

AUDITING

VI SEMESTER

CORE COURSE

B Com



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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342

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STUDY MATERIAL

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AUDITING

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Layout: Computer Section, SDE

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	<u>Contents</u>	<u>Page No.</u>
MODULE 1	MEANING AND DEFINITION OF AUDITING	5
MODULE 2	INTERNAL CONTROL	33
MODULE 3	PROCEDURE OF AUDIT	42
MODULE 4	AUDIT OF LIMITED COMPANIES	84
MODULE 5	AUDIT REPORT	93

MODULE 1

MEANING AND DEFINITION OF AUDITING

The word audit is derived from Latin word *audire* which means 'to hear'. Auditing is a critical examination of the records and books of account of a business by an independent qualified person for ascertaining the authenticity and the accuracy of entries appearing in the books of account and financial statement.

Spicer and Pegler have defined audit as "such 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 give 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 the profit or loss for the financial period, according to the best of his information and explanation given to him and is shown by the books and if not in what respect he is not satisfied."

Montgomery defined auditing as examination of the books and records of a business in order to ascertain or verify and report up on the facts regarding the financial operations and the results thereof."

ORIGIN AND EVOLUTION

The term audit is derived from the Latin word '*audire*', which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt, Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya had emphasized the importance of accounting and auditing.

The original objective of auditing was to detect and prevent errors and frauds. Auditing evolved and grew rapidly after the industrial revolution in the 18th century with the growth of the joint stock companies the ownership and management became separate. The shareholders who were the owners needed a report from an independent expert on the accounts of the company managed by the board of directors who were the employees. The objective of audit shifted and audit was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds.

In India, the companies Act 1913 made audit of company accounts compulsory with the increase in the size of the companies and the volume of transactions. The main objective of audit shifted to ascertaining whether the accounts were true and fair rather than true and correct. Hence the emphasis was not on arithmetical accuracy but on a fair representation of the financial efforts.

The companies Act.1913 also prescribed for the first time the qualification of auditors .The International Accounting Standards Committee and the Accounting Standard board of the Institute of Chartered Accountants of India have developed standard accounting and auditing practices to guide the accountants and auditors in the day to day work The later developments in auditing pertain to the use of computers in accounting and auditing. In conclusion it can be said that auditing has come a long way from hearing of accounts to taking the help of computers to examine computerized accounts

Objectives of Auditing

The objective of an audit may be classified as

- (1) Primary Objective
- (2) Subsidiary Objective
- (3) Specific Objective

Primary Objective or Main Objective: -

Expression of expert opinion: - The main objective of auditing is to verify the accounts and records and to report to the owners of the business whether the profit and loss account and the Balance sheet have been properly drawn up according to the requirements of law, and whether they exhibit a true and fair view of the profit and the financial position of the business.

To ensure that the primary objective of audit is achieved, an auditor must:

- (a) Examine the Internal Control and Internal Check.
- (b) Verify whether all the books of accounts as required by law are kept.
- (c) Verify whether proper accounting principles and procedures are followed.
- (d) Check the arithmetical accuracy of the books of accounts.
- (e) Verify the authenticity and validity of the transactions.
- (f) Confirm the existence and the values of the assets and liabilities by physical verification.
- (g) Find out whether the financial statement is properly drawn up.
- (h) Report whether the profit and loss gives a true and fair view of the profit or loss for the year and Balance sheet gives a true and fair view of the financial position of the business at the end of the financial year.

Subsidiary or Ancillary objectives: - Subsidiary objectives of auditing are

(1) Detection and prevention of errors.

(2) Detection and prevention of frauds.

Detection and prevention of Errors: - Errors refer to unintentional misstatements in the records or books. Errors are two types namely (1) Clerical or technical errors and (2) Errors of principle.

Clerical Errors: - Clerical errors refer to all types of errors committed on account of clerical mistakes. They are (a) Errors of omission (2) Errors of Commission (3) Compensating errors and (4) Errors of duplication.

