GOVERNMENT POLYTECHNIC BHUBNESWAR-2023

DEPARTMENT OF MODERN OFFICE MANAGEMENTLECTURER NOTES

SEMESTER-5th, PAPER- Auditing

Prepared by- Chandrakanta Paramguru

Unit I

Introduction to Auditing

Meaning and Definition of Auditing

The word Audit is derived from Latin word “Audire” which means ‘to hear’. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

“Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate.”-L.R.Dicksee

“Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports.” - R.K. Mautz

“Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement.” -R.E.Schlosser

Objectives of Auditing

The objectives of auditing are changing with the advancement of business techniques. Earlier it was only to check the correctness of receipts and payments. The objectives of the auditing have been classified under two heads:

1) Main objective

2) Subsidiary objectives

Main Objective: The main objective of the auditing is to find reliability of financial position and profit and loss statements. The objective is to ensure that the accounts reveal a true and fair view of the business and its transactions. The objective is to verify and establish that at a given date balance sheet presents true and fair view of financial position of the business and the profit and loss account gives the true and fair view of profit or loss for the accounting period. It is to be established that accounting statements satisfy certain degree of reliability. Thus the main objective of auditing is to form an independent judgement and opinion about the reliability of accounts and truth and fairness of financial state of affairs and working results.

Subsidiary objectives: The subsidiary objectives of the auditing are:

1. Detection and prevention of fraud: the one of the important subsidiary objective of auditing is the detection and prevention of fraud. Fraud refers to intentional misrepresentation of financial information. Fraud may involve:

a. Manipulation, falsification or alteration of records or documents

b. Misappropriation of assets.

c. Suppression of effect of transactions from records or documents.

d. Recording of transactions without substance.

e. Misapplication of accounting policies

2. Detection and prevention of errors: is another important objective of auditing. Auditing ensures that there is no mis-statement in the financial statements. Errors can be detected through checking and vouching thoroughly books of accounts, ledger accounts, vouchers and other relevant information.

Importance of Auditing

Importance of auditing can be judged from the fact that even those organizations which are not covered by companies Act get their financial statements audited. It has become a necessity for every commercial and even non- commercial organization. The importance of auditing can be summed in following points:

a. Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.

b. Dispute over correctness of profits can be avoided.

c. Shareholders, who do not know about day-to-day administration of the company , can judge the performance of management from audited accounts.

d. It helps management in detecting and preventing errors and frauds.

e. Management gets advice on financial affairs from the auditors.

f. Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.
g. Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.
h. Audited accounts are useful for the government while granting subsidies etc.
i. It can be used by insurance companies to settle the claims arising on account of loss by fire.
j. Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.
k. It safe guards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

Types of audit

Based on ownership: On the basis of ownership audit can be:-

1. Audit of Proprietorship: In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. Sole trader will decide about the scope of audit and appointment of auditor. The auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.
2. Audit of Partnership: To avoid any misunderstanding and doubt, partnership audits their accounts. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of auditor are defined in the mutual agreement and can be modified by the partners.
3. Audit of Companies: Under companies Act, audit of accounts of companies in India is compulsory. Chartered accountant who is professionally qualified is required for the audit of accounts of companies. Companies Act 1913 for the first time made it compulsory for joint stock companies to get their accounts audited from a qualified accountant. A number of amendments have been made in companies Act, 1956 and 2013 regarding appointment, duties, qualification, power and liabilities of a qualified auditor.
4. Audit of Trusts: The beneficiaries of the trusts may not have access and knowledge of accounts of the trust. The trustees are appointed to manage and look after the property and business of the trust. Accounts of the trust are maintained as per the

conditions and terms of the trust deed. The income of the trust is distributed to the beneficiaries. There are more chances of frauds and mis-appropriation of incomes. In the trust deed as well as in the Public Trust Act which provide for compulsory audit of the accounts of the trust by a qualified auditor. The audited accounts of the trust ensure true and fair view of accounts of the trust.

5. Audit of Accounts of Co-operative Societies: Co-Operative societies are established under the Co-Operative Societies Act, 1912. It contains various provisions for the regulations and the working of these societies. Some of the states have adopted it without any change, while others have brought certain changes to it. The auditor of the Co-operative Society should have an expert knowledge of the particular act under which Co-operative society under audit is functioning. He should also study by-laws of the society and make sure that the amendments made from time to time in the by-laws have been duly registered in the Registrar's Office. Companies Act is not applicable to the co-operative Societies. The Registrar of co-operative societies shall audit or cause to be audited by some person authorized by him, the accounts of the society once in every financial year.

6. Government Audit: Audit of government offices and departments is covered under this heading. A separate department is maintained by government of India known as Accounts and Audit Department. This department is headed by the Comptroller and Auditor General of India. This department works only for the government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

Based on Time: On the basis of time the audit can be of following types:

1. Interim Audit: When an audit is conducted between two annual audits, such audit is known as Interim audit. It may involve complete checking of accounts for a part of the year. Sometimes it is conducted to enable the board of directors to declare an Interim dividend. It may also be for the purpose of dealing with interim figures of sales.

2. Continuous Audit: The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

"A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals say weekly, fortnightly or monthly, during the whole period of trading.” - T.R. Batliboi

“A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or hiss staff attends at regular or irregular intervals during the period.” -R.C Williams.

3. Final Audit: Final Audit means when the audit work is conducted after the close of financial year. A final audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed.

4. Balance Sheet Audit: Balance Sheet Audit relates to the verification of various items of balance sheet such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

Based on Objectives: On the basis of objectives the audit can be of following types:

1. Internal Audit: It implies the audit of accounts by the staff of the business. Internal audit is an appraisal activity within an organization for the review of the accounting, financial and other operations as basis for protective and constructive service to the management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and financial matters but it may also properly deal with matters of operating nature.

2. Cost Audit: Cost Audit is the verification of the correctness of cost accounts and adherence to the cost accounting plans. Cost Audit is the detailed checking of costing system, techniques and accounts to verifying correctness and to ensure adherence to the objectives of cost accounting.

3. Secretarial Audit: Secretarial Audit is concerned with verification compliance by the company of various provisions o Companies Act and other relevant laws. Secretarial audit report includes.

4. Independent Audit: Is conducted by the independent qualified auditor. The purpose of independent audit is to see whether financial statements give true and fair view of financial position and profits. Mainly it is for safeguarding the interest of owners, shareholders and other parties who do not have knowledge of day-to-day operations of organization.

5. Tax Audit: Now-a-days tax audit has become very important to ascertain the accuracy of

tax related documents. Tax audit mostly covers income returns, invoices, debit and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has added one more chapter to the practice of auditing. Tax audit ensures the validity and credibility of tax related documents.

Unit 2

Internal check system

What is Internal Control

Internal Control comprises of the plan of the organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies.

Purpose of Internal Control

Let us now understand the purpose of Internal Control from different points of view.

From Auditor's Point of View

It is very important from the Auditor's point of view to study and evaluate the system of internal control. To obtain an adequate understanding of the internal control system, that must be tested. The Auditor has to determine whether audit is possible, if yes, then he should determine the scope of audit.

From Client's Point of View

- Internal control system provides reliable and accurate data that is necessary for decision making and to run business activity efficiently.
- Adequate internal control system safeguard business assets, in absence of it, assets of the company may be stolen, misused or accidentally destroyed.
- Internal control system within organization is necessary to discourage and stop non performing business activities and to protect business from wastage is all aspects of the business.
- Internal control system insures that rules and procedures are to be followed by business personnel.

