BCOM (PA) **2018-2019**

18PAU303A **AUDITING AND CORPORATE GOVERNANCE** **Semester – III** **4H – 3C**

Instruction Hours / week: L: 4 T: 0 P : 0 **Marks: Internal: 40 External: 60 Total: 100**

End Semester Exam: 3 Hours

COURSE OBJECTIVES:

To make the students

1. To Understand the Concept of auditing, corporate governance and Corporate social responsibility (CSR)
2. To learn the audit techniques, corporate governance and CSR practices.
3. To apply the best auditing process as lifelong practice,
4. To communicate orally and in written form the auditing concept and techniques, Corporate governance and CSR concepts and practices in business.
5. To be familiar with the standards and laws pertaining to the auditing, Corporate Governance and CSR.

COURSE OUTCOMES:

Learners should be able to

1. Comprehend on the Concept of auditing, corporate governance and Corporate social responsibility (CSR)
2. Recall theaudit techniques, corporate governance and CSR practices.
3. Apply lifelong the key learning of best auditing process, Corporate governance and CSR practices
4. Communicate orally and in written form the auditing concept and techniques, Corporate governance and CSR concepts and practices in business.
5. Familiar with the standards and laws pertaining to the auditing, Corporate Governance and CSR.

UNIT I INTRODUCTION

Definition-Nature-Scope and Objectives of Independent Financial Audit : Basic Principles Governing an Audit, Concept of Auditor’s Independence - Error and Fraud- Classification of Audit -Standards on Auditing (SA) : Concept and Purpose - Audit procedures and techniques - Audit Evidence : Concept, Need, Procedures to obtain Audit Evidence

UNIT II AUDIT RISK AND INTERNAL CONTROL SYSTEM

Audit Risk : Concept and Types, Relationship with audit materiality - Professional Skepticism.

Internal Control : Definition, Objectives, Evaluation, Internal Control Check List, Internal Control Questionnaire and COSO’s Internal Control Framework - Internal Check : Definition, Objectives and

General Principles on Internal Check for selected transactions - Internal Audit : Definition, Objectives, Regulatory Requirement, Use of Internal Auditor's Work by Statutory Auditor

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UNIT III VOUCHING, VERIFICATION AND VALUATION

Vouching :Meaning, Objectives - Difference with Routine Checking – Factors to be Considered during Vouching of Different items

Verification and Valuation: Concept, objectives, Importance, Difference with Vouching, Difference between Verification and Valuation, Verification and Valuation of Different Items.

UNIT IV AUDIT OF COMPANIES AND SPECIAL AREAS OF AUDIT

Audit of Companies: Qualification, Disqualification, Appointment, Reappointment and Rotation, Casual Vacancy, Removal and Resignation, Ceiling, Remuneration, Rights, Duties and Liabilities of Company Auditor - Audit Committee - Branch Audit and Joint Audit - Divisible Profit and Dividend (Final, Interim and Unclaimed/Unpaid): Provision of the Act and Legal Decisions and Auditor's Responsibility

Audit report and certificate: Definition – Distinction between Report and Certificate- Different Types of Report Contents of Audit Report (As per Companies Act and Standards on Auditing)True and Fair View – Concept Materiality – Concept and Relevance

Special areas of Audit: Cost Audit- Concepts, objectives, Relevant Provisions of Companies Act Management Audit – Concepts, Objectives, Advantages Tax Audit – Concepts, Objectives, Legal Provisions Social Audit – Propriety Audit – Performance Audit – Environment Audit (Concepts only)

UNIT V CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITIES

Conceptual framework of Corporate Governance: Theories & Models, Broad Committees; Corporate Governance Reforms. Common Governance Problems Noticed in various Corporate Failures. Codes & Standards on Corporate Governance, Clause 49 and Listing Agreement, Green Governance

Concept of CSR, Corporate Philanthropy, Strategic Planning and Corporate Social Responsibility; Relationship of CSR with Corporate Sustainability; CSR and Business Ethics, CSR and Corporate Governance; CSR provisions under the Companies Act 2013; CSR Committee; CSR Models, Codes, and Standards on CSR, Global Reporting Initiatives, ISO 26000

SUGGESTED READINGS:

1. Arun jha (2019), Auditing and Corporate Governance, 2nd edition, Taxmann Publication, New Delhi.
2. Anil Kumar, Lovleen Gupta, Jyotsna Rajan Arora (2019), Auditing and Corporate Governance, 2nd edition, Taxmann Publication, New Delhi.
3. Dr. T R Sharma, Dr. Gourav Sankalp (2018), Auditing and Corporate Governance, Sathiya Bhawan Publications, Agra
4. Ashok Sharma (2019), Auditing and Corporate Governance, VK Global Publications Pvt. Ltd., New Delhi.
5. Sharma, J.P., (2016), Corporate Governance, Business Ethics, and CSR, 2nd edition, Ane Books Pvt Ltd, New Delhi.

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)
(Established under section 3 of UGC Act 1956)
Coimbatore-641021
Department of Commerce

Name: **T.N.P.Nalini**
Department: **Commerce**
Subject Code: **18PAU303A** Semester: **III** Year: **2018 - 2021 Batch**
Subject: **Auditing and Corporate Governance** **Lesson Plan**

UNIT 1			
S.No	**Lecture Hours**	**Contents**	**References**
1	1	Definition-Nature-Scope and Objectives of Independent Financial Audit	R1:1-5
2	1	Basic Principles Governing an Audit	R3: 337
3	1	Concept of Auditor's Independence	R3: 335
4	1	Error and Fraud	R2: 10
5	1	Classification of Audit – Standards on Auditing (SA) - Concept and Purpose	R3: 335
6	1	Audit Procedures And Techniques - Audit Evidence – Concept	R1: 70
7	1	Audit Evidence – Need, Procedures to obtain Audit Evidence	R1: 70
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit 1			**8**
UNIT 2			
1	1	Audit Risk – Concept and Types, Relationship with audit materiality - Professional Skepticism	W1
2	1	Internal Control- Definition, Objectives, Evaluation	R1: 81
3	1	Internal Control Check List, Internal Control Questionnaire and COSO's Internal Control Framework	R2: 86
4	1	Internal Check: Definition, Objectives	R2: 48
5	1	General Principles on Internal Check for selected transactions	R1: 88

6	1	Internal Audit: Definition, Objectives, Regulatory Requirement	R1: 95
7	1	Use of Internal Auditor's Work by Statutory Auditor	W2
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit 2			**8**
UNIT 3			
1	1	Vouching: Meaning, Objectives	R1: 104
2	1	Difference with Routine Checking	R1: 105
3	1	Factors to be Considered during Vouching of Different items	R1: 106
4	1	Verification and Valuation: Concept, objectives	R1: 111
5	1	Importance, Difference with Vouching	R1: 110
6	1	Difference between Verification and Valuation	W3
7	1	Verification and Valuation of Different Items	R2: 135
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit 3			**8**
UNIT 4			
1	1	Audit of Companies: Qualification, Disqualification	R1: 208
2	1	Appointment, Reappointment and Rotation	R1: 210
3	1	Casual Vacancy, Removal and Resignation	R1: 231
4	1	Ceiling, Remuneration, Rights, Duties and Liabilities of Company Auditor	R1: 217
5	1	Audit Committee - Branch Audit and Joint Audit	W4
6	1	Divisible Profit and Dividend (Final, Interim and Unclaimed/Unpaid): Provision of the Act and Legal Decisions and Auditor's Responsibility	W5
7	1	Audit Report and Certificate: Definition – Distinction between Report and Certificate	R1: 305

8	1	Different Types of Report Contents of Audit Report (As per Companies Act and Standards on Auditing) True and Fair View	R1: 329
9	1	Concept Materiality – Concept and Relevance	R1: 315
10	1	Special areas of audit: Cost Audit- Concepts, objectives, Relevant Provisions of Companies Act	R1: 367
11	1	Management Audit – Concepts, Objectives	R1: 389
12	1	Advantages Tax Audit – Concepts, Objectives, Legal Provisions Social Audit	R1: 399
13	1	Propriety Audit – Performance Audit – Environment Audit (Concepts only)	W6
14	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit 4			**14**
UNIT 5			
1	1	Conceptual framework of Corporate Governance: Theories & Models, Broad Committees;	R4: 32
2	1	Corporate Governance Reforms. Common Governance Problems Noticed in various Corporate Failures	W7
3	1	Codes & Standards on Corporate Governance, Clause 49 and listing Agreement, Green Governance	W8
4	1	Concept of CSR, Corporate Philanthropy, Strategic Planning and Corporate Social Responsibility: Relationship of CSR with Corporate Sustainability	R4: 107
5	1	CSR and Business Ethics, CSR and Corporate Governance; CSR provisions under the Companies Act, 2013	W9
6	1	CSR Committee; CSR Models, Codes and standards on CSR. Global Reporting Initiatives, ISO 26000	W10
7	1	Recapitulation and discussion of Important questions	
8	1	Discussion of previous year ESE Question papers	
9	1	Discussion of previous year ESE Question papers	
10	1	Discussion of previous year ESE Question papers	
Total Number of hours planned for Unit 5 and discussion of previous year ESE Question papers			

Total Number of hours allotted for all five units	10

SUGGESTED READINGS:

R1: Ravinder Kumar & Virender Sharma "Auditing – Principles and Practice" PHI Edition

R2: R.G. Saxena "Principles and Practices and Auditing" Himalaya Publication

R3: D.S. Rawat "Accounting and Auditing Standard – Practice and Procedure" Taxmann's Publications

R4: N.Gopal Samy (2010) Corporate Governance – The new paradigm – Wheelar Publishing Ltd.

Websites:

W1: https://www.investopedia.com/terms/a/audit-risk.asp

W2: https://cleartax.in/s/sa-610-using-the-work-of-internal-auditors

W3: https://www.owlgen.com/question/point-out-the-difference-between-verification-and-valuation

W4: https://www.investopedia.com/terms/a/audit-committee.asp

W5:http://www.accountingnotes.net/auditing/company/dividends-and-divisible-profits-of-a-company-auditing/14789

W6: http://www.accountingnotes.net/auditing/propriety-audit-concept-and-requirements/4902

W7: https://jmuirandassociates.com/corporate-governance-issues/

W8: https://www.alticocap.com/corporate-governance.html

W9: https://www.managementstudyguide.com/csr-and-corporate-governance.htm

W10: https://iso26000.info/iso26000/

UNIT-I

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”

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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 trial balance 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

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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:

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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 maybe 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

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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

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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.

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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.

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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.

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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.

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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.

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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.

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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

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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.

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(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.

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(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

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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.

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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

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Auditing and Corporate Governance

Unit -1

s.no	**Questions**	**option1**	**option2**	**option3**	**option4**	**Answer**
1	Auditing standards differ from auditing procedures in that procedures relate to	Measure of performance.	Audit principles.	Acts to be performe	Audit judgments.	Audit principles.
2	The independent auditor of 1900 differs from the auditor of today in that the 1900 auditor was more concerned with the	Validity of the income statement.	Determination of fair presentation of financial statements.	Improvement of accounting systems.	Detection of irregularities.	Detection of irregularities.
3	The first general standard of generally accepted auditing standards which states, in part, that the examination is to be performed by a person or persons having adequate technical training, requires that an auditor have	Education and experience in the field of auditing.	Ability in the planning and supervision of the audit work.	Proficiency in business and financial matters.	Knowledge in the areas of financial accounting.	Knowledge in the areas of financial accounting.
4	The first standard of field work, which states that the work is to be adequately planned, and	Early appointment of the auditor is advantageous to the auditor and the client.	Acceptance of an audit engagement after the close of the client's fiscal year is generally not	Appointment of the auditor subsequent to the physical count of inventories requires a	Performance of substantial parts of the examination is necessary at interim dates.	Audit principles.

