts of a company can directed by
Which of the following is not recorded in audit notebook?
The wrong allocation of amount between capital and revenue expenditure is an
For which of the following types of enterprises an independent financial audit is required statut
The main objective of auditing is
Incorrect totaling of ledger accounts is an example of
Embezzlement of cash refs to

option1	**option2**	**option3**	**option4**
Measure of performance.	Audit principles.	Acts to be performe	Audit judgments.
Validity of the income state	Determination of fair prese	Improvement of account	Detection of irreg
Education and experience i	Ability in the planning and	Proficiency in business a	Knowledge in the
Early appointment of the au	Acceptance of an audit eng	Appointment of the audi	Performance of su
Assures the reader of financ	Confirms the accuracy of m	Lends credibility to the f	Guarantees that fi
The auditor will be able to c	The auditor will be able to	The auditor will be able	The auditor will b
A management fraud may e	Different interests may exis	A misstatement of accou	Poorly designed in
error of omission	compensating error	Error of Totalling	Error of Principle
Error	Fraud	omission	Principle
window dressing	secret reserves	Profit	Loss
Primary	secondary	Modern	Traditional
Assures the reader of financ	Confirms the accuracy of m	Lends credibility to the f	Guarantees that fi
Sole trader	Partnership	Companies	hindu undivided f
Supervision	Inspection	Personnel management	Consultation
Peer review.	Administrative control.	Engagement performanc	Time studies.
Individual knowledge and s	Organizational status and ol	Supervision within the o	Organizational kn
To relieve overburdened ma	To safeguard resources ent	To ensure the accuracy, r	To assist members
Determining if the organiza	Ensuring that fraud will no	Being aware of activities	Evaluating the eff
Partner assigned to the enga	Auditor in charge of field v	Management of the comp	Securities & Exch
A critical review of the wor	The examination of all corr	The exercise of error free	A study and revie
Stock	Cash	Assets	Loss
Can	Cannot	Mistake	Fraud
Within	Outside	inside	Mistake
Primary objective	Secondary objective	Both a and b	None
Misappropriation	Defalcation	Misrepresentation	None
Secret reserves	Window dressing	Mistake	Conflict
Incorrect allocation	correct allocation	Error of Totalling	Error of principles
Error of principles	Error of Totalling	Error of omission	Location of errors
Error of principles	Error of Totalling	Errors of duplication	Error of Commissi
Accounts	Audit	Cost	Marketing
Auditing	Accounting	Costing	Management
Secondary objectives	Primary objectives	Specific objectives	Auditing
Auditing	Accounting	Costing	Management
Mistake	fraud	Error	Clerical
Error of principles	Error of Totalling	Errors of duplication	Clerical errors
Error of principles	Error of Totalling	Compensating errors	Clerical errors
Error of principles	Error of Totalling	Trial balance errors	Clerical errors
Error of principles	Error of Totalling	Error of omission	Location of errors
Secret reserves	Window dressing	Mistake	Incorrect allocatio
Omission	Liabilities	outstanding	Omission of outsta
Valuation of assets	overvaluation of assets	Incorrect valuation of ass	undervaluation of a
Complete verification	Partial verification	verification	No verification
Location of error	Trial balance checking	Check cast	Check balances

Extensive checking	Trial balance checking	Check cast	Check balances
Mistake	fraud	Error	Clerical
Embezzlement of cash	Misappropriation of goods	Misrepresentation of Acc	Window dressing
window dressing	secret reserves	Embezzlement of cash	Misappropriation
window dressing	secret reserves	Embezzlement of cash	Misappropriation
Internal check system	Window dressing	Mistake	Incorrect allocatio
Income tax	Accounts	Costing	Management
1951	1955	1959	1949
Detection and prevention c	Detection and prevention	Detection of Frauds and	Expression of in
Principle	Compensating nature	Omission	Commission
The shareholders of the co	The company law board	The comptroller and aud	The central gove
Audit programme	Accounting statistics	Important balances	Analysis of tran
Error of principle	compensating error	Error of commission	Trail balance erro
Companies	Partnership firms	Hindu undivided families	Registered firms
To detect the errors and frau	To get money	To safe interest of shareh	None
Errors of principles	Error of omission	. Errors of commission	Error of totaling
Misappropriation of cash	Misappropriation of goods	Undervaluation of assets	Overvaluation of a