Characteristics of Internal Control

Following are the main characteristics of Internal Control usually abbreviated as CROSSASIA −

- Competent and trustworthy personnel
- Records, Financial and other Organization plan
- Organizational plans
- Segregation of duties

- Supervision
- Authorization
- Sound practice
- Internal Audit
- Arithmetic and accounting controls

Limitations of Internal Control

Following are the inherent limitations of Internal Control −

- Management decision to choose cost effective control system may reduce the effectiveness of internal control system.
- There are chances of misuse by a person of authority who is operating on internal control system.
- Objectives of internal control systems may be defeated by manipulation of management.
- Since internal control system is involved in routine transactions, irregular transactions may be overlooked.
- Changes in conditions may affect the effectiveness of internal control system.

Review of Internal Control System

Internal control system should be reviewed by the Auditor before star audit as described below −

- Reviewing the system of accounting entries, whether recorded as per accounting standard or not.
- To frame audit program according to present circumstances.
- Frauds, errors and mistakes are likely to be located or not.
- To review existence of internal audit program and to check the efficiency of internal control system.
- To review the reliability of reports, records and certificates as presented by the management.
- To check if there is any possibility of improvement in existing internal control system.

Audit procedure :-

> *Audit Procedures are steps performed by auditors to get all the information regarding the quality of the financials provided by the company, which enable them to form an opinion on financial statement whether they reflect the true and fair view of organisation financial position. They are identified and applied at the planning*

> *stage of the audit after determining audit objective, scope, approach, and risk involved.*

Audit Procedure Methods

During the process of the preliminary assessment, an auditor is required to identify and ascertain the amount of risk involved and accordingly develop an audit plan. The audit plans should define these steps, which will be applied by the auditor to obtain **audit evidence**.
They can be divided into two:

#1 - Substantive Audit Procedures

Substantive procedures are processes, steps, tests performed by auditors, which creates conclusive evidence regarding accuracy, completeness, existence, disclosure, rights, or valuation of assets/ liability, books of accounts, or **financial statements**. For any procedure to be concluded, the auditor should collect enough audit evidence so that another competent auditor, when applies the same procedure on the same documents, makes the same conclusion. It can be regarded as complete checking. Auditor usually uses this procedure when he is of opinion audit area includes a high frequency of risk.

#2 - Analytical Audit Procedures

Analytical procedures can be defined as tests/ study/ evaluations of **financial information** through analysis of plausible relationships among both financial and non-financial data. In simple language, certain checks/tests conducted by auditors based on study/ knowledge/ previous year figures to check and form an opinion on financial statements. Depending on the audit area, the analytical audit procedure may differ. For example, the auditor may compare two sets of financial statements of the same entity about two different financial years or sometimes may compare two separate entities' financial data for obtaining audit evidence.

Internal Check?

In the opinion of Spicer and Pegler, "A system of internal check is an arrangement of staff duties, whereby no one person is allowed to carry through and to record every aspect of a transaction so that without collusion between two or more persons, fraud is activated and at the same time the possibilities of errors are reduced to the minimum."

L.R. Dicksee defines an internal check as "such an arrangement of book-keeping routine that errors and frauds are likely to be prevented or discovered by the very **operation of the book-keeping** itself."

An internal check is a continuous process and is part of the day-to-day routine. It relates to all the transactions that take place every day. An internal check is achieved by a complimentary allocation of duties and by independent verification of the work of one person by another.

Essential Characteristics of Internal Check System

Certain qualities are needed to make an internal check system more effective and efficient. Such qualities are known as features of internal check system, which are as follows:

1. Division of Work

No one should be allowed to have the right to perform the work from origin to end.

For example – a transaction of sale may have to be split into a display of article by staff, the preparation of invoice by another, the receipt of cash against the invoice by a third clerk, the delivery of article against the proof of receipted invoice by another clerk, checking of outward movement of an article against delivery order by a clerk and so on.

In big business houses, such specialized tasks increase the speed of work and automatically introduce internal checks.

2. Provision of Check

An organization should set up such provisions so that work can be checked by another staff. An officer can check the work of one staff by transferring to the staff and again.

3. Use of Devices

In this modem world, various devices can be used to do various functions like the use of time record machines, wage determination machines, etc. An organization should use machines that help to make work of internal check easier.

4. Self-balancing System

An organization can use self-balancing ledger accounts, which help to make the work of internal check easier. Its effectiveness depends on its management.

5. Job Rotation

No individual clerk should be allowed to occupy a particular area of operation for long. Familiarity with and exclusiveness in a position offer a person greater flexibility to attempt manipulation with the system.

6. Specialization

Every staff may not have such specialized knowledge to maintain accounts properly. So, an organization should give the training to increase their skills so that internal checks can be made more effective.

7. Control

There is more chance of frauds where there is direct contact between consumers or the public. So, a manager can keep eyes in those works so that the internal check system can be made more effective.

8. Authority Level

There must be clear cut authority levels according to sanctions to various transactions. Commensurate to the authority vested, responsibility must be extracted. The existence of authority levels results in a review of the operations of subordinates.

Objectives of Internal Check

There are several objectives of the internal check. They are given below:

1. To minimize the possibility of error, fraud, and irregularity.
2. To prevent the misappropriation of cash and goods.
3. To allocate duties and responsibilities to every clerk in the organization.
4. To ensure an accurate recording of all business transactions.
5. To enhance the efficiency of the clerk in the organization.
6. To exercise moral influence over the staff member.
7. To prepare a final account with ease and efficiency.

Principles of Internal Check

An internal check is based on some specific principles. Without which, an internal check is of no use. These principles are given below:

a. The process should be allocated among the staff of the business according to the duties, responsibility, and rights in such a. There is no room for interference.
b. No single person should have independent control over the all-important aspects of the business.
c. The duties among the staff of the business should be changed from

An internal check is based on some specific principles. Without which, an internal check is of no use. These principles are given below:

a. The process should be allocated among the staff of the business according to the duties, responsibility, and rights in such a. There is no room for interference.
b. No single person should have independent control over the all-important aspects of the business.

c. The duties among the staff of the business should be changed from
d. time to time so that no staff should be engaged in a particular job for a long time.
e. Every member of the staff should be encouraged to go on leave at least once in a year .this will help in detecting concealed fraud.
f. An efficient system of internal check should provide for automatic
g. checking of the work of an assistant by others.
h. The division of work should not be much expensive.
i. The self-balancing system should be invariably used.
j. The financial and administrative power should be assigned very judiciously to different officers.
k. A person having physical custody of assets must not be permitted to have access to the books of account.

Advantages of Internal Check

The main advantages of an internal check are listed below:

1. Moral Influence on Employees

The system of internal check puts a morale check on members of staff and enables them to learn honesty, hard work, and straightforwardness.

2. Determination of Employees Liability

The system of the internal check determines the responsibilities of employees. The member of the staff may be held responsible for any irregularity carried on by him.

3. Less Possibility of Frauds

There is less possibility of fraud under the system of the internal check because errors and frauds can be detected at an early stage.

4. Increase in Efficiency

The system of internal check ensures greater .efficiency and speed because the arrangement of internal check is based on a division of labor.

5. Auditing Made Easy

The system of internal check facilitates the work of auditors to a great extent by enabling him to relay on test checking.