	assistants, if any, are to be properly supervised, recognizes that		permissible.	disclaimer of opinion.		
5	An independent audit aids in the communication of economic data because the audit	Assures the reader of financial statements that any fraudulent activity has been correcte	Confirms the accuracy of management's financial representations.	Lends credibility to the financial statements.	Guarantees that financial data are fairly presente	Assures the reader of financial statements that any fraudulent activity has been correcte
6	The first standard of field work recognizes that early appointment of the independent auditor has many advantages to the auditor and the client. Which of the following advantages is least likely to occur as a result of early appointment of the auditor?	The auditor will be able to complete the audit work in less time.	The auditor will be able to perform the examination more efficiently.	The auditor will be able to better plan for the observation of the physical inventories.	The auditor will be able to plan the audit work so that it may be done expeditiously.	The auditor will be able to perform the examination more efficiently.
7	Which of the following best describes the reason why an independent auditor reports on financial statements?	A management fraud may exist and is more likely to be detected by independent auditors.	Different interests may exist between the company preparing the statements and the persons	A misstatement of account balances may exist and is generally corrected as the result of the independent	Poorly designed internal control may exist.	A management fraud may exist and is more likely to be detected by

			using the statements.	auditor's work.		independent auditors.
8	when two or more errors are committed in such a way that the result of these errors on the debits and credits is nil, they are known as______(	error of omission	compensating error	Error of Totalling	Error of Principle	error of omission
9	—————— are always committed deliberately and intentionally to defraud the proprietors of the organisation	Error	Fraud	omission	Principle	Fraud
10	the main objective of ——————is to avoid or reduce the tax liability	window dressing	secret reserves	Profit	Loss	secret reserves
11	Supporting accounting records for a particular financial period is ____________of an audit	Primary	secondary	Modern	Traditional	Primary
12	An independent audit aids in the communication of economic data because the audit	Assures the reader of financial statements that any fraudulent activity has been correcte	Confirms the accuracy of management's financial representations.	Lends credibility to the financial statements.	Guarantees that financial data are fairly presente	Guarantees that financial data are fairly presente

13	Auditing of accounts is compulsory for_________	Sole trader	Partnership	Companies	hindu undivided family	Companies
14	Which of the following is an element of quality control?	Supervision	Inspection	Personnel management	Consultation	Inspection
15	Which of the following is a quality control standard?	Peer review.	Administrative control.	Engagement performance.	Time studies.	Peer review.
16	Independence permits internal auditors to render impartial and unbiased judgments. The best way to achieve independence is through	Individual knowledge and skills	Organizational status and objectivity	Supervision within the organization	Organizational knowledge and skills	Supervision within the organization
17	Which of the following is considered a major reason for establishing an internal audit function?	To relieve overburdened management of the responsibility for establishing an effective control structure	To safeguard resources entrusted to the organization	To ensure the accuracy, reliability and timeliness of financial and operating data used in managment's decision making	To assist members of the organization in the measurement and evaluation of the effectivenss of the established internal control structure	To assist members of the organization in the measurement and evaluation of the effectivenss of the established internal control structure
18	The internal auditor's responsibility for the prevention of fraud includes all of the	Determining if the organizational environment fosters control	Ensuring that fraud will not occur	Being aware of activities in which fraud is likely to occur	Evaluating the effectiveness of actions taken by management to deter fraud	Evaluating the effectiveness of actions taken by

	following except	consciousness				management to deter fraud
19	The primary responsibility for the adequacy of disclosure in the financial statements of a publicly held company rests with the	Partner assigned to the engagement.	Auditor in charge of field work.	Management of the company.	Securities & Exchange Commission.	Management of the company.
20	Due professional care requires	A critical review of the work done at every level of supervision.	The examination of all corroborating evidence available.	The exercise of error free judgment.	A study and review of the I/C's that include tests of controls	A critical review of the work done at every level of supervision.
21	In the ancient period of audit was confined to ________audit and not to detect fraud	Stock	Cash	Assets	Loss	Cash
22	An auditor who examines the books of account with due audit care_______escape liability for a subsequent discovery of misstatements arising from an error or fraud	Can	Cannot	Mistake	Fraud	Cannot
23	Detection of errors and frauds is ________the purview of an	Within	Outside	inside	Mistake	Within

	audit					
24	Expression of independent opinion by the auditor on correctness and reliability of financial statements and supporting acounting documents for a particular financial statement and supporting accounting documents for a particular fiancial period is ______	Primary objective	Secondary objective	Both a and b	None	Primary objective
25	________of accounts refers to fraudulent manipulation or falsification of accounts	Misappropri ation	Defalcation	Misrepresent ation	None	Misrepresentatio n
26	The main objective of ________is to win the confidence of shareholders	Secret reserves	Window dressing	Mistake	Conflict	Window dressing
27	________ occurs when the distinction between revenue and capital is not strictly maintained	Incorrect allocation	correct allocation	Error of Totalling	Error of principles	Incorrect allocation
28	_____occurs on account of transaction not being recorded in the books of	Error of principles	Error of Totalling	Error of omission	Location of errors	Error of omission

	account either wholly or partially.					
29	__________arise when an entry in a book of original record has been made twice	Error of principles	Error of Totalling	Errors of duplication	Error of Commission	Error of Commission
30	An__________ is an examination of accounting records	Accounts	Audit	Cost	Marketing	Audit
31	Auditing begins where _________ ends	Auditing	Accounting	Costing	Management	Accounting
32	___________of an independent financial audit is to determine whether the financial statement present a factual and impartial view of the financial position and working results of an enterprise.	Secondary objectives	Primary objectives	Specific objectives	Auditing	Primary objectives
33	Detection of errors and frauds is an integral part of	Auditing	Accounting	Costing	Management	Auditing
34	The term________in accounting refers to an unintentional misstatement of financial	Mistake	fraud	Error	Clerical	Error

	statement					
35	These errors arise because of mistake committed by the clerical staff means______	Error of principles	Error of Totalling	Errors of duplication	Clerical errors	Clerical errors
36	The errors which counter balance each other in such a manner that there remains no difference between two side of the trial balance means______	Error of principles	Error of Totalling	Compensating errors	Clerical errors	Compensating errors
37	casting errors in the trial balance is called________	Error of principles	Error of Totalling	Trial balance errors	Clerical errors	Trial balance errors
38	__________are those in which result from misapplication of or overlooking accounting priciples.	Error of principles	Error of Totalling	Error of omission	Location of errors	Error of principles
39	The distinction between revenue and capital is not strictly maintained is called________	Secret reserves	Window dressing	Mistake	Incorrect allocation	Incorrect allocation
40	When prepayments are ignored and the amount	Omission	Liabilities	outstanding	Omission of outstanding assets and liabilities	Omission of outstanding assets

	charged from the profit and loss account and outstanding expenses is called_______					and liabilities
41	Closing stock is not valued at cost or market price whichever is lower is called_______	Valuation of assets	overvaluatio n of assets	Incorrect valuation of assets	undervaluation of assets	Incorrect valuation of assets
42	An intelligent vouching and of the assets and liabilities can easily detect errors	Complete verification	Partial verification	verification	No verificatio n	Complete verification
43	Locate errors and discover the difference in the trial balance , the auditor should take	Location of error	Trial balance checking	Check cast	Check balances	Trial balance checking
44	Ascertain that all opening balances have been correctly brought forward in the current year books are called_______	Extensive checking	Trial balance checking	Check cast	Check balances	Extensive checking
45	________are often committed by two or more persons acting in collusion with one	Mistake	fraud	Error	Clerical	fraud

	another					
46	____________ refers to fraudulent manipulation or falsification of accounts.	Embezzlement of cash	Misappropriation of goods	Misrepresentation of Accounts	Window dressing	Misrepresentation of Accounts
47	The accounts are prepared to indicate a much better and sound financial position of the business enterprise is known as	window dressing	secret reserves	Embezzlement of cash	Misappropriation of goods	window dressing
48	To disclose worse fiancial position of the company than actual one is called_______	window dressing	secret reserves	Embezzlement of cash	Misappropriation of goods	secret reserves
49	Control of receipts and payments of cash can be exercised through a system is known as	Internal check system	Window dressing	Mistake	Incorrect allocation	Internal check system
50	Audited accounts are readily acceptable by	Income tax	Accounts	Costing	Management	Income tax
51	The chartered accountants act was enacted in the year	1951	1955	1959	1949	1949
52	Which of the following best describes the	Detection and prevention	Detection and prevention	Detection of Frauds and errors	Expression of independent opinion by the	Detection of Frauds and errors

	primary objective of an independent financial audit?	of frauds	of errors		auditor about the truth and fairness of financial information examined by him	
53	Transposition of figures is an error of:	Principle	Compensating nature	Omission	Commission	Principle
54	Special audit of the accounts of a company can directed by	The shareholders of the company	The company law board	The comptroller and auditor general of India	The central government	The central government
55	Which of the following is not recorded in audit notebook?	Audit programme	Accounting statistics	Important balances	Analysis of transaction and balances	Audit programmer
56	The wrong allocation of amount between capital and revenue expenditure is an	Error of principle	compensating error	Error of commission	Trail balance error	Trail balance error
57	For which of the following types of enterprises an independent financial audit is required statutorily?	Companies	Partnership firms	Hindu undivided families	Registered firms	Companies
58	The main objective of auditing is	To detect the errors and frauds	To get money	To safe interest of shareholders	None	To detect the errors and frauds
59	Incorrect totaling of ledger accounts is an example of	Errors of principles	Error of omission	. Errors of commission	Error of totaling	Error of totaling
60	Embezzlement of cash refs to	Misappropriation of cash	Misappropriation of goods	Undervaluation of assets	Overvaluation of assets	Misappropriation of cash

UNIT – II

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

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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.

S.no	**Questions**	**option1**	**option2**	**option3**	**option4**	**Answer**
1	When the audit is conducted at regular or irregular intervals throughout the year, it is called as	Interim audit	Internal audit	Continuous audit	Statutory audit	Statutory audit
2	Accounting control does not comprise	Internal check	Statistical analysis	Internal Audit	Budgetary Control	Statistical analysis
3	Internal auditors are appointed by	The Shareholders	The Management	Board of directors at he Board Meeting	The Company's Statutory auditor	The Management
4	Compliance of statutory requirements is the major concern of	Internal audit	Internal control	Internal Check	External audit	External audit
5	An arrangement in which the accounting work of each individual is checked by others members is known as	Internal check	Internal audit	External audit	Test Checking	Internal check
6	Internal Control is	A part of internal check	A part of Internal audit	Whole system of control employed by the management	None of the above	Whole system of control employed by the management
7	Weakness Letter' is concerned with evaluation of	Internal control	Internal audit	External audit	Internal Check	Internal control
8	Which of the following is not recorded in audit notebook	Audit programme	Accounting statistics	Important balances	Analysis of transactions and balances	Analysis of transactions and balances
9	Which of the following is not a method of obtaining audit evidence?	Inspection	Observation	Accounting statistics	Computation	Accounting statistics
10	Who is the custodian authority for audit working papers?	Shareholders	Managing director	Company secretary	Auditor	Auditor
11	Current file and permanent file jointly known as	Audit notebook	Audit programme	Audit working papers	Audit evidence	Audit working papers

12	A written plan containing the details regarding the conduct of a particular audit is called	Audit programme	Audit memorandum	Audit notebook	working papers	Audit programme
13	Memorandum book contains details of	Outstanding assets only	Outstanding liabilities only	both outstanding assets as well as outstanding liabilities	Deferred revenue expenditure only	both outstanding assets as well as outstanding liabilities
14	Which among the following does not full under outstanding liability?	Unearned income	Unpaid Expenses	Deferred revenue expenditure	Purchase made at the close of the year	Deferred revenue expenditure
15	Which among the following is not an example of deferred revenue expenditure?	Preliminary Expenses	Discount allowed on issue of Shares, Debentures, etc	R & D expenditure	Bills receivable discounted	Bills receivable discounted
16	Which among the following is not an contingent liability	Uncalled amount on partly paid shares	Pending Suit for damages	Forward contracts	Expenditure on certain experiments	Expenditure on certain experiments
17	The expenses which do not pertain to the current year through have been paid during the current year called :	Outstanding Expenses	Prepaid Expenses	Deferred revenue expenditure	outstanding liability	Prepaid Expenses
18	Vouching of cash transactions refers to	Vouching of all cash receipt items	Vounching of cash payment items	Vounching of both cash receipt as well as payment items	Vounching of cash purchase & ollection from debters only	Vounching of both cash receipt as well as payment items
19	The most important objectives of internal audit is	Early detection of errors and frauds	Facilitate final audit	Early Finalization of annual accounts	Ensure systemattic accounting	Early detection of errors and frauds
20	Which of the following is known as backbone of auditing	Verification of assests	Internal check	Vouching	Internal audit	Vouching
21	In Practice, the job of vouching is done by	Single Person	Two persons	Bookkeeper and external auditor	Three persons	Two persons