	Answer
	Audit principles.
ularities.	Detection of irregularities.
areas of financial accounting.	Knowledge in the areas of financial accounting.
ıbstantial parts of the examination	Audit principles.
nancial data are fairly presente	Assures the reader of financial statements that any fraudulent ac
e able to plan the audit work so th	The auditor will be able to perform the examination more efficie
nternal control may exist.	A management fraud may exist and is more likely to be detected
	error of omission
	Fraud
	secret reserves
	Primary
nancial data are fairly presente	Guarantees that financial data are fairly presente
amily	Companies
	Inspection
	Peer review.
owledge and skills	Supervision within the organization
s of the organization in the measur	To assist members of the organization in the measurement and e
ectiveness of actions taken by mar	Evaluating the effectiveness of actions taken by management to
ange Commission.	Management of the company.
w of the I/C's that include tests of	A critical review of the work done at every level of supervision.
	Cash
	Cannot
	Within
	Primary objective
	Misrepresentation
	Window dressing
	Incorrect allocation
	Error of omission
on	Error of Commission
	Audit
	Accounting
	Primary objectives
	Auditing
	Error
	Clerical errors
	Compensating errors
	Trial balance errors
	Error of principles
n	Incorrect allocation
nding assets and liabilities	Omission of outstanding assets and liabilities
assets	Incorrect valuation of assets
	Complete verification
	Trial balance checking

	Extensive checking	
	fraud	
	Misrepresentation of Accounts	
of goods	window dressing	
of goods	secret reserves	
n	Internal check system	
	Income tax	
		1949
dependent opinion by the auditor a	Detection of Frauds and errors	
	Principle	
ernment	The central government	
nsaction and balances	Audit programme	
or	Trail balance error	
	Companies	
	To detect the errors and frauds	
	Error of totaling	
assets	Misappropriation of cash	

tivity has been correcte
:ntly.
l by independent auditors.

:valuation of the effectivenss of the established internal control structure
deter fraud

UNIT II
Questions
When the audit is conducted at regular or irregular intervals throughout the year, it is called as
Accounting control does not comprise
Internal auditors are appointed by
Compliance of statutory requirements is the major concern of
An arrangement in which the accounting work of each individual is checked by others member
Internal Control is
Weakness Letter' is concerned with evaluation of
Which of the following is not recorded in audit notebook
Which of the following is not a method of obtaining audit evidence?
Who is the custodian authority for audit working papers?
Current file and permanent file jointly known as
A written plan containing the details regarding the conduct of a particular audit is called
Memorandum book contains details of
Which among the following does not full under outstanding liability?
Which among the following is not an example of deferred revenue expenditure?
Which among the following is not an contingent liability
The expenses which do not pertain to the current year through have been paid during the currer
Vouching of cash transactions refers to
The most important objectives of internal audit is
Which of the following is known as backbone of auditing
In Practice, the job of vouching is done by
Internal audit facilitates
Vouching may be best described as
verification of arithmatical accuracy of accounting entries and to ensure that ledger accounts ar
which of the following is not an objective of vouching
at the time of vouching any cash receipt item, an auditor should ensure that ,
receipt from debtors who became bankrupt should be vouched with the
Lapping is
Sales ledger is also called
Forward contracts are entered into in connection with
while vouching journal the auditor should ensure that
Forward purchase means
audit techniques are concerned with
internal control incorporates
Quality control and statistical analysis are covered by
the objective of issuing management letter is to identify any weaknesses in the internal
the _____________ should not be allowed any access to personal of general ledgers
internal auditor reports to the
a method of examination to substantiate an entry in the beeks of account
collateral voucher is a
in gerneral practice the job of vouching is done by
chances of fraud are maximum in the case of
when no entry is made in the cashbook by the casier and he makes a personal use of the cash co

fraud can be committed in the wage sheets by
if a director has forgone his fee, the auditor should examine the
while vouching purchase returns, the auditor need not insist on
the auditor should ensure that the sale of capital items like old machinery, old furniture, etc. is
in the absence of any special subsidiary book for recording transactions of a particular nature, t
purchase ledger is also called
capital expenditure implies
the benefit of expenses likely to be enjoyed not only in the current year but also in some more
audit note book contains
job information sheet is prepared by the auditor
working papers are the property of the
Impersonal ledger contains
companies act makes it binding on the companies to disclose
outstanding assets refer to
deferred revenue expenditure refers to
expenses incurred for future benefits are called
which relate to persons are called