6. Final Accounts Can Be Prepared

In an internal check system, the ‘Profit and Loss Account’ and Balance Sheet is prepared without any loss of time.

7. Correct and Complete Records of all the Transactions

The system of an internal check may also result in correct and complete records of all the transactions on each balancing of the books of accounts.

8. Detection of Dishonesty or Irregularity

Any dishonesty or irregularity in the concern by the members of staff can be detected before they assume any complication.

9. Test Checking Possible

Suppose the auditor finds the system of internal cheek satisfactory. Then by taking into mind, it defects or weak points he can take the help of test checking.

Disadvantages of Internal Check

The defects or weak points of the system

of an internal check are listed below:

1. Expensive

The system of Internal Check is more expensive and time-consuming.

2. Slackness in the Work

This is also a serious defect of the system of internal check. The auditor may show slackness at work. He may rely on the system of internal check blindfold, which may affect the quality of audit work adversely.

3. Not Suitable for Small Concern

The system of internal check is not suitable for small concern as it may be uneconomical in small concern.

4. Grouping among Employees

If the employees of the concern join hand, they may keep the employer in the dark and may cause many irregularities defying any-detection thereof.

This groupism amongst the employees may not be healthy.

Vouching

Definition: Vouching is a procedure followed in the process of the audit to authorise the credibility of the entries entered in the books of accounts. In simple and easier words, it is a precise investigation of the presented documents of the firm by an auditor to check the correctness and accuracy of such documents. It is the foremost step of the auditing process based on which auditor performs his work and prepare an audit report.

Vouching

March 30, 2020 by Anjali J Leave a Comment

Definition: Vouching is a procedure followed in the process of the audit to authorise the credibility of the entries entered in the books of accounts. In simple and easier words, it is a precise investigation of the presented documents of the firm by an auditor to check the correctness and accuracy of such documents. It is the foremost

step of the auditing process based on which auditor performs his work and prepare an audit report.

For understanding the process of vouching in detail it is essential to understand the concept of the voucher.

Content: Vouching

1. Concept of voucher
2. Types of vouchers
3. Sources of Vouchers
4. Objectives of Vouching
5. Importance of vouching
6. Difference between Vouching and Verification
7. Characteristics of Vouching
8. Vouching of cash transactions
9. Key points to remember
10. Conclusion

Concept of voucher

The documentary pieces of evidence such as counterfoil, cash memo, receipts and pay-in-slips used for recording transactions in books of accounts is defined as a voucher. The transactions supposed to be recorded only if relevant evidences are available.

For Example, Purchase transaction should have these supporting documents for preparing voucher:

1. Invoice bill
2. Quotation
3. Purchase order
4. Requisition slip
5. Entry gate pass (while receiving goods)

Types of vouchers

In general, vouchers are of two types:

1. **Primary Vouchers:** The bills or the documents that are available in the original copy are known as primary vouchers.
2. **Collateral vouchers:** These are the bills which are available in a duplicate copy.

Sources of Vouchers

There are two sources of vouchers:

1. **Internal vouchers:** The vouchers prepared by the company inside its premises are termed as internal vouchers, such as sales invoice.
2. **External vouchers:** The vouchers created outside the organisation are termed as external vouchers, such as bank statement.

Objectives of Vouching

It is the technique used by the auditors to judge the authenticity of the entries appearing in the financial statement. Procedure and accuracy followed for performing vouching decide the success or failure of the auditing. Some major objectives behind the vouching process are as follows:

1. To ensure that all the transactions took place during the financial year for the business purpose only (not for personal use), and are appropriately recorded in the books of accounts with true and fair evidences.
2. To check the accuracy of the totalling and carrying forward amount recorded in the financial statements.
3. To ensure that the person responsible for the business has verified his records or not.

4. To make the financial records free from malpractices.
5. To make sure that financial records are prepared in a lawful manner.

Importance of vouching

While performing an audit, the auditor is totally dependent on the documents presented to him by the responsible person for the business during the whole financial year. If any bill related to sales, purchase, electricity, telephone, that are not associated with the business is presented,it can only be detected with fair vouching. Various frauds can be detected while doing vouching if it is done in an intelligent manner.

For preparing reliable profit and loss a/c, Balance sheet, the vouching should be done accurately. It's an ethical duty of an auditor to check the arithmetical accuracy of records and see its substantial accuracy because if the primary document is wrong, the whole financial statement will show the wrong and unfair result.

Characteristics of Vouching

Following are the characteristics of vouching:

1. **Imperative Aspect of Auditing:** Vouching is an essential part of the auditing procedure. It makes the auditor's opinion more optimistic about the veracity of the transactions emerging in the records.
2. **Basis of Auditing:** Vouching acts as a base for the further procedures of auditing. To assure the fairness and accuracy of the further accounts maintained by the auditor proper vouching of the presented documents should be done.
3. **Drafted Evidence:** Vouchers are the recorded form of evidence which proves that the transactions have

genuinely occurred for the business during the current financial year.

4. **Disclosure of Extortion:** Though vouchers are the recorded evidence signed by the owner, it helps in disclosing any fraudulent transactions documented in the books of accounts.
5. **Report on Business Activities Only:** Vouchers helps in differentiating the business and personal transactions of the proprietor. Only the business transactions' vouchers will be taken into consideration by the auditor for evaluating the correct profit and loss of the business, and no personal expense vouchers will be recorded in the books of accounts.
6. **No Secret Transactions:** Vouchers helps the auditor in identifying business transactions. Thus, the owner cannot enclose any secret transaction other than business.
7. **Course of Voucher:** The date quoted in the voucher defines that the transaction has arisen currently.

Verification (audit)

Verification means "proving the truth" or "confirmation". Verification is an auditing process in which auditor satisfy himself with the actual existence of assets and liabilities appearing in the Statement of Financial position.[1] Verification is usually conducted through examination of existence, ownership, title, possession, proper valuation and presence of any charge of lien over assets.
Thus, verification includes verifying:

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

Verification in an audit process can be done offsite or onsite. Offsite verification means verification by checking documents, official records, photos and by questioning staff responsible or otherwise trusted to be a reliable source for the facility in verification. Onsite verification means the verifying party is physically visiting the facility, getting introduced into due facts about it on the site where the facility is located and operated. The process may be regulated by law in certain countries.

Objectives:-

Objectives of Verification are:

1. To show correct valuation of assets and liabilities.
2. To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business
3. To find out the ownership and title of the assets
4. To find out whether assets were in existence
5. To detect frauds and errors, if any
6. To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.
7. To verify the arithmetic accuracy of the accounts
8. To ensure that the assets have been recorded properly
9. To know whether the assets are mentioned above is used in the company

Unit 3

Audit of Limited Companies

Qualities of an Auditor:

The Auditor must possess the following qualifications and qualities:

1. Only the qualified chartered accountant can be appointed as auditor of a limited company.

2. The auditor must have thorough knowledge of principles and practice of all aspects of accountancy. He must be familiar with all systems of accountancy in use.

3. He should have adequate knowledge of financial management, industrial administration and business organization.

4. He must have thorough knowledge of audit case laws as per the various cases decide by the courts in and outside India.

5. He should be able to understand the technical details of business whose accounts he is going to audit.

6. An auditor must be honest i.e. He must certify that he does not believe to be true and he must take reasonable care and skill before he believes what he certifies is true.