22	Internal audit facilitates	internal check	internal control	final audit	statutory audit	internal control
23	Vouching may be best described as	identification of the documentary evidence supporting the transactions	verification of the document supporting the transaction	authentification of the document supporting the transaction	verification of the accuracy and authenticity of the transaction	verification of the accuracy and authenticity of the transaction
24	verification of arithmatical accuracy of accounting entries and to ensure that ledger accounts are properly balancedisthe main objective of	routine checking	test checking	vouching	internal audit	routine checking
25	which of the following is not an objective of vouching	to examine the accounting entries recorded in the books of account with reference to documentary evidence	to verify the authenticity of the transactions	to evaluate theadequacy and reliability of such documentary evidence as provided in support of transactions	to identify the documentary evidence in support of transactions	to identify the documentary evidence in support of transactions
26	at the time of vouching any cash receipt item, an auditor should ensure that ,	reliable system of internal check is in operation	discount if any is allowed at uniform rate	all the receipts noted in rough cashbook or diaryare promptly and properly entered in the cashbook	all the above	all the above
27	receipt from debtors who became bankrupt should be vouched with the	dividend warrants	correspondence exchanged between the official receiver and the client only	bad debts account	cashbook	correspondence exchanged between the official receiver and the client only
28	Lapping is	a device used to detect the misuse of cash collected from debtors	a malpractice under which a cashier makes private use of money for sometime	a method of vouching the cash transactions	cash collected from creditors	a malpractice under which a cashier makes private use of money for sometime
29	Sales ledger is	sales book	accounts	accounts	sales return	accounts

	also called		receivable ledger	payable ledger	ledger	receivable ledger
30	Forward contracts are entered into in connection with	purchase of goods	sales of goods	consignment of goods	return of goods	sales of goods
31	while vouching journal the auditor should ensure that	every journal entry has a narration	the transaction has been authorized by some responsible officer	the transaction is supported by documentary evidence	all of the above	all of the above
32	Forward purchase means	purchases made in the beginning of the financial year	purchases made at the end of the previous year	purchases to be made on a future date at a predetermined price	purchase	purchases to be made on a future date at a predetermined price
33	audit techniques are concerned with	examination of those evidence which have been traced by audit procedures	application of generally accepted accounting principles to accuracyand validity of management authorization to the accounts section employees	mehtod of conducting business affair and reporting in annual report	verify	examination of those evidence which have been traced by audit procedures
34	internal control incorporates	Accounting	Administrative	both accounting and administrative	internal audit	both accounting and administrative
35	Quality control and statistical analysis are covered by	accounting	administrative	internal check	internal audit	administrative
36	the objective of issuing management letter is to identify any weaknesses in the internal	control	audit	check	verify	control
37	the______________ should not be allowed any access to personal of general ledgers	Cashier	Bookkeeper	Auditor	auditee	Cashier
38	internal auditor reports to the	management	statutory auditor	internal auditor	board director	management
39	a method of examination to	Vouching	Routine checking	verification	lapping	Vouching

	substantiate an entry in the beeks of account					
40	collateral voucher is a	subsidiary	original	routine	lapping	subsidiary
41	in gerneral practice the job of vouching is done by	one	two	three	four	two
42	chances of fraud are maximum in the case of	credit sales	cash sales	cash and credit	credit purchase	cash sales
43	when no entry is made in the cashbook by the casier and he makes a personal use of the cash collected from debtors, its is called	Teeming and lading	error of principle	error of commission	malpractice	Teeming and lading
44	fraud can be committed in the wage sheets by	understating	overstating	routine	estimated	overstating
45	if a director has forgone his fee, the auditor should examine the	articles of association	waiver's letter	memorandum of association	management letter	waiver's letter
46	while vouching purchase returns, the auditor need not insist on	production credit note	system of internal check	higher	lower	production credit note
47	the auditor should ensure that the sale of capital items like old machinery, old furniture, etc. is not entered in the	Cashbook	Sales book	Purchase book	purchase return book	Purchase book
48	in the absence of any special subsidiary book for recording transactions of a particular nature, the entries for such transactions can also be passed through the	ledger account	journal account	trading acount	balancesheet	journal account
49	purchase ledger is	sudry	sudry debtors	purchase book	sales book	sudry creditors

	also called	creditors ledger	ledger			ledger
50	capital expenditure implies	acquisition of assets	deffered revenue	revenue expenditure	capital loss	acquisition of assets
51	the benefit of expenses likely to be enjoyed not only in the current year but also in some more years to come	prepaid expenses	deferred revenue expenditure	capital expenditure	accrued income	deferred revenue expenditure
52	audit note book contains	audit programme	working papers	audit note	documents	audit programme
53	job information sheet is prepared by the auditor	before commencing	after completing	inbetween	after one year	before commencing
54	working papers are the property of the	auditor	auditee	auditor and auditee	management	auditor
55	Impersonal ledger contains	all real accounts	all nominal accounts	Real and nominal	personal account	Real and nominal
56	companies act makes it binding on the companies to disclose	contingent liability	deferred revenue expenditure	capital expenditure	outstanding assets and liabilities	contingent liability
57	outstanding assets refer to	accrued income	unpaid expenses	unearned income	outstanding assets and liabilities	accrued income
58	deferred revenue expenditure refers to	non-recurring expenditure	capital expenditure	contingent liability	outstanding assets	non-recurring expenditure
59	expenses incurred for future benefits are called	prepaid or unexpired expenses	heavy expenses	unpaid expenses	liabilities	prepaid or unexpired expenses
60	which relate to persons are called	personal accounts	nominal	real	personal and nominal	personal accounts

UNIT –III

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.

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UNIT -3

	Questions	**option1**	**option2**	**option3**	**option4**	**Answer**
s.no	**Unit III**					
1	Verification means	truth &fairness	existence of assets	process	picture of the firm	truth&fairness
2	Verification is the process of examination by	Actual items	ownership of assets	valuation of opinion	financial information	financial information
3	Verification is done by affirm_________of the asset	classification	material aspects	physical existence	significance	physical existence
4	Question of ownwership is_________in respect of an asset	valid an true	verify the truth	disclosure	association of the company	valid on truth
5	The auditor is entitled to rely______upon the information	possible tests	technical knowledge	legal provisions	business and objects	technical knowledge
6	Ownership of assets and liabilities are _________	associate aspect	basic aspect	fundamental aspect	physical aspect	fundamental aspect
7	The auditor should verify _________should submit report	submit report	audit report	verified information	balancesheet	balance sheet
8	Ownership of assets is of ________types	three	two	one	four	two
9	__________as to assets were acquired for the business	valuation	verification	association	confirmation	verification
10	valuation of assets is an _________of their verification	basis	computed	integral part	associated	integral part
11	cost of an item of fixed asset comprises its _________including import duties	sales price	tax price	purchase price	levy price	purchase price
12	The assets are originally purchased and includes all other charges	cost price	market value	cost replacement	book value	cost price
13	__________means originalcost of the asset less depreciation	break value	scrap value	book value	cost value	book value
14	Overvaluation of assets means assets are	over depreciated	profit value	charge velue	under depreciated	under depreciated
15	Assets are classified under _______categories	five	four	three	two	five
16	________are of premenant nature	current assets	fixed assets	intangible assets	fictitious assets	fixed assets
17	current assets are known as _______	floating	circulating	obsolute	converted	floating

18	__________assets are do not have form or physical existence	tangible assets	business assets	intangible assets	wasting assets	intangible assets
19	___________are of a fixed nature but depleted or consumed	physical existence	wasting assets	intangible assets	fictitious assets	intangible assets
20	_________is represents the earniing capacity of the business	freehold preoperty	plant &machine ry	goodwill	patents	goodwill
21	The assets are acquired during the current accounting period means	sales price	purchase price	vouchers	inventorie s	purchase price
22	copyright is acquired by the client means,_________ is assigned	acknowledge ment	agreement	assign files	obtain lists	agreement
23	_________means original and verified value examine by the client	face value	book value	market value	asset value	book value
24	_________refers to appropriation surplus od resources	Inventories	bookdebts	Investme nts	patents	Investments
25	Examine the investments is known as owner and	book value	market balue	shortterm value	face value	face value
26	Bookvalue compare with the ledger and _____schedule	current year	previous year	upcoming year	none of these	previous year
27	Sales during the year should be verified with ________sold note	auditor's note	seller's note	broker's note	balancesh eet	broker's note
28	Scrutinize ________ investment amount to ensure the interest	Individual	partners	sellers	Auditors	Individual
29	________refers to the physical count of stock-in-trade	stock coming	stock taking	stock going	stock list	stock taking
30	Auditor's must make fullest use of all materials and________	Rawmaterials	Work-in-progress	finished goods	none of these	work-in-progress
31	closing stock arrived at is verified through _______	duty count	method count	physical count	stock count	physical count
32	stock cards with items pass through __________	sales voucher	sales journal	stock items	stock sheet	sales journal
33	Incorrect_________of stock affects the determination of profit or loss	Verification	Adjustme nt	valuation	counting	valuation
34	Profits should not be taken into account of _________	accurate	anticipate	approxim ate	alternativ e	anticipate

PRINCIPLES OF AUDITING
UNIT -3

35	Stock be valued at ______value	Gross value	netvalue	net realizable value	inventory value	net realizable value
36	_______method is received and first are issued first	LIFO	FIFO	Average cost method	Base stock method	FIFO
37	Purchase orders are placed throughout the year at	Prices	orders	stock value	Size	stock value
38	A minimum quantity of stock is known as	Average stock	base stock	first stock	realizable cost	base stock
39	Net realizable value refers to _________	Accurate price	Replacement price	estimated price	distributed price	estimated price
40	Estimated selling and distribution charge are deduct at _________	Purchase price	estimated price	selling price	replacing price	selling price
41	Cost of___________goods willinclude materials	semi-finished	finished	finished product	none of these	finished
42	Stock classified according to the nature of ________	business	workers	sales	purchase	business
43	Work in progress is generally accepted for accounting ________	policies	principles	records	values	principles
44	The provision of _______controls to guard the stock	Appropriate	accurate	adequate	accelerate	adequaute
45	The auditor should ________the accounting system.	Appropriate	accurate	evaluate	Determine	evaluate
46	Reserve is commonly used to meet_______demand or liability	Unforeseen	foreseen	stable	none of these	Unforeseen
47	Reserve is an________of profits	fixed	appropriate	accurate	associate	appropriate
48	Reserve is created to strengthen _________	balancing assets	liabilities	financial position	losses	financial position
49	General reserve is the portion of _______	losses	distribution	netprofit	additional profit	net profit
50	Capital reserve is the out of profits or________of capital nature	losses	gains	surplus	dividend	gains
51	Sinking fund is a _______ established for redemption	part of fund	Interest of fund	Specific fund	None of these	specific fund
52	_________has been shown seperately in the balance sheet.	specific reserve	sinking fund reserve	capital reserve	reserve fund	capital reserve
53	Replacement of any depreciable is________in life	fixed asset	wasting assets	floating assets	current assets	wasting assets

54	_________are the actual owners of the company	dirctors	suppliers	sharehold ers	none of these	shareholders
55	__________are permitted to create secret reserve	share holding	banking	dividend	profit	banking
56	Existence of_________is necessary in the interest of the company	capital reserve	general reserve	secret reserve	none of these	secret reserve
57	Charging capital expenditure to _________	Income	gains	revenue	All the above	revenue
58	To reduce tax liability gives less amount of	Income	profit	dividend	losses	profit
59	Financial statement should reflect true &fair view of	finance part	financial position	finance report	finance solution	financial position
60	As per companies act 1956_________is prohibited	capital reserve	secret reserve	general reserve	sinking fund reserve	secret reserve

UNIT IV

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

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* 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:

Valuation of Assets & Liabilities.

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1.Cost

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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:

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:		

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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

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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 knowledge to 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

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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:

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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:

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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

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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.

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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

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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 :-

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(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:

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(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

KAHE

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 ƒAdditions Used (amounts charged against the provision) ƒUnused amounts reversed Unwinding of the discount, or changes in 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

KAHE

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 written down value (WDV) Profit on revaluation of all assets/liabilities Profit earned prior to incorporation of the company Profit on reissue of forfeited shares Premium on issue of shares or debentures Profits on redemption of debentures Amount utilized out of profits to redeem redeemable preference 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 Capital repurchase reserve account Share premium account Profit prior to incorporation Any reserve regarded free for distribution 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

KAHE

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 purpose. 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.

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Crediting revenue receipts to

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

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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.

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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.

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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

KAHE

sheet as showing a true and fair view of the 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".