option1	**option2**	**option3**	**option4**
Interim audit	Internal audit	Continuous audit	Statutory audit
Internal check	Statistical analysis	Internal Audit	Budgetary Control
The Shareholders	The Management	Board of directors at he	The Company's St
Internal audit	Internal control	Internal Check	External audit
Internal check	Internal audit	External audit	Test Checking
A part of internal check	A part of Internal audit	Whole system of control	None of the above
Internal control	Internal audit	External audit	Internal Check
Audit programme	Accounting statistics	Important balances	Analysis of transac
Inspection	Observation	Accounting statistics	Computation
Shareholders	Managing director	Company secretary	Auditor
Audit notebook	Audit programme	Audit working papers	Audit evidence
Audit programme	Audit memorandum	Audit notebook	working papers
Outstanding assets only	Outstanding liabilities only	both outstanding assets a	Deferred revenue
Unearned income	Unpaid Expenses	Deferred revenue expen	Purchase made at
Preliminary Expenses	Discount allowed on issue c	R & D expenditure	Bills receivable di
Uncalled amount on partly p	Pending Suit for damages	Forward contracts	Expenditure on ce
Outstanding Expenses	Prepaid Expenses	Deferred revenue expenc	outstanding liabilit
Vouching of all cash receip	Vounching of cash paymen	Vounching of both cash	Vounching of casl
Early detection of errors and	Facilitate final audit	Early Finalization of ann	Ensure systematti
Verification of assests	Internal check	Vouching	Internal audit
Single Person	Two persons	Bookkeeper and external	Three persons
internal check	internal control	final audit	statutory audit
identification of the docume	verification of the documen	authentification of the dc	verification of the
routine checking	test checking	vouching	internal audit
to examine the accounting e	to verify the authenticity of	to evaluate theadequacy a	to identify the doc
reliable system of internal cl	discount if any is allowed at	all the receipts noted in re	all the above
dividend warrants	correspondence exchanged	bad debts account	cashbook
a device used to detect the r	a malpractice under which	a method of vouching the	cash collected fron
sales book	accounts receivable ledger	accounts payable ledger	sales return ledger
purchase of goods	sales of goods	consignment of goods	return of goods
every journal entry has a nar	the transaction has been au	the transaction is suppor	all of the above
purchases made in the begi	purchases made at the end c	purchases to be made on	purchase
examination of those evider	application of generally acc	mehtod of conducting bu	verify
Accounting	Administrative	both accounting and adn	internal audit
accounting	administrative	internal check	internal audit
control	audit	check	verify
Cashier	Bookkeeper	Auditor	auditee
management	statutory auditor	internal auditor	board director
Vouching	Routine checking	verification	lapping
subsidiary	original	routine	lapping
one	two	three	four
credit sales	cash sales	cash and credit	credit purchase
Teeming and lading	error of principle	error of commission	malpractice

understating	overstating	routine	estimated
articles of association	waiver's letter	memorandum of associat	management letter
production credit note	system of internal check	higher	lower
Cashbook	Sales book	Purchase book	purchase return bo
ledger account	journal account	trading acount	balancesheet
sudry creditors ledger	sudry debtors ledger	purchase book	sales book
acquisition of assets	deffered revenue	revenue expenditure	capital loss
prepaid expenses	deferred revenue expenditu	capital expenditure	accrued income
audit programme	working papers	audit note	documents
before commencing	after completing	inbetween	after one year
auditor	auditee	auditor and auditee	management
all real accounts	all nominal accounts	Real and nominal	personal account
contingent liability	deferred revenue expenditu	capital expenditure	outstanding assets
accrued income	unpaid expenses	unearned income	outstanding assets
non-recurring expenditure	capital expenditure	contingent liability	outstanding assets
prepaid or unexpired expen	heavy expenses	unpaid expenses	liabilities
personal accounts	nominal	real	personal and nomi