7. He must act impartially and not influenced by others, directly or indirectly while discharging his duties.

8. He should be hard working, systematic and methodical.

9. He must have capacity to hear arguments of others.

10. He should have adequate skills and courage to write audit report correctly clearly and concisely.

11. He should not disclose the secrets of his client.

Appointment of an Auditor

Appointment of Auditor in case of Sole proprietor: The appointment of Auditor in case of

sole trader is done by the owner of the business. In case of sole traders the auditor generally acts as an

accountant who also prepares accounts besides checking their accuracy. As He is appointed by an

individual he must get clear instructions from his client in writing as to what he is expected to do. His

work and its scope will depend upon the agreement with his client since the appointment of an auditor

is not under any statute, therefore the rights and the duties will depend upon the agreement.

Appointment of Auditor in case of partnership: The Auditor of a partnership firm is made

by the mutual consent of all the partners

Appointment of Companies Auditors: The provisions regarding appointment of the auditor

are contained in section 139 of Companies Act 2013

1. Appointment of auditor by members [sec 139(1)]:

a. A company shall appoint an individual or a firm as an Auditor at the first annual

general meeting and each subsequent sixth annual general meeting.

b. Such auditors shall hold office till conclusion of sixth annual general meeting.

c. Such appointment shall be placed before the members at each annual general

meeting for ratification.

2. Period for which the appointment is made [sec 139(2)]:

a. An individual can be appointed for a term no more than five years.

b. An audit firm can be appointed for a consecutive term not more than two terms

of five years.

c. An individual or a firm which has completed its term shall not be eligible for

reappointment as auditor in the same company for five years from the

completion of term.

3. Appointment of auditor of Government companies (sec 139 (5)): The comptroller and

Auditor general shall in respect of financial year appoint an auditor duly qualified within 180

days from the commencement of financial year who shall hold office till conclusion of annual

general meeting.

4. Appointment of First Auditor by Board of Directors [sec139 (6)]: The first auditor of a

company other than government company shall be appointed by the board of directors within 30 days of registration of company. If the board fails to appoint first auditor it shall inform the members of company who shall appoint auditor within 90 days at extra ordinary general meeting who shall hold the office till conclusion of first annual general meeting.

5. Appointment of First Auditor of Government Company [sec 139 (7)]: The first Auditor of a Government Company shall be appointed by Comptroller and Auditor general within 60 days of registration of company. In case of its failure to appoint first auditor, then board of directors shall appoint auditor within next 30 days. The company shall inform the members if the board fails to appoint first auditor who shall appoint the auditor within 60 days at extra ordinary general meeting who shall the office till conclusion of the first general meeting.

6. Casual vacancy of an Auditor [sec 139 (8)]:

a. The casual vacancy of auditor, except in case of Government Company, shall be filled by the board of directors within 30 days but if it arises as a result of resignation of the auditor it shall be approved by company at general meeting convened within 3 months o recommendation of board. Such auditor shall hold office till conclusion of next annual general meeting.

b. Casual vacancy in case of Government Company shall be filled by Comptroller and Auditor General within 30 days if he fails to fill the vacancy, the board shall fill the vacancy within next 30 days.

Reappointment of a retiring auditor [sec 139 (9)]:

Such an auditor can be reappointed at annual general meeting if.

a. He is not disqualified for reappointment.

b. He has not given notice to company of his unwillingness.

c. A special resolution has not been passed at annual general meeting appointing some other person or providing expressly that he shall not be reappointed.

All the above is subject to the provisions of sec 139 (1)

Qualifications of an Auditor:

1. A person shall be eligible for the appointment of an auditor of a company only if he is a chartered accountant.

2. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and

sign on behalf of firm.

Rights of an Auditor

1. Right to Access books of accounts: Every auditor of a company has right to free and complete access at all the times to the books, accounts and vouchers of the company
2. Right to obtain the information and explanation: An auditor is authorized to obtain such information and explanation as the auditor may think necessary for the performance of his duty as auditor.
3. Right to receive notice: All notices of the company and other communications relating to any general meeting of the company shall be forwarded to the auditor of the company. He is also authorized to attend the meetings and make any statement or explanation with regard to the accounts audited by him.
4. Right to sign audit report: only the person appointed as auditor of the company, where a firm so appointed only a partner in the firm practicing in India, may sign the auditor's report or authenticate any other document of the company required law to be signed or authenticated by auditor.
5. Right to seek legal and technical advice: The auditor of a company is entitled to seek the legal and technical advice which may be needed in the performance of his duties.
6. Right to remuneration: on completion of his work an auditor is entitled to his remuneration.
7. Right to be indemnified: for many purposes, an auditor is considered to be an officer the company. An officer has a right to be indemnified out of the assets of the company against any liability.

Duties of an Auditor: Duties under section 143 (1):

a. The auditor has a duty to enquire whether loans and advances made by the company have been properly secured whether the term and the conditions there of are prejudicial to the interest of the company or its members.
b. Duty to enquire whether assets of the company being shares or debentures and other securities have been sold at a price less than at which these were purchased.
c. Whether any shares have been allotted for cash, whether cash actually received and whether the position in the account books and balance sheet is correct, regular and not misleading.

Duties under section 143 (2):

The auditor has the duty to report the members of the company, the accounts examined by him and every financial statement to be laid before the company in the general meeting. The auditor shall state in his report to the best of his information and knowledge, the said accounts and financial statements whether give a true and fair view or not, of the state of company's affairs

Duties under section 143(3):

1. He has the duty to sought and obtain all information and explanation which are necessary for his audit.
2. He has a duty to ensure that the books of accounts as required by law have been kept by the company.
3. He has a duty to see whether the company has adequate internal financial control systems in place and their operative effectiveness.
4. He has a duty to ensure whether the company's balance sheet and profit and loss account dealt within the report or in agreement with the books of account and returns.

Liabilities of an Auditor:

The liabilities of an auditor can be summed under following heads:

1. Civil liabilities
2. Criminal Liabilities

1. Civil Liabilities:

(I) Liability for Negligence: The liability of an auditor arises where it is proved that his client has suffered a loss due to his professional negligence. The auditor may be held personally liable, if it is proved, that had he exercised reasonable care and skill, he must have discovered the discrepancy. In a case it was held that if an auditor fails to show as much skill and diligence as is expected of a man of ordinary prudence, he must suffer the consequences.

(ii) Liability for misfeasance: According to section (340), the court may assess damages against delinquent director and other officers of the company, including an auditor for misfeasance or breach of trust. In case of an auditor who also comes within the definition of officer in section 2 (59) for purpose of the section, if he is guilty of neglect of duty or misfeasance, so as to cause loss of company in any way, proceedings may be taken under this section against him either independently or other officers or jointly with them. This section provides a simple way to the company to recover damages where an auditor or any other officer of the company is guilty of misfeasance. The time limit for bringing an action is 5 years.

2. Criminal Liabilities:

i) Mis-statement in prospectus section 34: Where an auditor makes false statement with material particulars in returns, reports, prospectus or other statements knowingly it to be false or omits any material facts knowing them to be false, he shall be punishable with imprisonment for a minimum term of 6 months extendable to 10 years.

ii) Non compliance by auditor with section 143 and 145: If the auditor does not comply with section 143 and 145 regarding making his report or signing or authentication of any document and makes willful neglect on his part he shall be punishable with imprisonment up to 1 year and with fine not less than twenty thousand extendable to five lakhs.