KAHE

S.NO	Unit IV	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
1	As per companies act 1956________is prohibited	capital reserve	secret reserve	general reserve	sinking fund reserve	secret reserve
2	____________means breach of duty to take care.	Misfeasance	Negligence	Fraud	Mistake	Negligence
3	________means breach of trust	Misfeasance	Negligence	Fraud	Mistake	Misfeasance
4	Liability for Negligence and liability for Misfeasance are jointly known as _________	Civil liability	Criminal liability	liability for misconduct	fraud	Civil liability
5	When an auditor willfully makes a false statement either in the balancesheet or in any other document, destroys or mutilates any voucher or document this amount to_______	Civil liability	Criminal liability	liability on account of misfeasance	liability for misconduct	Criminal liability
6	Section 197 of _________provides for punishment for giving a certificate that is false in any material point in same manner as if a false evidence was given	Companies act 1956	Indian Penal code	liability for misconduct	Criminal liability	Indian Penal code
7	Misfeasance may be defined as__________	Breach of duty imposed by law	Breach of duty to take care	Negligence without any loss or damage	Loss or damage without negligence	Breach of duty to take care
8	which of the following sections provides penalty for fraudulently inducing persons to invest moneys______	Section 63	Section 68	Section 240	Section 242	Section 68
9	in which of the following cases auditor was acquitted for breach of duty in connection with valuation and verification of stock in trade________	London and general bank case(1893)	London oil storage vs Seear Hasluck and co (1904)	Re kingston Cotton Mills co ltd(1896)	Rex vs Kyslant and Moreland (1931)	London oil storage vs Seear Hasluck and co (1904)
10	If auditors are not satisfied on any material points , they must report	Shareholders	Board of Directors	Central Government	Comptroller and Auditor general of	Board of Directors

	it clearly to the ________				india	
11	__________refers to liabilites of auditors under statute.	Contractual liabilities	Statutory liabilities	Liabilities under common law	other liabilities	Statutory liabilities
12	Which arise out of civil wrong for which action for losses/damages can be initiated against the auditor in a civil court is called_______	Contractual liabilities	Statutory liabilities	Liabilities under common law	Civil liabilities	Civil liabilities
13	________denote the liabilities of an auditor under unwritten law for negligence and fraud	Contractual liabilities	Liabilities under common law	Liabilities to third parties	liability for misconduct	Liabilities under common law
14	_________of an auditor arises because of his failure to fulfil a contractual obligation.	Contractual liabilities	Liabilities under common law	Liabilities to third parties	liability for misconduct	Contractual liabilities
15	A________report should not be made unless material issues are involved or disclosure specifically requried by the act are not made	Clean	qualified	Disqualified	fraud	Clean
16	__________vouchsafes the truth and accuracy of the statement	Report	Certificate	Liability	Mistake	Certificate
17	To make a report on the accounts examined by him is the _________ duty of an auditor	statutory	Contractual	Civil liabilities	Liabilities under common law	statutory
18	Auditors report normally shows the_________of the audit work	scope and nature	nature	Merits	Merits and demerits	scope and nature
19	In the expression true and fair view , true indicates _________	Accuracy	correct	facts	Impartial	facts
20	A company auditor addresses his audit report to___________	Board of Directors	Members	Managing Directors	Company Secretary	Board of Directors
21	Chartered accountant year is passed in the year __________	1957	1949	1965	1945	1949
22	Chartered accountant is practicing as a soleproprietor,	board of directors	individual	corporate	none of these	individual

	appointed only by _______					
23	Registered auditors certificate rule is passed in _______	1945	1938	1956	1965	1956
24	chartered accountant's relative of_________is disqualified	director	company secretary	dealers	shareholders	directors
25	The appointment is made within _________ of the registration	onemonth	two month	three month	five month	one month
26	In_____________ removal of auditor is possible	general meeting	finance port	governerment	company auditor	general meeting
27	In companies act _________to appoint auditors of the company	directors	employees	shareholders	managers	share holders
28	___________auditor is not appinted on permanent basis	first auditor	statutory	company	final	statutory
29	A person holding voting rights after _______ from dec 13, 2000	period of tweo years	period of one year	period of 3 years	period of 5 years	period of one year
30	The disqualification extend to ________company	holding	starting	primary	secondary	holding
31	The provisions of_____ are intend to ensure independent	sec 256	sec 226	sec 247	sec 296	sec 226
32	_______of a company can be appointed by board of directors	subsequent auditors	first auditors	reappinted auditors	special auditors	first auditors
33	The auditor is appointed within_______of the registration	1 month	3 months	5 months	8 months	1 month
34	_____is not appointed on permanent basis	subsequent auditors	central auditor	statutory auditor	special auditors	statutory auditor
35	_________of at AGM the auditor is appinted or reappinted	Sec 226	Sec 224	Sec 237	Sec 247	Sec 224
36	________except caused by resignation of an auditor	retirement	special filling	casual vacancy	appointment	casual vancancy
37	______of the subscribed capital is used for special resolution	35%	45%	38%	25%	25%
38	A government company	58%	51%	54%	60%	51%

	has____of paidup capital					
39	________companies two or more accountant appointed as joint auditor	Banking	shareholding	stock	public	Banking
40	_______Auditor make the report to central government	cost	special	tax	concurrent	special
41	The central government is empowered to issue directions on _____	special accounts	cost accounts	tax	branch	cost accounts
42	The person undertakes cost audit is called	special auditor	joint auditor	cost auditor	tax auditor	cost auditor
43	Cost auditor is appointed by _____	shareholders	Government	board of directors	chartered accountant	Board of directors
44	Income tax act passed in the year____	1959	1961	1967	1977	1961
45	Business undertaken of turnover_______has compulsory tax audit	30 lakhs	35 lakhs	45 lakhs	40 lakhs	40 lakhs
46	A right of access at all times to the books and accounts______of the company	ledgers	vouchers	journals	statistics	vouchers
47	The auditor is refused by _____on the ground of required information	shareholders	employees	directors	members	directors
48	______of the companies act to receive all notices	sec 231	sec 238	sec 248	sec 251	sec231
49	The auditor has to conduct________ examination of the books of accounts	depedent	Independent	orderly	soughtout	Independent
50	The auditor has to make ____ to the members	operation	books	report	statements	Report
51	The auditor is appointed may______ of the auditor's report	Execute	sign	give opinion	authenticated	sign
52	_________of the act provide artificial statutory report	Sec 165	Sec 261	Sec 179	Sec 190	Sec 165
53	The principal duty of an auditor is gives _____	opinion about statement	Report to the members	give legal source	suggestions	Report to the memebers
54	At the end of financial year,auditor gives	profit and loss a/c	ledgers	balancesheet	other documents	balanacesheet

	statement					
55	The Auditor gives statement of______ must enquire securities	loans&advances	Investments	Personal expenses	shares	loans & Advances
56	The opinion of _______ gives on enquiries of research	Enquiring committee	Reserch committee	Decising committee	Information committee	Research committee
57	In the voluntary winding up of the company ,declaration is_________	solvency	Insolvency	Inspection	Prospectus	solvency
58	______is appointed by central govt to investigate the company	Analyser	inspector	prospector	investigator	inspector
59	Auditor asked to conduct _______to represent taxation matters	special audit	performance of audit	efficiency audit	common audit	efficiency audit
60	_______Institute for practicing chartered accountant	ICFI	ICAI	ICAS	ICAM	ICAI

INTRODUCTION:

The root of the word Governance is from 'gubernator', which means to steer. Corporate governance would mean to steer an organization in the desired direction. The responsibility to steer lies with the board of directors / governing board.

Corporate or a Corporation is derived from the Latin term "corpus" which means a "body". Governance means administering the processes and systems placed for satisfying stakeholder expectation. When combined, Corporate Governance means a set of systems, procedures, policies, practices, standards put in place by a corporate to ensure that relationship with various stakeholders is maintained in transparent and honest manner.

A corporation is a lawful artificial person having a separate and different identity from its members who bring it into the reality, its members having limited liability and it has a common seal. The various stakeholders who contribute the capital of the company are the legal owners of company. Shareholders choose board of directors to check the activities of the company on their behalf. The board of directors appoints managers who manage day-today functioning of the company and report to the board of directors. These managers work as the agent of shareholders and mandated to maximize the wealth of the company. This relationship is called agency relationship whereby the owners of the company (Joint Stock Company) called principals and their agents are the management of the company represented by the board of directors.

Concept and Definition of Corporate Governance

The concept of "Governance" is as old as human civilization. Governance is simply defined as the process of decision making and the process by which decisions are implemented or not. It can be used in several contexts such as corporate governance, international, national and local governance.

Corporate governance is dealing with problems that result from the separation of ownership and control. Corporate governance focuses on some structures and mechanisms that would ensure the proper internal structure and rule s of the board of directors, creations of independent committees, rules for disclosures of information to shareholders and control of management.

The concept of corporate governance has received a lot of attention these days in the developed as well as in the developing nations due to high profile scandals like Worldcom, Enron, Xerox, Harshad Mehta scam, Satyam scam etc. These scams have shaken the investor confidence and made it difficult for companies to raise funds from the stock market (Agrawal, 2005). And these scams highlight the requirement to develop corporate governance practices and accounting transparency. Corporate governance is considered to be different from the corporate management. It is not only corporate management but also it is much broader to corporate management and consists of efficient and transparent administration to meet certain well defined objectives.

Strong corporate-governance system helps ensure a country's long-term success; weak systems often lead to serious problem. Quality of governance has become a critical success factor for survival and a source of competitive advantage; has also become a major factor influencing the ability of a company to raise funds from capital markets (Aggarwal et al.,2007). A good corporate-governance practice provides s transparency, fairness, accountability and responsibility in the market. These features are known as pillars of corporate governance.

Shareholders, board of direct ors and management officials are the main players in the corporate governance. Board of directors is the most powerful player in the corporate governance matters due to separation in ownership, control and management. Shareholders are the actual owner of the company but they belong to different places, so it is not possible for them to monitor each and every activity of the company. Therefore, they appoint directors on their behalf to protect their interest in the company. The board of directors appoints managers to handle day to day activities of the organization and these managers report to the board of directors. The board of director s acts as middlemen between management and shareholders. Board of director s is responsible to shareholders for all activities of the managers. Good corporate governance depends upon the quality of board such as board structure in terms of separation of authority between chairman and CEO,

KAHE

board size, board composition related to proportion of executive, non- executive, independent and nominee directors in the board, knowledge, skill and abilities of members of the board and common understanding between directors at the time of taking decision. The board of directors has to perform mainly the functions such as taking strategic decisions, establishing objectives, formulation and implementation of policies an d performance evaluation of CEO and other management personnel. The board of direct ors not only provides the direction to the managerial personnel but also bear the responsibility on the shoulder of management.

NEED FOR CORPORATE GOVERNANCE

Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure. It refers to compliance with all the moral & ethical values, legal framework and voluntarily adopted practices.

(a) Corporate Performance: Improved governance structures and processes ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance- either in terms of share price or profitability.

(b) Enhanced Investor Trust: Investors consider corporate governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of upto 40 percent for shares in companies with superior corporate governance practices.

(c) Better Access to Global Market: a good corporate governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

(d) Combating Corruption: Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption would certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

(e) Easy Finance from Institutions: Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidences indicate that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

(f) Enhancing Enterprise Valuation: Improved management accountability and operational transparency fulfill investors' expectations and confidence on management and corporations, and in return, increase the value of corporations.

(g) Reduced Risk of Corporate Crisis and Scandals: Effective Corporate Governance ensures efficient risk mitigation system in place. A transparent and accountable system makes the Board of a company aware of the majority of the mask risks involved in a particular strategy, thereby, placing various control systems in place to facilitate the monitoring of the related issues.

(h) Accountability: Investor relations are essential part of good corporate governance. Investors directly/ indirectly entrust management of the company to create enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in Corporate Governance is integral to the existence of the company. order to maintain good investors relation. Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders.

Macro Issues in Corporate Governance

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Examples include:

- Competition
- Debt covenants
- Demand for and assessment of performance information (especially financial statements)
- Government regulations
- Managerial labor market
- Media pressure
- Takeovers

Micro Issues in Corporate Governance

Internal corporate governance controls monitor activities and then take corrective action to accomplish

Monitoring by the board of directors

The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, ex ante. It could be argued, therefore, that executive directors look beyond the financial criteria.

Internal control procedures and internal auditors

Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

Balance of power

The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

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Remuneration

Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior.

Board of Governance

A board of directors is a recognized group of people who jointly oversee the activities of an organization, which can be either a for-profit business, nonprofit organization, or a government agency

The Governance Committee (GC) is the most important committee of your nonprofit leadership. Its chief responsibilities are to determine the membership of your board and measure the quality of performance of the board as a whole and of your individual board members.

Every charity has a governing body (most often called a board) that takes overall responsibility for its work. The board is responsible for the governance of a charity - ensuring it is effectively and properly run and is meeting its overall purposes as set out in its governing document.

Governance has been defined to refer to structures and processes that are designed to ensure accountability, transparency, responsiveness, rule of law, stability, equity and inclusiveness, empowerment, and broad-based participation. In the development literature, the term 'good governance' is frequently used.