	Answer
	Statutory audit
	Statistical analysis
atutory auditor	The Management
	External audit
	Internal check
	Whole system of control employed by the management
	Internal control
ctions and balances	Analysis of transactions and balances
	Accounting statistics
	Auditor
	Audit working papers
	Audit programme
expenditure only	both outstanding assets as well as outstanding liabilities
the close of the year	Deferred revenue expenditure
iscounted	Bills receivable discounted
rtain experiments	Expenditure on certain experiments
ty	Prepaid Expenses
h purchase & ollection from debte	Vounching of both cash receipt as well as payment items
c accounting	Early detection of errors and frauds
	Vouching
	Two persons
	internal control
accuracy and authenticity of the tr	verification of the accuracy and authenticity of the transaction
	routine checking
umentary evidence in support of t	to identify the documentary evidence in support of transactions
	all the above
	correspondence exchanged between the official receiver and the
n creditors	a malpractice under which a cashier makes private use of money
	accounts receivable ledger
	sales of goods
	all of the above
	purchases to be made on a future date at a predetermined price
	examination of those evidence which have been traced by audit p
	both accounting and administrative
	administrative
	control
	Cashier
	management
	Vouching
	subsidiary
	two
	cash sales
	Teeming and lading

	overstating
r	waiver's letter
	production credit note
ook	Purchase book
	journal account
	sudry creditors ledger
	acquisition of assets
	deferred revenue expenditure
	audit programme
	before commencing
	auditor
	Real and nominal
s and liabilities	contingent liability
and liabilities	accrued income
	non-recurring expenditure
	prepaid or unexpired expenses
nal	personal accounts

client only
for sometime

procedures

Questions
Unit III
Verification means
Verification is the process of examination by
Verification is done by affirm ________ of the asset
Question of ownwership is________ in respect of an asset
The auditor is entitled to rely _____ upon the information
Ownership of assets and liabilities are ________
The auditor should verify ________ should submit report
Ownership of assets is of _______ types
_________ as to assets were acquired for the business
valuation of assets is an ________ of their verification
cost of an item of fixed asset comprises its ________ including import duties
The assets are originally purchased and includes all other charges
_________means originalcost of the asset less depreciation
Overvaluation of assets means assets are __________

Assets are classified under ______ categories
_______ are of premenant nature
current assets are known as ______
_________ assets are do not have form or physical existence
__________ are of a fixed nature but depleted or consumed
________ is represents the earniing capacity of the business
The assets are acquired during the current accounting period means _______
copyright is acquired by the client means,________ is assigned
________ means original and verified value examine by the client
________ refers to appropriation surplus od resources
Examine the investments is known as owner and ______
Bookvalue compare with the ledger and _____schedule
Sales during the year should be verified with _______ sold note
Scrutinize _______ investment amount to ensure the interest
_______ refers to the physical count of stock-in-trade
Auditor's must make fullest use of all materials and_______
closing stock arrived at is verified through ______
stock cards with items pass through _________
Incorrect ________ of stock affects the determination of profit or loss
Profits should not be taken into account of ________
Stock be valued at ______value
______ method is received and first are issued first
Purchase orders are placed throughout the year at ______
A minimum quantity of stock is known as _______
Net realizable value refers to ________
Estimated selling and distribution charge are deduct at ________
Cost of _________ goods willinclude materials
Stock classified according to the nature of _______
Work in progress is generally accepted for accounting _______

The provision of _______controls to guard the stock
The auditor should _______ the accounting system.
Reserve is commonly used to meet ______ demand or liability
Reserve is an _______ of profits
Reserve is created to strengthen ________
General reserve is the portion of ______
Capital reserve is the out of profits or _______of capital nature
Sinking fund is a ______ established for redemption
________ has been shown seperately in the balance sheet.
Replacement of any depreciable is _______ in life
________ are the actual owners of the company
_________ are permitted to create secret reserve
Existence of ________ is necessary in the interest of the company
Charging capital expenditure to ________
To reduce tax liability gives less amount of _______
Financial statement should reflect true &fair view of ______

As per companies act 1956 ________ is prohibited
____________ means breach of duty to take care.