Errors of Omission: - An error of omission is one which arises when a transaction has been omitted to be recorded in the books of accounts either wholly or partially. An error of omission may be an error of complete omission or an error of partial omission. An error of complete omission does not affect the agreement of the trial balance, as both the aspects of the transaction are omitted from the trial balance, they cannot be detected easily. They can be detected only by an intensive checking of the subsidiary books, and the postings from the subsidiary books to the ledger. On the other hand, an error of partial omission affects the agreements of the trial balance, as only one of the aspects of the transactions is omitted from the trial balance, it can be detected easily.

Errors of Commission: - Errors of commission refer to errors committed in the process of posting from the subsidiary books to the ledger accounts, casting, carry forward and balancing of ledger accounts. Some of the errors of commission will not affect the agreement of the trial balance. They cannot be detected easily. Only a thorough checking of the subsidiary books and posting to the ledger can help to detect these errors.

Compensating errors: - When the effect of one error is counter balanced, set off or compensated by another error, the errors are known as compensating errors or offsetting errors. Compensating errors do not affect the agreement of the trial balance, as they are counter balanced or set off.

Errors of Duplication: - Errors of duplication arise when an entry in a book of original entry has been made twice and also been posted twice.

Errors of Principle: - An error of principle arises when the generally accepted principles of accountancy are not observed, while recording a transaction in the books of account. In other words, if a transaction is recorded in the books of account against the generally accepted principles of accountancy, the error is known as an error of principle. Capital expenditure recorded as revenue expenditure or vice versa, capital receipt recorded as revenue receipt or vice versa is examples of errors of principle. Errors of principle will not affect the agreement of the trial balance. Only a detailed and intensive checking will reveal these errors.

Detection and prevention of frauds: - It is intentional or willful representation or deliberate concealment of material fact with a view to deceive, cheat or mislead somebody.

Fraud may be broadly classified into three types. They are

- (1) Misappropriation of cash
- (2) Misappropriation of goods
- (3) Manipulation of accounts

Misappropriation, Defalcation or Embezzlement of Cash: - Misappropriation of cash means the fraudulent appropriation of cash belonging to another person by whom it has been entrusted. Misappropriation of cash may take place in any of the following ways:

(a) Suppression or non disclosure of Cash receipts :

The following are examples of suppression of cash receipts:

(1) By misappropriating the receipt by not recording the same in the Cashbook.

(2) By entering lesser amount on the counterfoil and misappropriating

The difference between money actually-received and the amount entered on the counterfoil of the receipt book

(3) By not recording the receipt of sale of a casual nature for example Sale of scrap, sale of old newspapers etc.

(4) By omitting to record cash donations received by non-profit making charitable institutions

(5) By misappropriating the cash received on discounting the bills Receivable and showing them as bills outstanding on hand.

(6) By misappropriating cash received from debtors and concealing the same by giving artificial credit to the debtors in the form of bad debts, Discount or sales return etc.

(7) By adopting the method of "teeming and lading" or "lapping process". This is one of the methods of misappropriation of cash.

Under this method cash received from the first customer is misappropriated by the cashier. The money received from the second customer is credited to the account of the first customer, the money received from the third customer is credited to the account of second customer, and the money received from the

fourth customer is credited to the account of third customer and so on. This process is carried out throughout the year.

(8) By suppressing the cash sales by not recording them or by treating the cash sales as credit sales.

(9) By misappropriating the sale proceeds of VPP sales or sales of Goods on approval basis by treating the transaction as goods Received or not approved.

(10) By under casting receipt side total of the cashbook.

(b) Inflating the payments or showing false cash payments: - The following are examples of this type of misappropriation:

(1) Recording fictitious or false cash purchases and pocketing the amount.

(2) Inflating the cash purchases and pocketing the difference.

(3) Recording payments to fictitious creditors for purchases and pocketing the money.

(4) Recording the payment to creditors at a figure higher than the actual amount and pocketing the difference.

(5) Recording payments to dummy workers and pocketing the money.

(6) Recording fictitious payments of expenses and pocketing the money.

(7) Recording payments of some accounts at figures higher than the actual payments and pocketing the difference.