INTRODUCTION

The 21st century is characterized by unprecedented challenges and opportunities, arising from globalization, the desire for inclusive development and the imperatives of climate change. Indian business, which is today viewed globally as a responsible component of the ascendancy of India, is poised now to take on a leadership role in the challenges of our times. It is recognized the world over that integrating social, environmental and ethical responsibilities into the governance of businesses ensures their long term success, competitiveness and sustainability. This approach also reaffirms the view that businesses are an integral part of society, and have a critical and active role to play in the sustenance and improvement of healthy ecosystems, in fostering social inclusiveness and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective CSR, have image of socially responsible companies, achieve sustainable growth in their operations in the long run and their products and services are preferred by the customers.

Corporate Social Responsibility (CSR) is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from these corporate to give something in return to the society with whose explicit or implicit help these entities stand where they are.

Meaning and Definitions

CSR is understood to be the way firms integrate social, environmental and economic concerns into their values, culture, decision making, strategy and operations in a transparent and accountable manner and thereby establish better practices within the firm, create wealth and improve society. CSR is also called Corporate Citizenship or Corporate Responsibility.

According to Business for Social Responsibility (BSR) “Corporate social responsibility is operating a business in a manner which meets or excels the ethical, legal, commercial and public expectations that a society has from the business.”

Business entity is expected to undertake those activities, which are essential for betterment of the society. Every aspect of business has a social dimension. Corporate Social Responsibility means open and transparent business practices that are based on ethical values and respect for employees, communities and Lesson 13 Corporate Social Responsibility 375 the environment. It is designed to deliver sustainable value to society at large as well as to shareholders.

Corporate Social Responsibility is nothing but what an organization does, to positively influence the society in which it exists. It could take the form of community relationship, volunteer assistance programmes, special scholarships, preservation of cultural heritage and beautification of cities. The philosophy is basically to return to the society what it has taken from it, in the course of its quest for creation of wealth.

With the understanding that businesses play a key role of job and wealth creation in society, CSR is generally understood to be the way a company achieves a balance or integration of economic, environmental, and social imperatives while at the same time addressing shareholder and stakeholder expectations.

According to CSR Asia, a social enterprise, “CSR is a company’s commitment to operate in an economically,

Socially and environmentally sustainable manner whilst balancing the interests of diverse stakeholders”

CSR is generally accepted as applying to firms wherever they operate in the domestic and global economy. The way businesses engage/involve the shareholders, employees, customers, suppliers, Governments, non- Governmental organizations, international organizations, and other stakeholders is usually a key feature of the concept. While an organisation’s compliance with laws and regulations on social, environmental and economic objectives set the official level of CSR performance, it is often understood as involving the private sector commitments and activities that extend beyond this foundation of compliance with laws.

According to the Commission of the European Communities, 2003, “CSR is the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large.”

According to the World Business Council for Sustainable Development, 1999 “Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large.”

CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. The main function of an enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as welfare for society, particularly through an ongoing process of job creation. However, new social and market pressures are gradually leading to a change in the values and in the horizon of business activity.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

1. Social, economic, ethical and moral responsibility of companies and managers,
2. Compliance with legal and voluntary requirements for business and professional practice,
3. Challenges posed by needs of the economy and socially disadvantaged groups, and
4. Management of corporate responsibility activities.

CSR is an important business strategy because, wherever possible, consumers want to buy products from The term Corporate Social responsibility refers to the concept of business being accountable for how it manages the impact of its processes on stakeholders and takes responsibility for producing a positive effect on society.

Companies they trust; suppliers want to form business partnerships with companies they can rely on; employees want to work for companies they respect; and NGOs, increasingly, want to work together with companies seeking feasible solutions and innovations in areas of common concern. CSR is a tool in the hands of corporate to enhance the market penetration of their products, enhance its relation with stakeholders. CSR activities carried out by the enterprises affects all the stakeholders, thus making good business sense, the reason being contribution to the bottom line.

ETHICS

Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express and embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner conscience and sustainability.

The term "ethics" is derived from the Greek word "ethos" which refers to character, guiding beliefs, standards and ideals that pervade a group, a community or people. The Oxford Dictionary states ethics as "the moral principle that governs a person's behavior or how an activity is conducted". The synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct and standards.

Ethics refers to well-founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues.

Thus, ethics relates to the standards of conduct and moral judgments' that differentiate right from wrong. Ethics is not a natural science but a creation of the human mind. For this reason, it is not absolute and is open to the influence of time, place and situation.

In bygone times, kings used to keep food testers who used to eat the food prepared for the king before it was offered to him. This was royal clinical research to find out if the food was poisoned. This practice was not questioned because the king was regarded as the most important person in the kingdom, and his life was more precious than that of anyone else. It was the ethics of the time.

What is considered ethical behavior in one society might be considered unethical in another. For example, euthanasia (mercy killing) is permitted in some countries but it is considered strictly unethically most countries.

Ethics has following features:

- Ethics is a conception of right or wrong conduct. Ethics tells us when our behavior is moral and when it is immoral. It deals with the fundamental human relationship, how we think and behave towards others and how we want them to think and behave towards us.
- Ethics relates to the formalized principles derived from social values. It deals with the moral choices that we make in the course of performing our duties with regard to the other members of society. Hence, it is relevant in the context of a society only.

- Ethical principles are universal in nature. They prescribe obligations and virtues for everybody in a society. They are important not only in business and politics but in every human endeavor.
- There exist no sharp boundaries between ethical and non-ethical. Therefore, people often face ethical dilemmas wherein a clear cut choice becomes very difficult.
- The concepts of equity and justice are implicit in ethics. Fair and equitable treatment to all is its primary aim.
- Ethics and legality of action do not necessarily coincide. What a society interprets as ethical or unethical ends up expressed in laws. The legality of actions and decisions does not necessarily make them ethical. For example, not helping an injured person in a road accident may be unethical but not illegal.

The Purpose of Board of Director

The board of directors' key purpose is to ensure the company's prosperity by collectively directing the company's affairs, whilst meeting the appropriate interests of its shareholders and stakeholders.

Essentially it is the role of the board of directors to hire the CEO or general manager of the business and assess the overall direction and strategy of the business. The CEO or general manager is responsible for hiring all of the other employees and overseeing the day-to-day operation of the business.

Officers are usually appointed by the corporation's board of directors, and while specific positions may vary from one corporation to another, typical corporate officers include:

- Chief Executive Officer (CEO) or President.
- Chief Operating Officer (COO).
- Chief Financial Officer (CFO) or Treasurer.
- Secretary.

Composition and Operation of the Board of Directors

- The majority of the members of the Board of Directors shall be comprised of directors who are "Independent" as defined and required by applicable law and/or stock exchange listing standards.
- The Board shall decide whether the positions of Lead Director, Chairman and Chief Executive Officer should be established and maintained as separate positions or held by the same person in light of all relevant and changing circumstances.
- The Board of Directors shall participate in an extended session of meetings prior to the beginning of each year that shall be dedicated to the review of the Company's strategies, goals and financial objectives for that year.
- The Nominating and Governance Committee shall consider and make recommendations to the Board concerning the appropriate size and needs of the Board. The number of directors should not exceed a number that can function efficiently.
- Non-employee Directors shall be provided with exposure to operating management and major customers of the Company on a regular basis throughout the year. Non-employee Directors may elect to contact any employee, customer, advisor or supplier of the Company.
- All Related Person Transactions shall be presented by a Director or management to the Audit Committee for its review. All material information regarding the proposed transaction and the Related Person shall be brought to the attention of the Audit Committee prior to the time that the Committee takes action on the transaction. The Audit Committee shall either approve, ratify or reject the transaction or refer the transaction to the full Board of Directors or other appropriate Committee, in its discretion. All Related Person Transactions shall be disclosed to the full Board of Directors

- When a director's principal occupation or business affiliation changes, or other circumstances arise, which may raise questions about the director's continuing qualifications to serve as a director, then the director shall tender his/her resignation, or the Nominating and Governance Committee shall ask for such tender. The Nominating and Governance Committee shall consider the tendered resignation and recommend to the Board the action to be taken.

Selection of Directors

Under the Articles of Association, the Board of Directors has authority to fill vacancies in the Board and appoint additional directors (in each case subject to their re-election at the next annual general meeting) and to nominate candidates for election by the shareholders. The screening process is done by the Corporate Governance and Nominating Committee with direct input from the Chairman and CEO and from the other directors and from time to time with the assistance of director search firms. In considering candidates for director, the Corporate Governance and Nominating Committee will take into account all factors it considers appropriate, including, among other things, breadth of experience, understanding of business and financial issues, ability to exercise sound judgment, diversity, leadership, and achievements and experience in matters affecting business and industry. The Corporate Governance and Nominating Committee considers the entirety of each candidate's credentials and believes that at a minimum each nominee should satisfy the following criteria: highest character and integrity, experience and understanding of strategy and policy-setting, sufficient time to devote to Board matters, and no conflict of interest that would interfere with performance as a director. Shareholders may recommend candidates for Board membership for consideration by the Corporate Governance and Nominating Committee. Such recommendations should be sent to the Committee, care of the Secretary of the Company. Candidates recommended by shareholders are evaluated in the same manner as director candidates identified by any other means.

Director Retirement

Each non-employee director must retire at the annual general meeting immediately following his or her 75th birthday. Directors who change the occupation they held when initially elected must offer to resign from the Board. At that time, the Corporate Governance and Nominating Committee reviews the continued appropriateness of Board membership under the new circumstances and makes a recommendation to the Board. Employee directors, including the CEO, must retire from the Board at the time of a change in their status as an officer of the Company, unless the policy is waived by the Board.

Corporate Governance and the Role of the Board

The Company's business is managed under the direction of the Board of Directors. The Board delegates to the Chief Executive Officer, and through that individual to other senior management, the authority and responsibility for managing the Company's business. The Board's role is to oversee the management and governance of the Company and to monitor senior management's performance.

Among the Board's core responsibilities are

- Select individuals for Board membership and evaluate the performance of the Board, Board Committees and individual directors.
- Select, monitor, evaluate and compensate senior management.
- Assure that management succession planning is adequate.
- Review and approve significant corporate actions.
- Review and monitor implementation of management's strategic plans.
- Review and approve the Company's annual operating plans and budgets.
- Monitor corporate performance and evaluate results compared to the strategic plans and other long-range goals.
- Review the Company's financial controls and reporting systems.
- Review and approve the Company's financial statements and financial reporting.

- Review the Company's ethical standards and legal compliance programs and procedures.
- Oversee the Company's management of enterprise risk.
- Monitor relations with shareholders, employees, and the communities in which the Company operates.

BUSINESS ETHICS

Business ethics is one of the important branches of applied ethics. Business ethics is the application of general ethical ideas to business. " Business ethics refers to the moral principles and standards and a code of conduct that businessmen are expected to follow while dealing with others. Business essentially is a means of society to use scarce resources to produce in an efficient manner those goods and services which society wants and is willing to pay for. Businesses must balance their desire to maximize profits against the needs of stakeholders. The significant issues in business ethics include ethical management of enterprise in relation to its stakeholders in particular and natural environment in general.

Ethics is necessary and important in business due to several reasons, some of which are given below:

• There is a kind of social contract between the society and business by which the society expects the business to work in its interest. Society creates and accepts business enterprises, hence it expects them to work in a manner which is not detrimental to its well being and interests. Technological advancements have to be made but their impact on the environment and mankind has he kept in mind.

• Ethical conduct is in the long-term interests of businessmen. A business enterprise that is honest and fair to its customers, employees, and other stakeholders earns their trust and good will. It ultimately results in customer satisfaction, healthy competition, industrial growth and high earnings. Businesses must balance their desire to maximize profits against the requirements of stakeholders. Maintaining this balance often requires tradeoffs. To address this unique aspect of business, rules are articulated to guide it to earn profits without harming individuals or society as a whole. While referring to business activity profile, Mahatma Gandhi once mentioned that all business entrepreneurs should ask themselves the question whether the activities they are contemplating

KAHE

would be of some use to the common man. This statement emphasizes the importance of nobility of business purpose.

• Ethical business behavior is not only about good business but about good citizenship as well. Morally conscious businessmen have created names and built great business empires. They serve customers with good quality products at fair prices, treat their employees with great respect, reward their shareholders with good returns and pay their taxes honestly.

• Ethical policies and practices enable a business enterprise to build goodwill for itself. A business organization that adheres to a code of conduct gains a competitive advantage and builds long term value. On the other hand, unethical practices lead to the ultimate downfall of big organizations too.