option1	**option2**	**option3**	**option4**
truth &fairness	existence of assets	process	picture of the firm
Actual items	ownership of assets	valuation of opinion	financial informati
classification	material aspects	physical existence	significance
valid an true	verify the truth	disclosure	association of the (
possible tests	technical knowledge	legal provisions	business and objec
associate aspect	basic aspect	fundamental aspect	physical aspect
submit report	audit report	verified information	balancesheet
three	two	one	four
valuation	verification	association	confirmation
basis	computed	integral part	associated
sales price	tax price	purchase price	levy price
cost price	market value	cost replacement	book value
break value	scrap value	book value	cost value
over depreciated	profit value	charge velue	under depreciated
five	four	three	two
current assets	fixed assets	intangible assets	fictitious assets
floating	circulating	obsolute	converted
tangible assets	business assets	intangible assets	wasting assets
physical existence	wasting assets	intangible assets	fictitious assets
freehold preoperty	plant &machinery	goodwill	patents
sales price	purchase price	vouchers	inventories
acknowledgement	agreement	assign files	obtain lists
face value	book value	market value	asset value
Inventories	bookdebts	Investments	patents
book value	market balue	shortterm value	face value
current year	previous year	upcoming year	none of these
auditor's note	seller's note	broker's note	balancesheet
Individual	partners	sellers	Auditors
stock coming	stock taking	stock going	stock list
Rawmaterials	Work-in-progress	finished goods	none of these
duty count	method count	physical count	stock count
sales voucher	sales journal	stock items	stock sheet
Verification	Adjustment	valuation	counting
accurate	anticipate	approximate	alternative
Gross value	netvalue	net realizable value	inventory value
LIFO	FIFO	Average cost method	Base stock method
Prices	orders	stock value	Size
Average stock	base stock	first stock	realizable cost
Accurate price	Replacement price	estimated price	distributed price
Purchase price	estimated price	selling price	replacing price
semi-finished	finished	finished product	none of these
business	workers	sales	purchase
policies	principles	records	values

Appropriate	accurate	adequate	accelerate
Appropriate	accurate	evaluate	Determine
Unforeseen	foreseen	stable	none of these
fixed	appropriate	accurate	associate
balancing assets	liabilities	financial position	losses
losses	distribution	netprofit	additional profit
losses	gains	surplus	dividend
part of fund	Interest of fund	Specific fund	None of these
specific reserve	sinking fund reserve	capital reserve	reserve fund
fixed asset	wasting assets	floating assets	current assets
dirctors	suppliers	shareholders	none of these
share holding	banking	dividend	profit
capital reserve	general reserve	secret reserve	none of these
Income	gains	revenue	All the above
Income	profit	dividend	losses
finance part	financial position	finance report	finance solution
capital reserve	secret reserve	general reserve	sinking fund reser
Misfeasance	Negligence	Fraud	Mistake

	Answer
	truth&fairness
on	financial information
	physical existence
company	valid on truth
ts	technical knowledge
	fundamental aspect
	balance sheet
	two
	verification
	integral part
	purchase price
	cost price
	book value
	under depreciated
	five
	fixed assets
	floating
	intangible assets
	intangible assets
	goodwill
	purchase price
	agreement
	book value
	Investments
	face value
	previous year
	broker's note
	Individual
	stock taking
	work-in-progress
	physical count
	sales journal
	valuation
	anticipate
	net realizable value
l	FIFO
	stock value
	base stock
	estimated price
	selling price
	finished
	business
	principles

adequaute
evaluate
Unforeseen
appropriate
financial position
net profit
gains
specific fund
capital reserve
wasting assets
shareholders
banking
secret reserve
revenue
profit
financial position

ve secret reserve
Negligence

Unit IV
As per companies act 1956 ________ is prohibited
____________ means breach of duty to take care.
________ means breach of trust
Liability for Negligence and liability for Misfeasance are jointly known as _________
When an auditor willfully makes a false statement either in the balancesheet or in any other do
Section 197 of _________ provides for punishment for giving a certificate that is false in any r
Misfeasance may be defined as__________
which of the following sections provides penalty for fraudulently inducing persons to invest m
in which of the following cases auditor was acquitted for breach of duty in connection with val
If auditors are not satisfied on any material points , they must report it clearly to the _________
__________ refers to liabilites of auditors under statute.
Which arise out of civil wrong for which action for losses /damages can be initiated against the
_________denote the liabilities of an auditor under unwritten law for negligence and fraud
_________ of an auditor arises because of his failure to fulfil a contractual obligation.
A________ report should not be made unless material issues are involved or disclosure specifi
__________ vouchsafes the truth and accuracy of the statement
To make a report on the accounts examined by him is the _________ duty of an auditor
Auditors report normally shows the _________of the audit work
In the expression true and fair view , true indicates _________
A company auditor addresses his audit report to___________
Chartered accountant year is passed in the year __________
Chartered accountant is practicing as a soleproprietor, appointed only by _______
Registered auditors certificate rule is passed in _______
chartered accountant's relative of_________ is disqualified
The appointment is made within _________ of the registration
In ____________ removal of auditor is possible
In companies act _________ to appoint auditors of the company
___________ auditor is not appinted on permanent basis
A person holding voting rights after _______ from dec 13, 2000
The disqualification extend to ________company
The provisions of_____ are intend to ensure independent
_______ of a company can be appointed by board of directors
The auditor is appointed within ______ of the registration
_____ is not appointed on permanent basis
_________ of at AGM the auditor is appinted or reappinted
________ except caused by resignation of an auditor
______ of the subscribed capital is used for special resolution
A government company has ____ of paidup capital
________ companies two or more accountant appointed as joint auditor
_______ Auditor make the report to central government
The central government is empowered to issue directions on _____
The person undertakes cost audit is called
Cost auditor is appointed by _____
Income tax act passed in the year ____