In case an auditor knowingly or willfully with the intension to deceive the company or shareholders or creditors or tax authorities, he shall be punishable with imprisonment up to 1 year and fine not less than 1 lakh extendable up to twenty five lakhs.

iii) Failure to assist in the investigation section 217 (6): Where the central Government appoints an inspector to investigate the affairs of the company, it is the duty of the auditor to preserve and produce to the inspector all books and papers relating to the company. If an auditor fails to assist the inspector in investigation he shall be punishable with imprisonment up to 1 year and with fine not less than twenty five thousand extendable to 1 lakh

iv) Penalty for falsification of books section 336: Any officer including auditor of a company which is being wound up, with an intention to defraud or deceive any person, destroys, mutilates, alters, falsifies any books, papers or securities. He shall be punishable with imprisonment for a term not less than 3 years extendable to 5 years and with fine not less than 1 lakh extendable to three lakhs.

V) Penalty for deliberate act of commission or omission section 448: If any officer including auditor of the company deliberately make a statement in any return, report, certificate, balance sheet, prospectus etc. which false or which contains omission of material facts he shall be punishable with imprisonment for a term not less than 6 months extendable to 10 years and fine not less than amount involved in fraud extendable to 3 times of such amount.

Audit Programme

Meaning and Definition

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

According to Megis, An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.

According to holmes, Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

Advantages of audit programme:

Some of the important advantages of thee audit programme are:

1. It enables the auditor to keep in touch with the work done and general progress of the work.
2. The auditor can be certain that the audit staff will cover whole of the ground.
3. It will help the audit assistants to know their duties.
4. It helps to increase the efficiency of audit assistants.
5. Fixing of the responsibility of audit assistants becomes easier.
6. It provides a check against the possibility of certain important items requiring verification which are being omitted.
7. Continuity is not lost even if the person on the duty is changed.

Audit Note book:

Audit note book is a diary or register maintained by audit staff to note errors, doubtful quarries and difficulties. The purpose is to note down the various points which need to be either clarified with the client or the chief editor. The Audit note book is used for recording important points to be included in the auditor's report.

Contents of an Auditor's Note Book:

1. A list of books of accounts maintained.

2. The names, duties and responsibilities of principal officers.

3. The particulars of missing receipts and vouchers.

4. Mistakes and errors detected.

5. The points which need clarifications and explanations.

6. The points deserving the attention of the auditor.

7. Various totals and balances.

8. The Points to be a part of auditor's report.

Advantages of Audit Note book:

Some of the advantages of the audit note book are.

1. It ensures the uniformity and helps in knowing the amount of work performed.

2. Important matters relating to the audit work may be easily recalled.

3. Facilities and preparation of the audit report.

4. In case of the assistant in charge is changed, no difficulty is faced in continuing the incomplete work.

5. The responsibility of the errors undetected can be fixed on clerk concerned.

6. The audit note book shows the extent of the interest and pain taken by the audit staff. It helps in their appraisal.

7. It ensures that the audit programme has been sincerely followed. Deviations can be noticed.

8. It is reliable evidence in the court of law, If an auditor has to defend himself.

Audit working papers

Meaning and Definition

The term audit working papers designate the files of analysis, summaries, comments and correspondence built by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about the accounts which are under audit.

According to Arnold W. Johnson, '' Audit working papers are the written private materials, which an auditor prepares for each audit. They describe the accounting information which he receives from his client, the methods of examination used, the conclusions (and reasons thereof) and the financial statements."

Internal Control

Meaning and Definition

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

According to The American Institute of Certified Public Accountants, "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."

The system of internal control can be defined as, "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

Objectives/Need of the Internal Control:

1. Providing reliable data: Business decisions require accurate information o run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.

2. To promote operational Efficiency: the controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use of resources so as to promote the operational efficiency.

3. To encourage adherence to the prescribed policies: the system of internal control is meant to provide reasonable assurance that procedures and rules of various institutes are followed by company personnel.

4. Safeguarding assets and records: the physical assets of the company can be stolen, misused

or accidently destroyed if not properly protected by adequate controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company.

Internal Check

Meaning and Definition:

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

According to F.R. M.e paula, “internal check means practically a continuous internal audit Carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff.”

According to D.R. Davar, “ Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim.

All the definitions of internal check give a common idea about system organized within the concern itself, wherein the work of one employee is automatically checked up by the other and the possibility of error or fraud is reduced to the minimum.

Objectives of internal check:

1. To exercise moral pressure over the staff.
2. To ensure that the accounting system produces reliable and adequate information.
3. To provide protection to the resources of the business against fraud, carelessness and in efficiency.
4. To distribute work in such a manner that no business is left unrecorded.
5. To allocate duties and responsibilities of each clerk in such a way that he may held responsible for particular fraud or error.
6. To increase the efficiency of clerks because the allocation of duties is based on the principle of division of labour.
7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Advantages of Internal Check:

1. Proper division of work: internal check entails a proper and rational distribution of work among the members of staff of the enterprise keeping in view their individual qualifications, experience and area of specialization.

2. Detection of errors and frauds: since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds.

3. Increased efficiency coupled with economy: A good system of internal check increases the efficiency of work among the staff and leads to overall economy.

4. Convenience to auditor: where an organization is operating the system of internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.

5. Accuracy of the accounts can be relied upon: If there is a good system of internal check the owner of the concern may rely upon the genuineness and accuracy of the accounts.

6. Increase in Profits: overall efficiency and economy in operations result in more profits- thus ensuring larger dividends for the owners or shareholders.

Vouching and Audit of Financial Statements

Vouching

Meaning and Definition

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

"Vouching means testing the truth of items appearing in the books of original entry." – J.R. Batliboi

"Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof." - Dicksee

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

Objectives of Vouching:

1. All the transactions which are connected with the business have been recorded in the books of accounts properly.
2. To verify that all transactions recorded in the books of accounts are supported by documentary evidence.
3. The vouchers which support the entries are legally valid from the view point that they are authentic, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account.

Vouching of cash Transactions:

How to vouch various cash receipts (Receipt side)

1. Cash sales: In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same. Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.
2. Cash received from the debtors: The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.
3. Loans: While vouching the loans received, the terms and the conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.
4. Bills receivable: Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with

the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonor of such bill has been made.

A verification of the bills discounted should be made. Whether, entry for discount has been made. Such bills should appear as contingent liability in the balance sheet; if the date of maturity is after the date of balance sheet.

5. Sale of Investment: If the sales have been affected through a bank, the auditor should examine the bank advice to know the various details. Sometimes the investment is sold through the broker. Broker's sold note or commission should be examined to verify the sale proceeds and commission charged by the broker.

If the investments are sold at cum-dividend price, auditor should see that proper apportionment has been made between capital receipts and revenue receipts.

Sometimes the investments are made against specified funds. Profit or loss on sale of such investments must be transferred to such funds account.

6. Sale of Fixed Assets: Sale of fixed assets may be vouched with minute book of board of directors, correspondence, agents' sale account and sale contract. It should be seen that proper account has been credited. Any profit arising on the sale of asset shall be credited to revenue account which is not available for distribution of dividends. If any expense on the sale of assets is paid, the sale proceeds of the asset should be reduced by such amount and the balance should be credited to asset account. It must be seen that sale of fixed assets has been sanctioned by the authorized person or committee.