(8) By showing credit purchases as cash purchases and misappropriating the amount

(9) Recording personal expenses as business expenses

MANIPULATION OF ACCOUNTS

Manipulation of accounts means falsification of accounts without any misappropriation of cash or goods. It implies presentation of accounts more favorably than what they actually are. Manipulation of accounts may be done in any of the following ways:

(1) Non provision of depreciation on fixed assets.

(2) Provision of less depreciation on fixed assets

(3) Provision of more depreciation on fixed assets

(4) Over valuation of assets

- (5) Under valuation of assets
- (6) Over valuation of liabilities.
- (7) Under valuation of liabilities
- (8) Recording revenue expenditure as capital expenditure.
- (9) Recording capital expenditure as revenue expenditure
- (10) Showing expenses of the next year in the current year's profit and loss account
- (11) Showing income of the next year in the current year's profit and loss account.
- (12) Not recording the accrued expenses in the current year's profit and loss account.
- (13) Not recording the accrued incomes in the current year's profit and loss account.
- (14) Omission of prepaid expenses.
- (15) Omission of incomes received in advance.
- (16) Inflating the profits by showing fictitious purchases and sales returns.
- (17) Deflating the profits by showing fictitious expenses.
- (18) Window dressing: - It is the practice by which the balance sheet is made to show a state of affairs that is different from the actual state of affairs. Generally, the practice of window dressing is adopted to make the balance sheet show a state of affairs far better than the actual state of affairs.

Window dressing may be done in any of the following ways:

- (1) Non provision of depreciation on fixed assets.
- (2) Provision of less depreciation on fixed assets
- (3) Over valuation of assets
- (4) Under valuation of liabilities
- (5) Recording revenue expenditure as capital expenditure.
- (6) Showing income of the next year in the current year's profit and loss account.
- (7) Recording of fictitious sales.
- (8) Recording fictitious purchase returns

(9) Showing short term liabilities as long term liabilities.

(10) Recording sales of the next year in the current year's revenue account.

Specific objectives

There will be specific objective in respect of each type of specific audits. For example, in operational audit, the aim of audit is to evaluate the existing operations of the entity in order to give expert advice to improve their efficiency. The cost audit is to check the cost records of the entity in order to make a report on the proper ascertainment of cost of production of goods or services. Depending upon the nature of specific audit, there may be different objective in respect of each specific audit.

PROCEDURE TO BE FOLLOWED TO DETECT ERRORS

Following procedures may be adopted by the auditor to detect the errors.

1. Check the opening balances from the balance sheet of the last year.
2. Check the posting into respective ledger accounts
3. Check the total of the subsidiary books.
4. Verify all the castings and the carry forwards.
5. Ensure that the list of debtors and creditors tally with the ledger accounts.
6. Make sure that all accounts from the ledger are taken into accounts.
7. Verify the total of the trial balance.
8. Compare the various items from the trial balance with that of the previous year.
9. Find out the amount of difference and see whether an item of half or such amount is entered wrongly.
10. Check differences involving round figures as Rs. 1,000; Rs. 100 etc.
11. See where there is misplacement or transposition of figures that is 45 for 54; or 81 for 18 etc.
12. Ultimately careful scrutiny is the only remedy for detection of errors.

THE AUDITOR'S Position and duty in regard to detection and prevention of errors and frauds

1. Examine all aspects of the finance.

2. Vouch all the receipts from the counterfoils or carbon copies or cash Memos, sales mart reports etc.
3. Check thoroughly the salary and wages register.
4. Verify the methods of valuation of stocks.
5. Check up stock register, goods inwards notes, goods out wards books and delivery challans etc
6. Calculate various ratios in order to detect fraudulent manipulation of accounts
7. Go through the details of unusual items.
8. Probe into the details of the problems when there is a suspicion.
9. Exercise reasonable skill and care while performing the duty.
10. Make surprise visit to check the accounts.

An auditor's position and duty in relation to detection and prevention of errors and frauds had been beautifully explained in the case of Kingston Cotton Mill Company. In this case it was remarked, "An auditor is a watch dog and not a blood hound".