Business undertaken of turnover _______ has compulsory tax audit
A right of access at all times to the books and accounts _______ of the company
The auditor is refused by _____ on the ground of required information
______ of the companies act to receive all notices
The auditor has to conduct ________ examination of the books of accounts
The auditor has to make ____ to the members
The auditor is appointed may ______ of the auditor's report
_________ of the act provide artificial statutory report
The principal duty of an auditor is gives _____
At the end of financial year,auditor gives statement
The Auditor gives statement of______ must enquire securities
The opinion of _______ gives on enquiries of research
In the voluntary winding up of the company ,declaration is_________
______ is appointed by central govt to investigate the company
Auditor asked to conduct _______ to represent taxation matters
_______ Institute for practicing chartered accountant
_________means an inquiry into the accounts of a business for a special purpose.
Accounts of a joint stock company must be audited according to law while investigation is ___
Special Section under section_________

capital reserve	secret reserve	general reserve	sinking fund reser
Misfeasance	Negligence	Fraud	Mistake
Misfeasance	Negligence	Fraud	Mistake
Civil liability	Criminal liability	liability for misconduct	fraud
Civil liability	Criminal liability	liability on account of mi	liability for miscor
Companies act 1956	Indian Penal code	liability for misconduct	Criminal liability
Breach of duty imposed by l	Breach of duty to take care	Negligence without any l	Loss or damage wi
Section 63	Section 68	Section 240	Section 242
London and general bank ca	London oil storage vs Seear	Re kingston Cotton Mills	Rex vs Kyslant an
Shareholders	Board of Directors	Central Government	Comptroller and A
Contractual liabilities	Statutory liabilities	Liabilities under commor	other liabilities
Contractual liabilities	Statutory liabilities	Liabilities under commor	Civil liabilities
Contractual liabilities	Liabilities under common la	Liabilities to third parties	liability for miscor
Contractual liabilities	Liabilities under common la	Liabilities to third parties	liability for miscor
Clean	qualified	Disqualified	fraud
Report	Certificate	Liability	Mistake
statutory	Contractual	Civil liabilities	Liabilities under c
scope and nature	nature	Merits	Merits and demeri
Accuracy	correct	facts	Impartial
Board of Directors	Members	Managing Directors	Company Secretar
1957	1949	1965	1945
board of directors	individual	corporate	none of these
1945	1938	1956	1965
director	company secretary	dealers	shareholders
onemonth	two month	three month	five month
general meeting	finance port	governerment	company auditor
directors	employees	shareholders	managers
first auditor	statutory	company	final
period of tweo years	period of one year	period of 3 years	period of 5 years
holding	starting	primary	secondary
sec 256	sec 226	sec 247	sec 296
subsequent auditors	first auditors	reappinted auditors	special auditors
1 month	3 months	5 months	8 months
subsequent auditors	central auditor	statutory auditor	special auditors
Sec 226	Sec 224	Sec 237	Sec 247
retirement	special filling	casual vacancy	appointment
35%	45%	38%	25%
58%	51%	54%	60%
Banking	shareholding	stock	public
cost	special	tax	concurrent
special accounts	cost accounts	tax	branch
special auditor	joint auditor	cost auditor	tax auditor
shareholders	Government	board of directors	chartered accounta
1959	1961	1967	1977