• Business can prosper only when a society is stable and peaceful. Unethical practices at times create distrust, disorder and turmoil in society.

Business ethics refers to a 'code of conduct' which businessmen are expected to follow while dealing with others. 'Code of conduct' is a set of principles and expectations that are considered binding on any person who is member of a particular group. The alternative names for code of conduct are 'code of ethics' and 'code of practice'.

Business ethics comprises of the principles and standards that guide behavior in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, articulated as well as implicit rules are developed to guide the businesses to earn profits without harming individuals or society as a whole.

The coverage of business ethics is very wide as it deals with norms relating to a company and its employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. It reflects the philosophy of business, one of whose aims is to determine the fundamental purposes of a company.

Business ethics stands for the saneness or purity of purpose that is upheld through carefully designed actual practices of business enterprises. It is an embodiment of conscious concern towards execution of business processes in tune with the nobility of the purpose.

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While referring to business activities, Mahatma Gandhi once mentioned that all businesses have a social responsibility which has nothing to do with its ordinary economic activity. For instance, if there is a natural calamity in an area adjoining a business organization, the society would expect the business to participate in the relief work. Such a social responsibility arises out of ethical considerations and not out of profit-making considerations. Therefore, the responsibility towards society is a moral obligation arising out of business ethics, which in turn is steeped in the philosophy of business.

CORPORATE GOVERNANCE ETHICS

Business ethics and corporate governance of an organization go hand in hand. In fact, an organization that follows ethical practices in all its activities will, in all probability, follow best corporate governance practices as well.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders including creditors, distributors, customers, employees, the society at large, governments and even competitors are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just the shareholders alone.

Corporate governance is not something which regulators have to impose on a management, it should come from within.

A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its stat-of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. This would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

Corporate Social Reporting

Corporate Social Reporting is a process through which information is passed to the public regarding companies activities undertaken for the benefit of society. It has multiple effects. CSD reporting companies may gain an edge as compared to their silent peers. It enhances companies‟ reputation and helps to strengthen stakeholder's relations as reporting promotes corporate transparency and instills confidence and trust among the stakeholders. It gives motivation to silent companies also who lack behind in the field of CSR. Previous studies on developed countries have shown that CSD in annual reports has increased over time in response to a number of factors. Some of the reasons may be attributed to increase in legislation, risk, activities of pressure groups, ethical investors, specific events, awards, economic activities, media interest, societal awareness, and politics. A trend towards increasing levels of disclosure has been observed. However, the levels of disclosures are still low. Some of the efforts taken by stock exchanges and Govt. in India in context with CSD are as follows Disclosure efforts by stock exchanges

(i) 2009 Voluntary guidelines for CSR are issued.
(ii) 2008 The Companies Act states that board of directors‟ reports shall contain information on Conservation of energy.
(iii) 1986 Specified corporations shall submit an annual environmental audit.
Disclosure efforts by Govt
2012 -Bombay Stock Exchange launches green index.
2011- The Securities and Exchange Board of India mandates listed companies report on Environmental, Social and Governance (ESG) initiatives undertaken by them, according to the key principles enunciated in the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business.'

SEBI Committee on Corporate Governance.

Cadbury Committee, U.K
"(It is) the system by which companies are directed and controlled"
Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims:—
(i) Fulfilling long-term strategic goals of owners;
(ii) Taking care of the interests of employees;
(iii) A consideration for the environment and local community;

(iv) Maintaining excellent relations with customers and suppliers;

(v) Proper compliance with all the applicable legal and regulatory requirements.

"Corporate governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-à-vis its claimants - in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of 'good' corporate governance: maximizing long-term shareholder value."

Confederation of Indian Industry (CII) - Desirable Corporate Governance Code (1998)

"Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

Report of Kumar Mangalam Birla Committee on Corporate Governance constituted by SEBI (1999)

"Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

Report of N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI (2003)

"Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."

The Kotak Committee Headed by Uday Kodak on Corporate Governance (2017)

The Kotak Committee on Corporate Governance (hereinafter referred to as 'The Committee') was constituted on June 2, 2017, under the chairmanship of Uday Kotak. Its primary objective was improving standards concerning corporate governance of listed companies in India.

The Committee was represented by different stakeholders, including the government, the industry, stock exchanges, academicians, proxy advisors, professional bodies, lawyers, etc. It was requested to provide recommendations on diverse issues such as ensuring independence in spirit of independent

KAHE

directors and their active participation in the functioning of the company, and improving safeguards and disclosures pertaining to related party transactions.

Other subjects on which the Committee was asked to make recommendations were accounting and auditing practices by listed companies, board evaluation practices, disclosure and transparency related issues and addressing issues faced by investors on voting and participation in general meetings.

In a significant development, Securities and Exchange Board of India's (SEBI) board, at a meeting held in Mumbai on March 28, 2018, took important decisions on the recommendations of the Committee. The Committee submitted its report detailing several recommendations on October 5, 2017.

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Possible Questions

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

Part B

(2 Marks)

1. Define corporate governance.
2. Define business ethics.
3. Define corporate social responsibility.
4. Explain the recent trends in corporate social responsibility
5. Explain the various elements macro issues.
6. Explain the various elements micro issues.
7. Explain various objectives of corporate governance
8. What are the needs for business ethics?
9. What is the board of governance?
10. What are the responsibilities of board of governance?

Part C (6 Marks)

1. Trace the historical evolution of corporate governance.
2. Explain the concept of corporate social responsibility.
3. Discuss the Macro and Micro Issues in corporate governance.
4. Discuss the benefits of corporate governance.
5. Describe the SEBI committee on corporate governance.
6. Explain the corporate social responsibilities in companies.
7. Describe the corporate governance and the role of the board.
8. Explain the current trends in corporate governance system in worldwide.
9. Describe the concept of business ethics.
10. Define Business Ethics. Discuss its nature and need in business organization.

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INTRODUCTION:

The root of the word Governance is from 'gubernator', which means to steer. Corporate governance would mean to steer an organization in the desired direction. The responsibility to steer lies with the board of directors / governing board.

Corporate or a Corporation is derived from the Latin term "corpus" which means a "body". Governance means administering the processes and systems placed for satisfying stakeholder expectation. When combined, Corporate Governance means a set of systems, procedures, policies, practices, standards put in place by a corporate to ensure that relationship with various stakeholders is maintained in transparent and honest manner.

A corporation is a lawful artificial person having a separate and different identity from its members who bring it into the reality, its members having limited liability and it has a common seal. The various stakeholders who contribute the capital of the company are the legal owners of company. Shareholders choose board of directors to check the activities of the company on their behalf. The board of directors appoints managers who manage day-today functioning of the company and report to the board of directors. These managers work as the agent of shareholders and mandated to maximize the wealth of the company. This relationship is called agency relationship whereby the owners of the company (Joint Stock Company) called principals and their agents are the management of the company represented by the board of directors.

Concept and Definition of Corporate Governance

The concept of "Governance" is as old as human civilization. Governance is simply defined as the process of decision making and the process by which decisions are implemented or not. It can be used in several contexts such as corporate governance, international, national and local governance.

Corporate governance is dealing with problems that result from the separation of ownership and control. Corporate governance focuses on some structures and mechanisms that would ensure the

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proper internal structure and rule s of the board of directors, creations of independent committees, rules for disclosures of information to shareholders and control of management.

The concept of corporate governance has received a lot of attention these days in the developed as well as in the developing nations due to high profile scandals like Worldcom, Enron, Xerox, Harshad Mehta scam, Satyam scam etc. These scams have shaken the investor confidence and made it difficult for companies to raise funds from the stock market (Agrawal, 2005). And these scams highlight the requirement to develop corporate governance practices and accounting transparency. Corporate governance is considered to be different from the corporate management. It is not only corporate management but also it is much broader to corporate management and consists of efficient and transparent administration to meet certain well defined objectives.

Strong corporate-governance system helps ensure a country's long-term success; weak systems often lead to serious problem. Quality of governance has become a critical success factor for survival and a source of competitive advantage; has also become a major factor influencing the ability of a company to raise funds from capital markets (Aggarwal et al.,2007). A good corporate-governance practice provides s transparency, fairness, accountability and responsibility in the market. These features are known as pillars of corporate governance.

Shareholders, board of direct ors and management officials are the main players in the corporate governance. Board of directors is the most powerful player in the corporate governance matters due to separation in ownership, control and management. Shareholders are the actual owner of the company but they belong to different places, so it is not possible for them to monitor each and every activity of the company. Therefore, they appoint directors on their behalf to protect their interest in the company. The board of directors appoints managers to handle day to day activities of the organization and these managers report to the board of directors. The board of director s acts as middlemen between management and shareholders. Board of director s is responsible to shareholders for all activities of the managers. Good corporate governance depends upon the quality of board such as board structure in terms of separation of authority between chairman and CEO,

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board size, board composition related to proportion of executive, non- executive, independent and nominee directors in the board, knowledge, skill and abilities of members of the board and common understanding between directors at the time of taking decision. The board of directors has to perform mainly the functions such as taking strategic decisions, establishing objectives, formulation and implementation of policies an d performance evaluation of CEO and other management personnel. The board of direct ors not only provides the direction to the managerial personnel but also bear the responsibility on the shoulder of management.

NEED FOR CORPORATE GOVERNANCE

Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure. It refers to compliance with all the moral & ethical values, legal framework and voluntarily adopted practices.

(a) Corporate Performance: Improved governance structures and processes ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance- either in terms of share price or profitability.

(b) Enhanced Investor Trust: Investors consider corporate governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of upto 40 percent for shares in companies with superior corporate governance practices.

(c) Better Access to Global Market: a good corporate governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

(d) Combating Corruption: Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption would certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

(e) Easy Finance from Institutions: Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidences indicate that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

(f) Enhancing Enterprise Valuation: Improved management accountability and operational transparency fulfill investors' expectations and confidence on management and corporations, and in return, increase the value of corporations.

(g) Reduced Risk of Corporate Crisis and Scandals: Effective Corporate Governance ensures efficient risk mitigation system in place. A transparent and accountable system makes the Board of a company aware of the majority of the mask risks involved in a particular strategy, thereby, placing various control systems in place to facilitate the monitoring of the related issues.

(h) Accountability: Investor relations are essential part of good corporate governance. Investors directly/ indirectly entrust management of the company to create enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in Corporate Governance is integral to the existence of the company. order to maintain good investors relation. Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders.

Macro Issues in Corporate Governance

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Examples include:

- Competition
- Debt covenants
- Demand for and assessment of performance information (especially financial statements)
- Government regulations
- Managerial labor market
- Media pressure
- Takeovers

Micro Issues in Corporate Governance

Internal corporate governance controls monitor activities and then take corrective action to accomplish

Monitoring by the board of directors

The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, ex ante. It could be argued, therefore, that executive directors look beyond the financial criteria.

Internal control procedures and internal auditors

Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

Balance of power

The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

Remuneration

Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior.

Board of Governance

A board of directors is a recognized group of people who jointly oversee the activities of an organization, which can be either a for-profit business, nonprofit organization, or a government agency

The Governance Committee (GC) is the most important committee of your nonprofit leadership. Its chief responsibilities are to determine the membership of your board and measure the quality of performance of the board as a whole and of your individual board members.

Every charity has a governing body (most often called a board) that takes overall responsibility for its work. The board is responsible for the governance of a charity - ensuring it is effectively and properly run and is meeting its overall purposes as set out in its governing document.

Governance has been defined to refer to structures and processes that are designed to ensure accountability, transparency, responsiveness, rule of law, stability, equity and inclusiveness, empowerment, and broad-based participation. In the development literature, the term 'good governance' is frequently used.

INTRODUCTION

The 21st century is characterized by unprecedented challenges and opportunities, arising from globalization, the desire for inclusive development and the imperatives of climate change. Indian business, which is today viewed globally as a responsible component of the ascendancy of India, is poised now to take on a leadership role in the challenges of our times. It is recognized the world over that integrating social, environmental and ethical responsibilities into the governance of businesses ensures their long term success, competitiveness and sustainability. This approach also reaffirms the view that businesses are an integral part of society, and have a critical and active role to play in the sustenance and improvement of healthy ecosystems, in fostering social inclusiveness and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective CSR, have image of socially responsible companies, achieve sustainable growth in their operations in the long run and their products and services are preferred by the customers.

Corporate Social Responsibility (CSR) is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from these corporate to give something in return to the society with whose explicit or implicit help these entities stand where they are.

Meaning and Definitions

CSR is understood to be the way firms integrate social, environmental and economic concerns into their values, culture, decision making, strategy and operations in a transparent and accountable manner and thereby establish better practices within the firm, create wealth and improve society. CSR is also called Corporate Citizenship or Corporate Responsibility.