The remark an auditor is a watch dog limits the audit examination to mere verification of accounts but does not cover detection of errors and frauds. But an effort to detect errors and frauds and suggest ways and means to prevent the errors and frauds in the future. Verification of accounts also implies vigilance on the part of the auditor to detect errors and frauds. As such while verifying the books of accounts, if an auditor smells some irregularities he must follow them up and unearth them. He should act honestly and takes reasonable skill and care in detecting errors and frauds.

In India, the duty of an auditor has to detect errors and frauds have also been emphasized by the Council of Chartered Accountants. According to this council, an auditor should bear in mind the possibility the existence of fraud or other irregularities, because the financial position may be misstated as a result of errors and frauds.

It is true that an auditor has to detect errors and frauds. But while performing his task of detection of errors and frauds, he need not be a blood hound. He is not required to take to task those staff that has been found guilty of committing errors and frauds. This view was upheld in the case of London Oil Storage Company Ltd VS Sears Hasluck and Company. In this case it was held

an auditor is not bound to assume when he comes to do his duty that he is dealing with fraudulent and dishonest people. If circumstances of suspicions arise, it is his duty to probe them to bottom.

To sum up, an auditor is not an insurer against errors and frauds. That he does not guarantee that the books do not contain any errors and frauds.

However, he has always to be very careful about errors and frauds. He must exercise reasonable care and skill in the detection of errors and frauds. Once he suspects the existence of errors and frauds, he must go in to the roots and unearth them. In short, an auditor is not just a watch dog. But, at the same time, he need not be blood hound.

ADVANTAGES OF AUDIT: -

Audit offers several advantages. They are:

1. Advantages of Audit to the business enterprise and Management

- (1) Audit ensures the accuracy or correctness of the books of accounts
- (2) Audit ensures the authenticity and reliability of the financial statements.
- (3) Audit helps in the detection and rectification of errors and frauds.
- (4) Audit helps the enterprise and management to ascertain whether the legal requirements are complied with.
- (5) Audit point out the weakness of the existing system of internal check and internal control.
- (6) Audit examination makes the employees in charge of accounts and records vigilant, regular and up- to -date in their work.
- (7) Loans and credit facilities can be easily obtained by a concern on the basis of audited accounts.
- (8) Liability of an enterprise as to income tax, wealth tax, and value added tax etc can be easily determined on the basis of audited accounts.
- (9) A business can enjoy better reputation, if its accounts are audited by an independent professional auditor.
- (10) Audited accounts are more reliable as evidence in courts of law.
- (11) Facilitates calculation of purchase consideration.
- (12) The insurance claim can be easily determined on the basis of audited accounts.

(13) Audited accounts serve as a basis for solving the disputes as to higher wages.

(14) Comparison of accounts from year to year becomes easier since the accounts are uniformly prepared.

2. Advantages of audit to the owners of the business:

- (1) In the case of a sole trader, auditing assures him that all business transactions have been duly accounted for and there are no errors or frauds. It also helps him to know the true facts about the business.
- (2) In the case of partnership firm, audited accounts serve as an evidence of proper management of the affairs of the business. Audited accounts are help in the valuation of goodwill and settlement of accounts on the admission, retirement or death of a partner. Again audited accounts minimize the chances of disputes among the partners.
- (3) In the case of a joint stock company, audit of accounts assures the shareholders that the affairs of their company are smoothly and their investment is safe. The shareholders of a company can value their shares on the basis of audited accounts.
- (4) In the case of a co – Op society or a trust, audit assures the members or the beneficiaries that the affairs of the society or trust are conducted properly and their investment are looked after properly.

3. Advantages of Auditing to others: -

(1) Lenders can depend on audited financial statements while taking a decision to grant credit to the business concern.

(2) Tax authorities can depend on audited statements in assessing sales tax, income tax and wealth tax of the business.

(3) Audit of accounts safeguards the interests of the workers and is helpful in the settlement of claim for higher wages and bonus.