Audit Report /Auditor's Report

An auditor's Report is the format of result of all the effort that goes into the audit.

Communicating the Auditor's findings to interested users is part of all audits. Thus, the Final phase of an

Audit involves preparing that communication, which is known as auditor's report.

According to Lancaster, "Audit report is statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of full facts of subject matter of the report."

It presents the results of the examination done by the auditor. An audit involves collection of evidence about the financial statements. The evidence collected needs to be carefully shifted and analyzed to enable the auditor to draw appropriate conclusions. The conclusions drawn are communicated to the interested parties through the auditor's report.

Contents of Audit Report

Under section 227 (2) every auditor is required to make report to the shareholders on the accountants examined by him and every balance sheet and profit and loss A/c and every document declared by law to be part of or annexed to the balance sheet and profit or loss A/C which are placed before the shareholders of the company at the general meeting during tenure of his office. The report has to state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accountants give the information required by the Companies Act in manner so required and give a true and fair view.

i. In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

ii. In the case of profit and loss account, of the profit or loss account for its financial year.

Sub-section (iii) of the section 227 required that the auditor's report shall also state.

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

b. Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from hiss examination of these books, and proper returns adequate for the purposes of his audits have been received from the branches not visited by him .

c. Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

d. Whether the company's balance sheet and profit and loss A/C dealt with by the report are in agreement with the books of accounts and returns.

If any of the matters as referred to in section 227 (2) and (3) is answered in the negative or with the qualification the auditor has to state in his report the reasons for such answer.

The Auditor's report shall also include a statement on such additional matters as specified by the Central Government under section 227 (4-A) of the

Companies Act, This section empowers the Central Government to order the

inclusion of certain matters in the auditor's report.

The Institute of Chartered Accountants of India requires the auditor's to

ensure that the accounting standards are implemented in the presentation of

financial statements covered by their audit reports. The deviation should be

reported in the report.

Unqualified/ Clean/ Fair report:

When an auditor is satisfied with the fairness of the balance sheet and profit and loss account

he will give a clean report. The auditor makes various statutory affirmations without reservations He is

said to have the given an unqualified report on financial statements of the company.

Even when an auditor has given a clean report, it does not mean that it is absolutely accurate in

other words the auditor is not guarantor of insurer as is observed by

Lord Justice lopes in re. Kingston cotton mills co. Ltd. Case, "auditor must not be held liable for

not tracing out ingenious and carefully laid schemes or fraud, when there is nothing to arose their

suspicion."

Qualified Report:

If the auditor is of the opinion that the balance sheet does not give the true and the fair view of

the state of company's affairs or, that profit and loss account does not give true and fair view of the

profit or loss for the year he must qualify his report accordingly. When an auditor concludes on the basis

of sufficient appropriate audit evidence that mis-statements are material but not pervaise to the

financial statements or he is unable to obtain sufficient or appropriate evidence to conclude that

financial statements are free from material mis-statements, such mis-statements remaining undetected

may be material but not pervaise.

DIVISIBLE PROFIT--

The portion of profit, which can legally be distributed to the shareholders of the company by way of dividend, is called the 'divisible profit'.

The term 'divisible profit' is not defined in the Companies Act.

Duties of Auditor regarding the distribution of dividends---

The auditor should perform the following duties regarding the distribution of dividend:

1. The auditor should examine the Memorandum of Association and Articles of Association of the company under audit to ascertain the rights of shareholders holding different classes of shares.

2. As stated already if the rate of dividend exceeds 10% of the profits of the year, the company is required to transfer not less than 2.5% of profit to the reserve account. It is the duty of the auditor to verify whether the company has appropriated the profit accordingly and whether the company has obtained any consent from the Central Government in this regard.

3. The auditor should examine the Minutes of the General Meeting and the Board of directors to confirm the amount of dividend recommended by the directors and declared in the general meeting.

4. He should verify the dividend payments with the bank pass book.

5. Register of Members and dividend list are to be compared and the dividend payable to each shareholder is to be verified. If dividend is taxable at the hands of the shareholder, the amount of tax to be deducted at source is to be checked.

6. The auditor should check the dividend warrants surrendered with the dividend paid. He should also check the outstanding dividend warrants with the balance in dividend account.

7. He should see whether company has opened a separate account in a scheduled bank as “Unpaid Dividend Account of “X” Co., Ltd.” and transfer the total amount of dividend remaining unpaid within 30 days from declaration of dividend. The amount is to be transferred to the account within 7 days from the date of expiry of thirty days. The auditor should ensure that the company has followed the above procedure regarding the unpaid/unclaimed dividend.

8. If such dividend remains unclaimed for a period of seven years, it is to be transferred to Investor Education and Protection Fund. The auditor should see whether the provision is duly complied with.

Di•visible Profits--

These refer to that portion of profits (i.e., the excess of income over expenditure including pro•vision for taxes and depreciation) which are avail•able for distribution as dividend to the sharehold•ers of the company. But this does not mean that any profit will be distributed if available.

The avail•able profit should be such that is legally distribut•able in accordance with the provisions contained in:

(i) The Companies Act, 1956,

(ii) The Income Tax Act, 1961, and

(iii) The Articles of Association of the Company.

In this context, a relevant question arises as to whether capital profits (which are not earned during the normal business operations but arise on the revaluation or sale of assets or on the re-issue of forfeited shares, etc.) are to be consi•dered as available for distribution as dividends. Un•der normal circumstances, these profits should not be distributed.

But these are distributable only on the conditions that:

(a) Such distribution is author•ised by the Articles of Association,

(b) Such sur•plus is actually realised in cash or remains after a proper valuation of all assets, and

(c) The capital losses are made good.

The divisible profits of the company mean "profits available for recommendation and distri-bution as dividends after setting aside to reserve or after carrying forward such amounts as the direc•tors deem fit. Even the whole of the profit for the year can be carried forward."

Audit of educational Institutions:-

Audit of books of educational institutions i.e. Schools, Colleges, Universities etc is known as audit of educational institutions. This type of audit comes under the category of special audit. Generally, the procedures for auditing is same like other audit even auditor need to follow other steps. The steps for audit of educational institutions are as follows:-

●Study of the trust deed or regulations.

●Examine the previous financial statements. Noting of provisions applicable.

●Evaluation of internal control system.

●Examine the minute of the meeting and resolution. ●Verification of students fee register.Authorization for fee concessions .

●Verification of cashbook with respect of counterfoils of receipts and payments.

●Examination of capital fund regarding admission fees.

●Verify free studentship and concessions.

●Confirmation of fines for late payment or absence.

●Check hostel dues recovery.

●Verification of rental income or expenses.

●Examine the bank pass book of different nature.

●Verification of investment register and also ask about any interest and dividend from investment if any.

●Verify grants from any local bodies or Government with reference to memo or sanction letter. Reporting of any arrears.

●Vouch counterfoils of receipts taken from donors.

●Confirmation of any deposits and caution money and its treatment.

●Examination of expenses for library books and sports equipments.

●Checking of acknowledgement letter if any with regards to scholarship. Examination of payments with respect to prizes if any.

●Examine the salary register.

●Verify the Provident Fund Register.

●Check annual report with accurate supporting documents.

●Vouching of all establishment expenses. Vouch payment for electricity and water bill.

●Examination of payment for hostel maintenance and any other miscellaneous expenses.