According to Business for Social Responsibility (BSR) "Corporate social responsibility is operating a business in a manner which meets or excels the ethical, legal, commercial and public expectations that a society has from the business."

Business entity is expected to undertake those activities, which are essential for betterment of the society. Every aspect of business has a social dimension. Corporate Social Responsibility means open and transparent business practices that are based on ethical values and respect for employees, communities and Lesson 13 Corporate Social Responsibility 375 the environment. It is designed to deliver sustainable value to society at large as well as to shareholders.

Corporate Social Responsibility is nothing but what an organization does, to positively influence the society in which it exists. It could take the form of community relationship, volunteer assistance programmes, special scholarships, preservation of cultural heritage and beautification of cities. The philosophy is basically to return to the society what it has taken from it, in the course of its quest for creation of wealth.

With the understanding that businesses play a key role of job and wealth creation in society, CSR is generally understood to be the way a company achieves a balance or integration of economic, environmental, and social imperatives while at the same time addressing shareholder and stakeholder expectations.

According to CSR Asia, a social enterprise, “CSR is a company’s commitment to operate in an economically,

Socially and environmentally sustainable manner whilst balancing the interests of diverse stakeholders”

CSR is generally accepted as applying to firms wherever they operate in the domestic and global economy. The way businesses engage/involve the shareholders, employees, customers, suppliers, Governments, non- Governmental organizations, international organizations, and other stakeholders is usually a key feature of the concept. While an organisation’s compliance with laws and regulations on social, environmental and economic objectives set the official level of CSR performance, it is often understood as involving the private sector commitments and activities that extend beyond this foundation of compliance with laws.

According to the Commission of the European Communities, 2003, “CSR is the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large.”

According to the World Business Council for Sustainable Development, 1999 “Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large.”

CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. The main function of an enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as welfare for society, particularly through an ongoing process of job creation. However, new social and market pressures are gradually leading to a change in the values and in the horizon of business activity.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

1. Social, economic, ethical and moral responsibility of companies and managers,
2. Compliance with legal and voluntary requirements for business and professional practice,
3. Challenges posed by needs of the economy and socially disadvantaged groups, and
4. Management of corporate responsibility activities.

CSR is an important business strategy because, wherever possible, consumers want to buy products from The term Corporate Social responsibility refers to the concept of business being accountable for how it manages the impact of its processes on stakeholders and takes responsibility for producing a positive effect on society.

Companies they trust; suppliers want to form business partnerships with companies they can rely on; employees want to work for companies they respect; and NGOs, increasingly, want to work together with companies seeking feasible solutions and innovations in areas of common concern. CSR is a tool in the hands of corporate to enhance the market penetration of their products, enhance its relation with stakeholders. CSR activities carried out by the enterprises affects all the stakeholders, thus making good business sense, the reason being contribution to the bottom line.

ETHICS

Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express and embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner conscience and sustainability.

The term “ethics” is derived from the Greek word “ethos” which refers to character, guiding beliefs, standards and ideals that pervade a group, a community or people. The Oxford Dictionary states ethics as “the moral principle that governs a person’s behavior or how an activity is conducted”. The synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct and standards.

Ethics refers to well-founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues.

Thus, ethics relates to the standards of conduct and moral judgments’ that differentiate right from wrong. Ethics is not a natural science but a creation of the human mind. For this reason, it is not absolute and is open to the influence of time, place and situation.

In bygone times, kings used to keep food testers who used to eat the food prepared for the king before it was offered to him. This was royal clinical research to find out if the food was poisoned. This practice was not questioned because the king was regarded as the most important person in the kingdom, and his life was more precious than that of anyone else. It was the ethics of the time.

What is considered ethical behavior in one society might be considered unethical in another. For example, euthanasia (mercy killing) is permitted in some countries but it is considered strictly unethically most countries.

Ethics has following features:

- Ethics is a conception of right or wrong conduct. Ethics tells us when our behavior is moral and when it is immoral. It deals with the fundamental human relationship, how we think and behave towards others and how we want them to think and behave towards us.
- Ethics relates to the formalized principles derived from social values. It deals with the moral choices that we make in the course of performing our duties with regard to the other members of society. Hence, it is relevant in the context of a society only.

KAHE

- Ethical principles are universal in nature. They prescribe obligations and virtues for everybody in a society. They are important not only in business and politics but in every human endeavor.
- There exist no sharp boundaries between ethical and non-ethical. Therefore, people often face ethical dilemmas wherein a clear cut choice becomes very difficult.
- The concepts of equity and justice are implicit in ethics. Fair and equitable treatment to all is its primary aim.
- Ethics and legality of action do not necessarily coincide. What a society interprets as ethical or unethical ends up expressed in laws. The legality of actions and decisions does not necessarily make them ethical. For example, not helping an injured person in a road accident may be unethical but not illegal.

The Purpose of Board of Director

The board of directors' key purpose is to ensure the company's prosperity by collectively directing the company's affairs, whilst meeting the appropriate interests of its shareholders and stakeholders.

Essentially it is the role of the board of directors to hire the CEO or general manager of the business and assess the overall direction and strategy of the business. The CEO or general manager is responsible for hiring all of the other employees and overseeing the day-to-day operation of the business.

Officers are usually appointed by the corporation's board of directors, and while specific positions may vary from one corporation to another, typical corporate officers include:

- Chief Executive Officer (CEO) or President.
- Chief Operating Officer (COO).
- Chief Financial Officer (CFO) or Treasurer.
- Secretary.

Composition and Operation of the Board of Directors

- The majority of the members of the Board of Directors shall be comprised of directors who are "Independent" as defined and required by applicable law and/or stock exchange listing standards.
- The Board shall decide whether the positions of Lead Director, Chairman and Chief Executive Officer should be established and maintained as separate positions or held by the same person in light of all relevant and changing circumstances.
- The Board of Directors shall participate in an extended session of meetings prior to the beginning of each year that shall be dedicated to the review of the Company's strategies, goals and financial objectives for that year.
- The Nominating and Governance Committee shall consider and make recommendations to the Board concerning the appropriate size and needs of the Board. The number of directors should not exceed a number that can function efficiently.
- Non-employee Directors shall be provided with exposure to operating management and major customers of the Company on a regular basis throughout the year. Non-employee Directors may elect to contact any employee, customer, advisor or supplier of the Company.
- All Related Person Transactions shall be presented by a Director or management to the Audit Committee for its review. All material information regarding the proposed transaction and the Related Person shall be brought to the attention of the Audit Committee prior to the time that the Committee takes action on the transaction. The Audit Committee shall either approve, ratify or reject the transaction or refer the transaction to the full Board of Directors or other appropriate Committee, in its discretion. All Related Person Transactions shall be disclosed to the full Board of Directors

- When a director's principal occupation or business affiliation changes, or other circumstances arise, which may raise questions about the director's continuing qualifications to serve as a director, then the director shall tender his/her resignation, or the Nominating and Governance Committee shall ask for such tender. The Nominating and Governance Committee shall consider the tendered resignation and recommend to the Board the action to be taken.

Selection of Directors

Under the Articles of Association, the Board of Directors has authority to fill vacancies in the Board and appoint additional directors (in each case subject to their re-election at the next annual general meeting) and to nominate candidates for election by the shareholders. The screening process is done by the Corporate Governance and Nominating Committee with direct input from the Chairman and CEO and from the other directors and from time to time with the assistance of director search firms. In considering candidates for director, the Corporate Governance and Nominating Committee will take into account all factors it considers appropriate, including, among other things, breadth of experience, understanding of business and financial issues, ability to exercise sound judgment, diversity, leadership, and achievements and experience in matters affecting business and industry. The Corporate Governance and Nominating Committee considers the entirety of each candidate's credentials and believes that at a minimum each nominee should satisfy the following criteria: highest character and integrity, experience and understanding of strategy and policy-setting, sufficient time to devote to Board matters, and no conflict of interest that would interfere with performance as a director. Shareholders may recommend candidates for Board membership for consideration by the Corporate Governance and Nominating Committee. Such recommendations should be sent to the Committee, care of the Secretary of the Company. Candidates recommended by shareholders are evaluated in the same manner as director candidates identified by any other means.

Director Retirement

Each non-employee director must retire at the annual general meeting immediately following his or her 75th birthday. Directors who change the occupation they held when initially elected must offer to resign from the Board. At that time, the Corporate Governance and Nominating Committee reviews the continued appropriateness of Board membership under the new circumstances and makes a recommendation to the Board. Employee directors, including the CEO, must retire from the Board at the time of a change in their status as an officer of the Company, unless the policy is waived by the Board.

Corporate Governance and the Role of the Board

The Company's business is managed under the direction of the Board of Directors. The Board delegates to the Chief Executive Officer, and through that individual to other senior management, the authority and responsibility for managing the Company's business. The Board's role is to oversee the management and governance of the Company and to monitor senior management's performance.

Among the Board's core responsibilities are

- Select individuals for Board membership and evaluate the performance of the Board, Board Committees and individual directors.
- Select, monitor, evaluate and compensate senior management.
- Assure that management succession planning is adequate.
- Review and approve significant corporate actions.
- Review and monitor implementation of management's strategic plans.
- Review and approve the Company's annual operating plans and budgets.
- Monitor corporate performance and evaluate results compared to the strategic plans and other long-range goals.
- Review the Company's financial controls and reporting systems.
- Review and approve the Company's financial statements and financial reporting.

- Review the Company's ethical standards and legal compliance programs and procedures.
- Oversee the Company's management of enterprise risk.
- Monitor relations with shareholders, employees, and the communities in which the Company operates.

BUSINESS ETHICS

Business ethics is one of the important branches of applied ethics. Business ethics is the application of general ethical ideas to business. " Business ethics refers to the moral principles and standards and a code of conduct that businessmen are expected to follow while dealing with others. Business essentially is a means of society to use scarce resources to produce in an efficient manner those goods and services which society wants and is willing to pay for. Businesses must balance their desire to maximize profits against the needs of stakeholders. The significant issues in business ethics include ethical management of enterprise in relation to its stakeholders in particular and natural environment in general.

Ethics is necessary and important in business due to several reasons, some of which are given below:

• There is a kind of social contract between the society and business by which the society expects the business to work in its interest. Society creates and accepts business enterprises, hence it expects them to work in a manner which is not detrimental to its well being and interests. Technological advancements have to be made but their impact on the environment and mankind has he kept in mind.

• Ethical conduct is in the long-term interests of businessmen. A business enterprise that is honest and fair to its customers, employees, and other stakeholders earns their trust and good will. It ultimately results in customer satisfaction, healthy competition, industrial growth and high earnings. Businesses must balance their desire to maximize profits against the requirements of stakeholders. Maintaining this balance often requires tradeoffs. To address this unique aspect of business, rules are articulated to guide it to earn profits without harming individuals or society as a whole. While referring to business activity profile, Mahatma Gandhi once mentioned that all business entrepreneurs should ask themselves the question whether the activities they are contemplating

KAHE

would be of some use to the common man. This statement emphasizes the importance of nobility of business purpose.

• Ethical business behavior is not only about good business but about good citizenship as well. Morally conscious businessmen have created names and built great business empires. They serve customers with good quality products at fair prices, treat their employees with great respect, reward their shareholders with good returns and pay their taxes honestly.

• Ethical policies and practices enable a business enterprise to build goodwill for itself. A business organization that adheres to a code of conduct gains a competitive advantage and builds long term value. On the other hand, unethical practices lead to the ultimate downfall of big organizations too.

• Business can prosper only when a society is stable and peaceful. Unethical practices at times create distrust, disorder and turmoil in society.

Business ethics refers to a ‘code of conduct’ which businessmen are expected to follow while dealing with others. ‘Code of conduct’ is a set of principles and expectations that are considered binding on any person who is member of a particular group. The alternative names for code of conduct are ‘code of ethics’ and ‘code of practice’.

Business ethics comprises of the principles and standards that guide behavior in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, articulated as well as implicit rules are developed to guide the businesses to earn profits without harming individuals or society as a whole.

The coverage of business ethics is very wide as it deals with norms relating to a company and its employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. It reflects the philosophy of business, one of whose aims is to determine the fundamental purposes of a company.

Business ethics stands for the saneness or purity of purpose that is upheld through carefully designed actual practices of business enterprises. It is an embodiment of conscious concern towards execution of business processes in tune with the nobility of the purpose.

While referring to business activities, Mahatma Gandhi once mentioned that all businesses have a social responsibility which has nothing to do with its ordinary economic activity. For instance, if there is a natural calamity in an area adjoining a business organization, the society would expect the business to participate in the relief work. Such a social responsibility arises out of ethical considerations and not out of profit-making considerations. Therefore, the responsibility towards society is a moral obligation arising out of business ethics, which in turn is steeped in the philosophy of business.