- (5) Insurance company can rely on audited accounts to settle claims in respect of damage or loss of any business asset by fire, theft etc.
- (6) The purchaser of a business can easily calculate the amount of purchase consideration on the basis of audited accounts.
- (7) Audited accounts create confidence in the minds of investors in a joint stock company.

Limitations of Auditing: -

Generally following are the Limitations of auditing

1. **Non-detection of errors or frauds:** - Auditor may not be able to detect certain frauds which are committed by the clients.

2. **Dependence on explanation by others:** - Auditor has to depend on the explanation and information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.
3. **Dependence on opinions of others:-** Auditor has to rely on the views or opinions given by different experts viz Lawyers, Solicitors, Engineers, Architects etc, he cannot be an expert in all the fields
4. **Conflict with others:** - Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal judgement plays an important role. It differs from person to person.
5. **Effect of inflation :** - Financial statements may not disclose true picture even after audit due to inflationary trends.
6. **Corrupt practices to influence the auditors:** - The management may use corrupt practices to influence the auditors and get a favourable report about the state of affairs of the organisation.
7. **No assurance:** - Auditor cannot give any assurance about future profitability and prospects of the company.
8. **Inherent limitations of the financial statements:** - Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgement of the owners. Certain non-monetary facts cannot be measured. Audited statements due to these limitations cannot exhibit true position.
9. **Detailed checking not possible:** - Auditor cannot check each and every transaction. He may be required to do test checking.
10. **Auditing is a post mortem examination of accounts.**

AUDITING Vs INVESTIGATION:

Investigation is an enquiry into the accounts and records of a business concern for a special purpose, say, to know the actual financial position of the concern or to know the real earning capacity of the business or to know the extent of fraud, if any. There are many differences between the two. They are:

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

DISTINCTION BETWEEN ACCOUNTING AND AUDITING

Points of difference	Accounting	Auditing
1. Meaning	It is recording of all the day to day transactions in the books of accounts leading to preparation of financial statements.	It is the critical examination of the transactions recorded in the books of accounts.
2. Nature	It is concerned with finalization of accounts.	It is concerned with establishment of reliability of financial statements.
3. Objects	The object is to ascertain the trading results.	The object is to certify the correctness of financial statements.
4. Commencement	Accounting Commences when book keeping ends.	Auditing begins when Accounting ends.
5. Scope	It involves various financial statements. It involves maintenance of books of accounts.	It depends upon the agreement or upon the provisions of law. It goes beyond books of accounts.
6. Report	An accountant is not required to submit any report to the proprietor of the business.	An auditor is required to submit a report to the proprietor of the business.
7. period	Accountancy work is conducted continuously throughout the year	Auditing work is generally, conducted at the end of the year or periodically.
8. Qualification	An accountant, who is in charge of accounting work, need not be a qualified person.	An auditor, who is in charge of auditing work, must be a qualified person.

9. Position	An accountant is an insider ie an employee of the undertaking.	An auditor is an outsider, not an employee of the undertaking.
10. Remuneration	An accountant being an employee of the concern is paid regular salary for his work.	An auditor is paid fixed fee for his work.

Qualification and Qualities of an Auditor

To be an efficient auditor, an auditor must possess certain professional qualifications and professional and personal qualities.

Professional qualification: - An auditor is a professional accountant. So he must possess certain professional qualifications. Under the Companies Act, an auditor of a joint stock Company must be a Chartered accountant within the meaning of the Chartered Accountants Act of 1949. To be a Chartered accountant, he must pass the C.A examination conducted by the Institute of Chartered Accountants. He must also obtain a certificate from the institute from the Institute of Chartered Accountants to take up public practice of accountancy.

Professional Qualities: - To perform his work efficiently, an auditor must possess certain professional qualities. They are :

1. Knowledge of principles and practice of general accounting.
2. Knowledge of Cost accounting
3. Knowledge of Management accounting
4. Thorough knowledge of techniques of auditing
5. Knowledge of provisions relating to income tax , wealth tax, VAT etc.
6. Knowledge of business laws.
7. Knowledge of economics.
8. Knowledge of Mathematics and Statistics
9. Knowledge of Business Management and Organization and financial administration
10. Knowledge of report writing.
11. Knowledge of technical details of the business under audit.
12. Knowledge of the accounts of the business under audit.