●Inspection of facilities given to students under any schemes associated with Government.

●Verification of Fixed Assets Register. Verify ownership and existence of Fixed Assets .

Confirmation of statutory compliance i.e. P.F., Income Tax etc.

●Verification of separate statements of accounts for different funds.

●Checking of calculation of salary payable and deductions.

At last, cross check all procedure.

Unit 4

Investigation

Investigation is a detailed examination of accounts and and enquiry

into the state of affairs of the business or for a specific purpose. It involves the

process of analysing, collecting and presenting facts in a manner which enables

the parties to know the essential facts regarding the matter under enquiry.

Definition

According to spicer and peglar,”the term investigation implies an examination

of records for some special purpose.”

Objectives :-

 To ascertain the financial position and the earning capacity of the

concern.

 To investigate when fraud is suspected by the proprietor.

 To investigate on behalf of Income Tax authorities for tax liability.

 To investigate for the purpose of lending money to a concern.

 To investigate for claims under insurance policy covering losses.

Characteristics:-

 It involves critical examination and verification of specific records

 It is undertaken with certain suspicion depending upon the case.

 It is confined with the policy matters.

 The scope of investigation may be limited or extended.

 Future course of action has to be achieve by the investigator.

When Fraud is suspected-

Fraud investigation audit is conducted to detect, trace, quantify and

prevent fraud, terror finance, and money laundering. It involves a thorough

examination of the financial records of a company to discover financial

irregularities.

– Fraud investigations begin with a meeting between

the investigator and client. The person launching the investigation explains why they suspect deceit and hands over

any evidence they have supporting their claims.

– A good fraud investigator will use this initial information to find

more evidence and information. But it must be remembered that

fraud is committed by those who handle cash and goods.

This fraud is usually committed in the following ways:-

a) Misappropriation of Cash

Misappropriation of cash is the easiest way of fraud especially in large business houses where there is limited or no communication between the owner of an organization and the cashier. Following are some of the ways through which embezzlement or misappropriation can be done −

 Theft of cash receipts and petty cash and showing fictitious payment to workers, creditors, purchases, etc.

 Showing false payments or excess payments in cash book.

 Cash sale can be shown as credit sale.

Strict internal control system should be followed in receipts and payments of cash so that the work done by one person should be automatically checked by another person.

b) Misappropriation of Goods

Misappropriation of goods can be done in the following ways −

 Goods may be stolen by employees or with the help of employees.

 By issuing false credit notes to customer on account of goods return.

Detection of misappropriation of goods is more difficult rather than detecting misappropriation of money, especially where management is not much vigilant and sound system of book-keeping, internal control and adequate system of securities are not available. To keep control on the physical verification of goods, reconciliation of physical stock with books and careful checking of sale and purchase is must.

c) Manipulation of Accounts

Two types of manipulation of accounts are mainly done by top management to mislead some parties for some specific purpose.

 Showing higher profits − Following are the reasons behind showing higher profit than actual −

To obtain credit or to enhance existing credit from financial institutions and also to show credit worthies to suppliers of the company.

o To maintain confidence of shareholders.

o To get more commission where commission is calculated on the basis of profit earned.

o To declare dividend at higher rate.

 Showing low profits − Following are the reasons behind showing lower profit than actual −

o To avoid or to reduce Direct Taxes of the company (Income Tax, Wealth Tax).

o To purchase shares at lower price.

o To give wrong impression to the other competitors of the business.

Audit of non-profit companies:-

 Non profit companies are those social institution who is operating their social activities with public donations .

 So, making the accounts and financial statement is needed for showing the performance to general public .

 Its accounts are also audited by independent Chartered Accountant . The procedure for auditing is very simple .

 An Auditor should verify assets and liabilities on institutions on the date of Balance-sheet.

 He should verify the cash in hand and the cash at bank.

 All the related expenses should be vouched carefully according to general auditing practices and principles.

 Like auditing for other business accounts , auditor will audit first day book with all previous data .

 After this he will check ledger accounts and trial balance .

 Checking of receipt and payment account and income and expenditure accounts are very important in the auditing for NPO. What amount NPO has received from what source and also check its voucher and also check different expenses of NPO .

 He will see whether expenses are revenue or capital nature and accountant of NPO has proper distribute it in final account.

 He will also make audit report after seeing fully all financial statements including social accounting specially in USA and UK .

Auditor should obtain list of members to verify the amount of subscriptions and list of regular donors to know the nature and purpose of donation of regular donors.

 Auditor should vouch the amount of subscription and donations from counterfoils of receipts, members list, donation register and cash book, etc.

Unit-5

Recent trends in auditing

Cost Audit

Meaning:-A cost audit represents the verification of cost accounts and checking on the adherence to cost accounting plan. Cost audit ascertains the accuracy of cost accounting records to ensure that they are in conformity with cost accounting principles, plans, procedures and objectives.[1] A cost audit comprises the following;

– Verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing technique.

– Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objective &

– To report to the government on optimum utilisation of national resources.

Definition:-

 According to ICWAI,“ the system of audit introduced by the government of India for the review, examination and appraisal of the cost accounting records and attendant information required to be maintained by specified industries”

 According to Chartered Institute of Management Accountants, London as “the verification of cost accounts and a check on the adherence to the cost accounting plan”.

Purpose/ Objectives:-

 The basic objective of cost audit is to ensure that the cost of production as well as cost of sales includes only those factors which are absolutely necessary and that those factors are used in the most efficient way.

 To verify that that cost accounts/records are accurate.

To detect all errors or frauds in cost records.

 To introduce some sort of internal audit with a focus on costs to reduce the work of financial auditor..

 To see that the organisation maintains proper cost books, accounts and records either required by law or otherwise as a managerial decision..

 To report on the optimum utilisation of national resources, to the government.

Advantages :-

1. It provides necessary information for prompt decision decisions.

2. It helps management to regulate production.

3. Errors, omission, fraud, and mistakes can be detected and prevented due to the effective auditing of cost accounts.

4. It helps the government to take necessary measures to improve the efficiency of sick industrial units.

5. It facilitates settlement of trade disputes of the companies.

Disadvantages:-

1. Expensive

One primary disadvantage associated with cost audits is the excessive fees. Auditors are typically independent contractors who can charge relatively high prices for services rendered.

2. Lengthy

Cost audits are also lengthy processes that require employee devotion.

3. Lost Time

Although thorough an auditor’s report is usually given three to five weeks after the balance sheet is released. This means people who have been stealing from an establishment have nearly a month to form an excuse or leave the company.

4. Uncertainty

Because a major part of the process involves estimating there’s the possibility of numerical figures being wrong.

Besides, if receipts and other forms of record-keeping are skewed an auditor relying on such documents may produce an inaccurate report.

Cost Audit Rules 1996

Cost Audit (Report) Rules, 1996 * This Rules have been amended vide the Cost Audit Report Rules 2001, dated 27.12.2001, notification No.G.S.R. 924(E) In exercise of the powers conferred by sub-section (4) of section 233B, read with sub-section (1) of section 227 and clause (b) of sub-section (1) of section 642, of the Companies Act, 1956 (1 of 1956), and in supersession of the Cost Audit (Report) Rules, 1968, except as respect things done or omitted to be done, before such supersession, the Central Government hereby makes the following rules, namely :-

1. Short title and commencement-

 These rules may be called the Cost Audit (Report) Rules, 1996.