30 lakhs	35 lakhs	45 lakhs	40 lakhs
ledgers	vouchers	journals	statistics
shareholders	employees	directors	members
sec 231	sec 238	sec 248	sec 251
depedent	Independent	orderly	soughtout
operation	books	report	statements
Execute	sign	give opinion	authenticated
Sec 165	Sec 261	Sec 179	Sec 190
opinion about statement	Report to the members	give legal source	suggestions
profit and loss a/c	ledgers	balancesheet	other documents
loans&advances	Investments	Personal expenses	shares
Enquiring committee	Reserch committee	Decising committee	Information comm
solvency	Insolvency	Inspection	Prospectus
Analyser	inspector	prospector	investigator
special audit	performance of audit	efficiency audit	common audit
ICFI	ICAI	ICAS	ICAM
Auditing	Investigation	Liabilities	Assets
Compulsary	Investigation	Not Compulsary	Assets
233A	234A	235A	Auditing

management

ve	secret reserve	
	Negligence	
	Misfeasance	
	Civil liability	
nduct	Criminal liability	
	Indian Penal code	
ithout negligence	Breach of duty to take care	
	Section 68	
d Moreland (1931)	London oil storage vs Seear Hasluck and co (1904)	
uditor general of india	Board of Directors	
	Statutory liabilities	
	Civil liabilities	
nduct	Liabilities under common law	
nduct	Contractual liabilities	
	Clean	
	Certificate	
ommon law	statutory	
ts	scope and nature	
	facts	
y	Board of Directors	
		1949
	individual	
		1956
	directors	
	one month	
	general meeting	
	share holders	
	statutory	
	period of one year	
	holding	
	sec 226	
	first auditors	
	1 month	
	statutory auditor	
	Sec 224	
	casual vancancy	
		25%
		51%
	Banking	
	special	
	cost accounts	
	cost auditor	
nt	Board of directors	
		1961

ittee

40 lakhs
vouchers
directors
sec231
Independent
Report
sign
Sec 165
Report to the memebers
balanacesheet
loans & Advances
Research committee
solvency
inspector
efficiency audit
ICAI
Auditing
Investigation
Not Compulsary

auditing

Unit V
Investigation is ___________of the books of accounts
The report of the investigation is a _________
Investigation where __________is suspected by the proprietor
Investigation on behalf of _________authorities for tax liability
The investigator may draft the ___________report
Entering less amount in the cash book than what has been received is called
In the case of the companies with no share capital not less than _______of the persons in the co
The investigator may investigate the affairs of any other company if the other company is a sub
An investigator may be appointed by the ___________ to find out the persons who are the actu
The assessee would have understated his income of shifted the profit of one year to another yea
Under investigation frauds may be in the form of treating cash sale as__________
Investigation relating to defalcation of stock the investigator examine____________
Frauds can be committed by way of _________
Investigation relates to books that have been already been ________
An investigation is an examination of accounting records undertaken for a __________Purpose
A prospectus investigation usually covers the previous_________
Teeming and lading is a technique , exercised by the staff of the client with motive of _______
EDP stands
computer nowadays play a vital role in the processing of
the computer based accounting system requires an auditor to employ
auditor software refers to the ______used by the auditor to examine the contents of the enterpri
______ data used by the auditor to test the operation of the enterprise
________ a number of audit procedures are carried out manually
auditing in an EDP environment can be divided into ____ parts
the basic objective and scope of an audit do not change in a
the use of computer for processing and _____ information may affect the structure and nature o
___ refers to the situation in which the users of the computer systems are involved in all stages
the use of computer assisted audit technique may be required due to
the standard of working papers and retention procedures for a ______ should be audit as a who
CAATs stands
the working papers should contain sufficient documentation to describe the
Controls over data centre and network operations and access security include
CAATs are those featuring the application of auditing procedures using the computer as
Enquiry programs could be used for audit purposes to search for all customers with
which one is the CAAT applications
details of the audit test performed by the
In the computerised accounting and processing, it is possible that there may not exist the prope
____consists of data submitted by the auditor for processing by the client's computer system.
The principle objective is to test the operation of
_____used when test data is run live, involves the establishment of dummy records
_____as one of the characteristics of the audit that needs to be considered in developing the ov
Increases accuracy of the audit results is the benefit of
The auditor will perform their own_____ of the electronic data with your books and records
the auditor and Computer Audit Specialist will request _____ that would be used to compile th