Personal Qualities or General Qualities: - Besides the professional qualities, an auditor must also have certain personal or general qualities to perform his work efficiently and smoothly. The requisite personal qualities are :

- (i) Honesty and Integrity.
- (ii) Tactfulness
- (iii) Vigilance
- (iv) An enquiry mind
- (v) Methodical
- (vi) Care and Skill
- (vii) Diligence
- (viii) Judgement.
- (ix) Responsibility
- (x) Impartiality and independence.
- (xi) Common sense
- (xii) Ability to communicate
- (xiii) Ability to work hard
- (xiv) Patience
- (xv) Courtesy
- (xvi) Ability to maintain secrets.

Classification of audit or types of audit

Audit can be classified on different types:

- (1) Classification of Audit on the basis of Organization structure.
- (2) Classification of audit on the basis of Degree of independence of the auditor
- (3) Classification of Audit on the basis of method or approach to audit work or on the basis of extent of work to be performed or on the basis of conduct of audit.
- (4) Classification of audit on the basis specific objectives

Classification on the basis of organization or organization structure : - On the basis of organization structure, audit may be classified into three types. They are:

- (1) Statutory audit
- (2) Government audit
- (3) Private Audit

Statutory Audit: - Statutory audit refers to the audit of accounts of a business enterprises carried out compulsorily under the provisions of a statute or law. It is the audit carried out compulsorily under any statute any law.

Features of statutory audit are:

1. Statutory audit is compulsory under law.
2. Statutory audit is required to be conducted by a qualified auditor.
3. In the case of Statutory audit, the rights, duties and liabilities of the auditor are governed by the statute or law applicable to the undertaking.
4. Statutory audit is an independent audit.
5. Statutory audit is an external audit.
6. Statutory audit must be a complete or full audit. It cannot be partial.

Statutory audit is carried out in a number of Organizations, such as

1. Joint stock Companies governed by the Companies Act of 1956.
2. Banking companies governed by the Banking Regulation Act of 1949.
3. Insurance companies governed by the Insurance Act of 1938.
4. Electricity supply companies governed by the electricity supply Act of 1948.
5. Co – operative societies registered under the Co –operative Societies Act.
6. Public and charitable trusts registered under Religious and Endowment Acts

2. Government audit: - Government audit refers to the audit of accounts of Government departments and offices, Government companies and statutory or public corporations.

The features of government audit are

1. Government audit is prescribed for by law.
2. It is conducted either by the comptroller and Auditor General of India and his staff or professional chartered accountant approved by the Comptroller and Auditor General of India.
3. It is internal audit.
4. A government audit is a continuous audit.

Objectives of Government audit

1. To ensure that all payment has been sanctioned by the competent authority.
2. To ensure that every payments is made as per the rules and regulations.
3. To see that the payments have been made to the right persons.
4. To ensure that the expenditure is not excessive.
5. To see that payments are properly classified as capital and revenue.
6. To verify the existence of stocks and stores.
7. To ensure that a proper system of stock taking has been adopted.

Government audit may be classified into three types. They are:

1. Audit of government departments and offices.
2. Audit of Government Companies.
3. Audit of Statutory Corporations registered as statutory corporations.

3.Private audit or Voluntary audit : - Where an audit is not compulsory under any statute, but is undertaken by the owners voluntarily to get the benefit of audit, the audit is called private audit. In other words , private audit refers to the audit of accounts of private enterprises such as a sole trading concerns, partnership firms and other individuals and institutions.

Advantages of private audit

1. Audit assures to the owners that the accounts of the business are properly maintained and there are no irregularities.
2. It provides a moral check on the employees.
3. It helps the owners of the business to know the real profitability and the state of affairs of their business.
4. Audited accounts serve as a basis for assessment of tax liability.
5. Audited accounts facilitate the process of raising loans from banks and other financial institutions.
6. Audited accounts help in the settlement of dispute and claims between the partners of a firm.