 They shall come into force on the date of their publication in the Official Gazette.

2. Definitions In these rules, unless the context otherwise requires,

(a) "Act" means the Companies Act, 1956 (1 of 1956)

(b) "Cost Auditor" means an auditor appointed under sub-section (1) of section 233B of the Act

(c) "Form" means the Form of Cost Audit Report specified in the Schedule ; and includes Annexure to the Cost Audit Report and Proforma specified in the Schedule.

(d) "Product under reference" means the product to which the rules made under clause (d) of sub-section (1) of section 209 of the Companies Act, 1956 (1 of 1956) apply

(e) "Schedule" means Schedule annexed to these rules

(f) All other words and expressions used in these rules but not defined, and defined in the Act and rules made under section 209 of the Act shall have the same meanings respectively assigned to them in the Act or rules, as the case may be.

3. Application – These rules shall apply to every company in respect of which an audit

of the cost accounting records has been ordered by the Central Government under sub-section (1) of section 233B of the Act.

4. Form of Report-

i. Every Cost Auditor who conducts an audit of the cost accounting records of the company shall submit a report in triplicate to the Central Government in the Form (including Annexures and proforma) in accordance with the procedure specified in the Schedule annexed to these rules and at the same time forward a copy of the report to the company.

ii. Every Cost Auditor, who submits a report under sub-rule (1), shall also give clarifications, if any, required by the Central Government on the Cost Audit Report submitted by him, within thirty days of receipt of the communication addressed to him calling for such clarifications.

5. Time limit for submission of report -

The Cost Auditor shall send his report referred in sub-rule (1) of rule 4 to the Central Government and to the concerned company within one hundred and eighty days from the end of the company's financial year to which the Cost Audit Report relates.

6. Penalties –

- If default is made by any Cost Auditor in complying with the provisions of rule 4 or rule 5, he shall be punishable with fine which may extend to five hundred rupees.
- If a company contravenes the provisions of rule 6, the company and every officer of the company including the persons referred to in sub-section (6) of section 209 of the Act, who is in default, shall, subject to the provisions of section 233B of the Act, be punishable with fine which may extend to five hundred rupees and where the contravention is a continuing one, with a further fine which may extend to fifty rupees for every day after the first day during which period such contravention continues.

Ceiling on Cost Audit

Cost audit shall be conducted by the cost accountant who is appointed by the

Board; In case of any default on the part of the company, it shall be punishable with the fine of an amount not less than INR 25,000, however, such fine cannot

be more than INR 5 Lakhs.

Tax Audit

Meaning & Definition:-A Tax Audit is an examination of one's Tax Return to

verify that one's declaration of income and deductions are accurate.

In India, Tax Audit is compulsory under the Income Tax Act (if only the total

turnover exceeds the prescribed limits). Tax audit mostly covers income returns,

invoices, debt and credit notes and various current and fixed assets.

How it arise:-

i. Under Income Tax Act, profits shown by profit and loss A/c have to be

adjusted as per the provisions of the Act.

ii. In this way profits for accounting and profits for taxation are not the

same. These profits differ due to various reasons. Profits for accounting

are ascertained as per accounting policies and standards but profits for the

tax purpose are computes as per the provisions and rules of Income Tax

Act.

iii. The Income Tax Department cannot verify each and every detail of

provisions compiled by the assessee.

iv. In this regard expertise of auditors is utilized, who certify the compliance

of the provisions of Income Tax Act.

How to conduct tax Audit:-

i. The tax auditor shall be guided by the auditing standards and guidance

notes as issued from time to time by Institute of Chartered Accountants of

India.

ii. Obtaining books of accounts, financial statements and other statements of

particulars duly authenticated.

iii. Evaluation of internal control system on the basis of which extent of

vouching and verification can be determined.

iv. While conducting tax audit the provisions and objectives of sec, 44 AB shall be kept in mind.

v. The auditor shall have thorough knowledge of taxation provisions and judicial pronouncements.

The Central Government has notified the following ‘accounting Standards’ in respect of audit of financial statements under section 44 AB.

Compulsory Tax Audit:-

According to Section(44 AB), provisions relating to Compulsory Tax Audit are as follows –

- If the total sales or gross receipts of a business during the previous year exceeds Rupees One Crore.
- If the gross receipt of a profession exceeds Rs. 25 lacs in previous year.
- If the business or profession of a person is covered under section 44AD, 44AE, 44B, 44BB, 44BBA and 44BBB and assesse claims that his income from said business is less than as computed under above said sections.

In all the above cases, audit of accounts is compulsory.

Appointment of Tax Auditor:-

Any practicing Chartered Accountant or firm of Chartered Accountants can conduct Tax Audit. The Board of Directors in case of Company, Partner of a firm and proprietor of the business can appoint Tax Auditor.

Removal Tax Auditor:-

Assesse can remove Tax Auditor on some valid ground only. In normal case, an Auditor cannot be removed during specified period.

Management audit

Meaning:-It is a systematic examination of decisions and actions of the management to analyse the performance. Management audit involves the review of managerial aspects like organizational objective, policies, procedures, structure, control and system in order to check the efficiency or performance of the management over the activities of the Company

Definition:-

 According to Leslie R. Howard, “ An investigation of a business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organization and smooth running of internal organization.”

 According to W.P. Leonard, “A comprehensive and constructive examination of an organization structure of a company, institution or a branch of government or of any component thereof such as division or department, and its plans and objectives, its means of operations, and its uses of human and physical facilities.”

Thus it can be simply stated that management audit, on
the basis of established standards, examines, reviews and appraises the various policies and actions of management.

Objectives/Aim:-

1. To ensure that sound objectives are set by the management.
2. To reveal any irregularity or defect in the process of management and to suggest improvements to obtain the best results.
3. To ensure that the management objectives are achieved.
4. To help various levels of management in the effective discharge of their duties.
5. To assist management in achieving coordination among various departments.
6. To help to achieve the efficiency of management.
7. To assist management in establishing good relations with the employees and to elaborate duties, rights and liabilities of entire staff.
8. To evaluate the performance by comparing inputs with outputs (human and physical both).
9. To ensure most effective relationship with the outsiders and the most efficient internal organization.
10. To recommend changes in the policies and procedure for a better future.

Advantages:-

 It helps management in preparation of plans, objectives and
policies and their efficient achievement.

 It helps management in taking vital decisions for maximization of
profits.

 It helps the management in strengthening its communication
systems within and outside the business.

 It helps in evaluating the performance of management in various
areas and measures to improve it.

It can help management in preparation of budgets and resource
management.

 It can help management in training of personnel and marketing
policies.

Disadvantages:-

 Management auditor cannot understand practical problems. So, the
suggestions provided by them is theoretical but not practical.

 It is a costly method of auditing. It involves high cost and it is suitable
only to big organizations. So, it is not suitable for small firms having
limited resources.

 Scope of management audit is vague. It may create complexity in
authority-responsibility relationships. So, it does not help to achieve a
specific goal.

 It lacks fixed methods and techniques of auditing. The management
auditor may lack independence and may simply take instructions from the
top management. So, it is not well defined.

 Generally, the management gives more emphasis on maintaining books of
accounts rather than concentrating on other factors. So, it consumes the
time of farsighted management.

 It provides only theoretical suggestions to the management which are not
suitable or applicable to solve practical problems.

Chandrakanta Paramguru