_______is computer-assisted **auditing**
A Computer Audit Specialist (CAS) is specially trained in
Computer Assisted Audit reduces the
e-Auditing is
Electronic tax auditing reduces the amount of
Electronic audits permit tax auditors to work at ____ most of the time.
More efficient techniques for reviewing taxpayer information are used in
the investigate accountant may be asked to investigate the ______ of the company
auditors can expect most accounting transactions to be in_________ without any paper docum
which type of fraud usually committed by the cashier
Auditors performing attest services for _____ that process financial transactions on these advar
Paperless auditing includes
investigation should not be confused with

Auditing	Accounting	finacing	236A
Positive	Negative	report	examination
Fraud	Mistake	Facts	Positive Report
Government	Income tax	Company	Error
Investigation	Management	Financial	banker
Misappropriation of cash	Misappropriation of goods	Misappropriation of prop	Auditing
4-Jan	5-Jan	6-Jan	Misappropriation o
Holding	Private	Public	7-Jan
state government	central Government	Local body	jointstock
Income	Expenses	Profit	board of directors
Credit sale	Cash purchase	Credit purchase	Loss
Credit sale	Stock book	purchase book	purchase of machi
Defalcation of cash	Misappropriation of goods	Manipulation of acounts	credit note
Audited	Accounted	Manipulated	All the above
General	Special	ordinary	Scrutinized
3 years	2 years	5 years	examination
Defalcation of cash	Misappropriation of goods	Falsification of accounts	4 years
electronic data processing	excel data processing	electronic data purchasing	Manipulation of ac
electronic data processing	storage	audit software	excel data protecti
computer assisted audit tecl	computer aided design	computer software	accounting data
computer program	storage	installation	computer note
audit software	EDP	test data	detected
audit software	test data	information	audit evidence
4	6	3	EDP environment
audit nature	audit programme	computer based accounti	7
storing accounting	saved into system	deleting	test
End-user environment'	excel data processing	electronic data purchasin	inserting
EDP function	skill and competence	the absence of input docu	excel data protecti
EDP	CAAT	MAT	internal control
companies audit accounting	cost audit accounting techn	computer assisted audit te	TET
CAAT application	audit track	virus	computer account
System development control	prevent or detect errors duri	computer based accounti	confidential infor
audit programme	audit working paper	audit tool	confidential infor
credit balances	revenues	all loss and gains	audit paper
lack of audit track	chances of manupulations	computer virus	all income only
EDP	CAAT	MAT	audit evidence
manual accounting system	audit track	chances of manipulations	TET
output data	merge data	Test data	computer virus and
storage	application control	maintain secrecy	Check the data
computer based accounting	information data	Integrated test facilit	delivering the info
EDP	CAAT	MAT	planning
audit	Computer Assisted Audit	company assisted audit	TET
verification and reconciliati	vouching	validating	computer documer
typed data	manual data	electronic data	checking

internal audit	external audit	electronic audit	oral information
data systems and statistical s	information data	Integrated test facilit	statutory audit
over all time to verify audit	overall time to complete th	investigate	planning
save time	defalcation	errors and fraud	testing
records	fax	paper work	verification
company	tax office	general department	validating
manual audit	internal audit	external audit	accounts departme
accounts and records	products	manufacturing	electronic audits.
written form	electronic form	fax	marketing
misappropriation of goods	falsification	manipulation	paper work
manager	vendor	clients	defalcation
EDP	CAAT	MAT	director
marketing	auditing	advertising	TET
			management

	233A	
	examination	
	Positive Report	
	Fraud	
	Income tax	
	Investigation	
of accounts	Misappropriation of cash	
		5-Jan
	Holding	
	central Government	
	Expenses	
inery	Credit sale	
	Stock book	
	All the above	
	Audited	
	Special	
	5 years	
ccounts	Defalcation of cash	
ion	electronic data processing	
	accounting data	
	computer assisted audit techniques	
	computer program	
	test data	
	EDP environment	
		7
	computer based accounting	
	storing accounting	
on	End-user environment’	
	the absence of input documents	
	CAAT	
s audit tests	computer assisted audit techniques	
nation	CAAT application	
nation	prevent or detect errors during program execution	
	audit tool	
	credit balances	
	audit evidence	
	CAAT	
d other failure	manual accounting system	
	Test data	
rmation	application control	
	Integrated test facilit	
	CAAT	
ntary report	Computer Assisted Audit	
	verification and reconciliation	

nt

electronic data
electronic audit
data systems and statistical sampling
overall time to complete the audit.
save time
paper work
tax office
electronic audits.
accounts and records
electronic form
defalcation
clients
EDP
auditing