CORPORATE GOVERNANCE ETHICS

Business ethics and corporate governance of an organization go hand in hand. In fact, an organization that follows ethical practices in all its activities will, in all probability, follow best corporate governance practices as well.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders including creditors, distributors, customers, employees, the society at large, governments and even competitors are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just the shareholders alone.

Corporate governance is not something which regulators have to impose on a management, it should come from within.

A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its stat-of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. This would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

Corporate Social Reporting

Corporate Social Reporting is a process through which information is passed to the public regarding companies activities undertaken for the benefit of society. It has multiple effects. CSD reporting companies may gain an edge as compared to their silent peers. It enhances companies‟ reputation and helps to strengthen stakeholder's relations as reporting promotes corporate transparency and instills confidence and trust among the stakeholders. It gives motivation to silent companies also who lack behind in the field of CSR. Previous studies on developed countries have shown that CSD in annual reports has increased over time in response to a number of factors. Some of the reasons may be attributed to increase in legislation, risk, activities of pressure groups, ethical investors, specific events, awards, economic activities, media interest, societal awareness, and politics. A trend towards increasing levels of disclosure has been observed. However, the levels of disclosures are still low. Some of the efforts taken by stock exchanges and Govt. in India in context with CSD are as follows Disclosure efforts by stock exchanges

(i) 2009 Voluntary guidelines for CSR are issued.

(ii) 2008 The Companies Act states that board of directors‟ reports shall contain information on Conservation of energy.

(iii) 1986 Specified corporations shall submit an annual environmental audit.

Disclosure efforts by Govt

2012 -Bombay Stock Exchange launches green index.

2011- The Securities and Exchange Board of India mandates listed companies report on Environmental, Social and Governance (ESG) initiatives undertaken by them, according to the key principles enunciated in the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business.'

SEBI Committee on Corporate Governance.

Cadbury Committee, U.K

"(It is) the system by which companies are directed and controlled"

Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims:—

(i) Fulfilling long-term strategic goals of owners;

(ii) Taking care of the interests of employees;

(iii) A consideration for the environment and local community;

(iv) Maintaining excellent relations with customers and suppliers;

(v) Proper compliance with all the applicable legal and regulatory requirements.

"Corporate governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-à-vis its claimants - in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of 'good' corporate governance: maximizing long-term shareholder value."

Confederation of Indian Industry (CII) - Desirable Corporate Governance Code (1998)

"Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

Report of Kumar Mangalam Birla Committee on Corporate Governance constituted by SEBI (1999)

"Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

Report of N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI (2003)

"Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."

The Kotak Committee Headed by Uday Kodak on Corporate Governance (2017)

The Kotak Committee on Corporate Governance (hereinafter referred to as 'The Committee') was constituted on June 2, 2017, under the chairmanship of Uday Kotak. Its primary objective was improving standards concerning corporate governance of listed companies in India.

The Committee was represented by different stakeholders, including the government, the industry, stock exchanges, academicians, proxy advisors, professional bodies, lawyers, etc. It was requested to provide recommendations on diverse issues such as ensuring independence in spirit of independent

KAHE

directors and their active participation in the functioning of the company, and improving safeguards and disclosures pertaining to related party transactions.

Other subjects on which the Committee was asked to make recommendations were accounting and auditing practices by listed companies, board evaluation practices, disclosure and transparency related issues and addressing issues faced by investors on voting and participation in general meetings.

In a significant development, Securities and Exchange Board of India's (SEBI) board, at a meeting held in Mumbai on March 28, 2018, took important decisions on the recommendations of the Committee. The Committee submitted its report detailing several recommendations on October 5, 2017.

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Possible Questions

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

Part B

(2 Marks)

1. Define corporate governance.
2. Define business ethics.
3. Define corporate social responsibility.
4. Explain the recent trends in corporate social responsibility
5. Explain the various elements macro issues.
6. Explain the various elements micro issues.
7. Explain various objectives of corporate governance
8. What are the needs for business ethics?
9. What is the board of governance?
10. What are the responsibilities of board of governance?

Part C (6 Marks)

1. Trace the historical evolution of corporate governance.
2. Explain the concept of corporate social responsibility.
3. Discuss the Macro and Micro Issues in corporate governance.
4. Discuss the benefits of corporate governance.
5. Describe the SEBI committee on corporate governance.
6. Explain the corporate social responsibilities in companies.
7. Describe the corporate governance and the role of the board.
8. Explain the current trends in corporate governance system in worldwide.
9. Describe the concept of business ethics.
10. Define Business Ethics. Discuss its nature and need in business organization.

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Register No.: …………..

[18CMU303A,18CCU303A,18PAU303A]

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University Established Under Section 3 of UGC Act, 1956)

COIMBATORE – 641021

(For the candidates admitted from 2018 onwards)

Continuous Internal Examination, July - 2019

BCOM/BCOM [CA]/BCOM [PA]

AUDITING AND CORPORATE GOVERENCE

Time: 2 Hours **Maximum: 50 Marks**

Date & Session:

PART A[20*1=20MARKS]

ANSWER ALL THE QUESTIONS

1. Auditing standards differ from auditing procedures in that procedures relate to __________.

 a) Measure of performance b) Audit principles

 c) Acts to be perform d) Audit judgments.

2. The first general standard of generally accepted auditing standards which states, in part, that the examination is to be performed by a person or persons having adequate technical training, requires that an auditor have _________________

 a) Education and experience in the field of auditing

 b) Ability in the planning and supervision of the audit work

 c) Proficiency in business and financial matters

 d) Knowledge in the areas of financial accounting

3. An independent audit aids in the communication of economic data because the audit _____________

 a) Assures the reader of financial statements that any fraudulent activity has been correct

 b) Confirms the accuracy of management's financial representations.

 c) Lends credibility to the financial statements.

 d) Guarantees that financial data are fairly presente

4. Which of the following best describes the reason why an independent auditor reports on financial statements?

a) A management fraud may exist and is more likely to be detected by independent auditors.

b) Different interests may exist between the company preparing the statements and the persons

c) A misstatement of account balances may exist and is generally corrected as the result of the independent

d) Poorly designed internal control may exist.

5. When two or more errors are committed in such a way that the result of these errors on the debits and credits is nil, they are known as ______.

a) error of omission   b) compensating error

c) Error of Totaling   d) Error of Principle

6. _______________are always committed deliberately and intentionally to defraud the proprietors of the organization.

a) Error   b) Fraud   c) omission   d) Principle

7. Supporting accounting records for a particular financial period is _____________of an audit.

a) Primary   b) secondary   c) Modern   d)Traditional

8. Which of the following is an element of quality control?

a) Supervision   b) Inspection   c) Personnel management   d) Consultation

9. The primary responsibility for the adequacy of disclosure in the financial statements of a publicly held company rests with the________________

a) Partner assigned to the engagement   b) Auditor in charge of field work.

c) Management of the company   d) Securities & Exchange Commission

10. In the ancient period of audit was confined to __________audit and not to detect fraud

a) Stock   b) Cash   c) Assets   d) Loss

11. Detection of errors and frauds is __________the purview of an audit.

a) Within   b) Outside   c) inside   d) Mistake

12. The main objective of __________is to win the confidence of shareholders.

a) Secret reserves b) Window dressing c) Mistake d) Conflict

13. ______occurs on account of transaction not being recorded in the books of account either wholly or partially.

a) Error of principles b) Error of Totaling

c) Error of omission d) Location of errors

14. An__________ is an examination of accounting records.

a) Accounts b) Audit c) Cost d) Marketing

15. ___________ of an independent financial audit is to determine whether the financial statement present a factual and impartial view of the financial position and working results of an enterprise.

a) Secondary objectives b) Primary objectives

c) Specific objectives d) No Objectives

16. Detection of errors and frauds is an integral part of __________

a) Auditing b) Accounting c) Costing d) Management

17. The term ________ in accounting refers to an unintentional misstatement of financial statement.

a) Mistake b) fraud c) Error d) Clerical

18. These errors arise because of mistake committed by the clerical staff means__________

a) Error of principles b) Error of Totaling

c) Errors of duplication d) Clerical errors

19. Which of the following is not recorded in audit notebook?

a) Audit programme b) Accounting statistics

c) Important balances d) Analysis of transaction and balances

20. The chartered accountants act was enacted in the year.

a) 1951 b) 1955 c) 1959 d) 1949

PART B [3*2=6MARKS]

ANSWER ALL THE QUESTIONS

21. Define auditing.

22. What is cost audit?

23. Narrate what is internal control.

PART C [3*8=24MARKS]

ANSWER ALL THE QUESTIONS

24.a. Compare between Auditing and Accounting briefly.

(or)

b. Explain the objectives of auditing.

25.a.Highligts the qualities of an Auditor .

(or)

b. Enumerate the classification of audit based on organizational structure.

26.a. Compare final audit with continuous audit. For what type of business concern, continuous audit is applicable?

(or)

b. Narrate internal audit. Distinguish between internal audit, internal check and internal control.

Register No.: …………..

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(Deemed to be University Established Under Section 3 of UGC Act, 1956)

COIMBATORE – 641021

(For the candidates admitted from 2018 onwards)

Continuous Internal Examination, August - 2019

BCOM/BCOM [CA]/BCOM [PA]

AUDITING AND CORPORATE GOVERENCE

Time: 2 Hours **Maximum: 50 Marks**

Date & Session:

PART A [20*1=20MARKS]

ANSWER ALL THE QUESTIONS

1. In Practice, the job of vouching is done by __________
   a. Single Person b. Two persons
   c. Bookkeeper and external auditor d. Three persons

2. Internal audit facilitates _____________
   a. internal check b. internal control c. final audit d. Statutory audit

3. Verification of arithmetical accuracy of accounting entries and to ensure that ledger accounts are properly balanced is the main objective of _____________
   a. routine checking b. test checking c. vouching d. internal audit

4. Which of the following is not an objective of vouching?
   a. to examine the accounting entries recorded in the books of account with reference to documentary evidence
   b. to verify the authenticity of the transactions
   c. to evaluate the adequacy and reliability of such documentary evidence as provided in support of transactions
   d. to identify the documentary evidence in support of transactions

5. Receipt from debtors who became bankrupt should be vouched with the ___________
   a. Dividend warrants
   b. correspondence exchanged between the official receiver and the client only
   c. bad debts account
   d. cashbook

6. Forward contracts are entered into in connection with ____________
   a. purchase of goods b. sales of goods
   c. consignment of goods d. return of goods

7. Collateral voucher is a ___________
a. subsidiary b. original c. routine d. lapping

8. Verification means _________
a. truth &fairness b. existence of assets c. process d. picture of the firm

9. Verification is done by affirm _________ of the asset
a. classification b. material aspects
c. physical existence d. significance

10. The auditor is entitled to rely ______ upon the information.
a. possible tests b. technical knowledge
c. legal provisions d. business and objects

11. The auditor should verify _________ should submit report
a. submit report b. audit report
c. verified information d. balance sheet

12. __________ as to assets were acquired for the business
a. valuation b. verification
c. association d. confirmation

13. Cost of an item of fixed asset comprises its _________ including import duties
a. sales price b. tax price
c. purchase price d. levy price

14. The assets are acquired during the current accounting period means ________
a. sales price b . purchase price c. vouchers d. inventories

15. _________ means original and verified value examine by the client
a. face value b. book value c. market value d. asset value

16. Closing stock arrived at is verified through __________
a. duty count b. method count
c. physical count d. stock count

17. Incorrect _________ of stock affects the determination of profit or loss
a. Verification b. Adjustment c. valuation d. counting

18. The auditor should ________ the accounting system.
a. Appropriate b. accurate c. evaluate d. Determine

19. To reduce tax liability gives less amount of ________
a. Income b. profit c. dividend d. losses

20. As per companies act 1956 ________ is prohibited

a. capital reserve b. secret reserve

c. general reserve d. sinking fund reserve

PART B [3*2=6MARKS]

ANSWER ALL THE QUESTIONS

21. Define vouching.

22. What is voucher?

23. List out the types of voucher.

PART C [3*8=24MARKS]

ANSWER ALL THE QUESTIONS

24.a. Compare between Vouching and Verification briefly.

(or)

b. Explain the features of a valid voucher.

25. a. Highlights the objectives of Vouching .

(or)

b. Enumerate the classification of audit based on specific objectives.

26.a. Describe the process of verification of assets and liabilities.

(or)

b. Narrate the important points to be considered at the time of conducting the vouching.