Classification of audit on the basis of Degree of Independence:-

1. Internal audit
2. External audit

Internal audit: -Internal audit is a continuous and systematic review of the accounting, financial and other operations of a concern by the staff specially appointed for the purpose. In other words, it is the audit of accounts by the staff specially appointed for the purpose.

Objectives of Internal audit: -

1. To ascertain whether internal check and accounting systems are adequate and effective.
2. To ascertain whether predetermined policies, plans and procedures have been complied with.
3. To ascertain the reliability of the accounting and other data.
4. To evaluate the performance of the personnel.
5. To ascertain whether the properties of the concern are safeguarded.
6. To suggest to the management the improvements desired in the internal check systems, accounting system etc.

Features of Internal audit: -

1. It is generally undertaken by large concerns.
2. It is not compulsory.
3. The scope of internal audit may vary, depending upon the nature and size of the concern.
4. It may be in addition to external audit.
5. It is conducted by the staff of the concern.
6. The techniques and methods of auditing employed in internal audit are the same as those in external audit.
7. It is an integral part of internal control.
8. The staff engaged in internal audit is appointed by the management. They are responsible to the management.

Importance and advantages of internal audit

1. It is helpful to the management to ascertain whether the internal check and accounting systems are adequate and effective to prevent errors and frauds.
2. It helps the management to ascertain whether the predetermined policies, plans and procedures have been complied with.
3. It is helpful to ascertain the reliability of the accounting and other data complied within the organization.
4. It is helpful to evaluate the performance of the personnel.

5. It helps to ascertain whether the properties of the concern are safeguarded.
6. It covers the review of accounting and non accounting matters.

Disadvantages

It is conducted by staff who may not be a qualified one.

- 1) It is optional.
- 2) Quality depends upon the decisions of management.

2. External Audit.

Audit conducted by independent qualified person and examines the books of accounts and report to the management.

Difference between Government Audit and Commercial Audit

Government Audit	Commercial Audit
1. It is adopted in government departments, government offices and Government Company.	1. It is conducted in private enterprise.
2. It is compulsory.	2. It is optional.
3. It is conducted by CAGI and his staff and qualified staff.	3. It is conducted by professionally qualified persons.
4. Continuous audit.	4. Periodical audit.
5. Disbursing officer is responsible for the work of audit.	5. Disbursing officer is not responsible.
6. Treasury officer undertake preliminary audit.	6. There is no preliminary audit.

3. On the basis of Conduct of audit or methods or approach to audit work

1. Continuous Audit.

Continuous audit is one where the auditor’s staff is occupied continuously on the accounts whole the year round and performs interim audit. It is an audit under which detailed examination of the books of accounts is conducted continuously throughout the year. It is continuous review of the accounts of the organization. It is generally applicable to banking company and insurance company.

Advantages.

- 1) Easy and quick discover of errors and frauds.
- 2) Technical knowledge.

- 3) Quick presentation of accounts.
- 4) Keep the client staff regular.
- 5) Moral check on the client's staff.
- 6) Efficient audit.
- 7) Preparation of interim accounts is very easy.
- 8) Audit staff can be kept busy.

Limitations.

- 1) Alteration of figures.
- 2) Dislocation of the work of the client staff.
- 3) Expensive.
- 4) Queries may remain outstanding
- 5) Extensive note taking may be necessary.
- 6) Chance for collusion between client staff and audit staff.
- 7) Mechanical and monotonous.

Precautions or steps to be taken to overcome the drawbacks:

- 1) Well dream up audit program should be followed by the auditor.
- 2) No alterations to be allowed after the accounts are audited.
- 3) If any alterations are made, it should be made in the rectification entries in the journal.
- 4) A note should be made in respect of queries asked.
- 5) If any alterations are made in figures before auditing, a special tick mark must be made.
- 6) Recommend surprise visit.
- 7) Rotate the audit work among auditors.

2. Final Audit or Annual or periodical audit

It is an audit carried out after the preparation of financial statement. It is an audit where the auditor takes up his work of checking the books of accounts only at the end of the accounting year. In this case, the audit work is commenced and completed in a single uninterrupted session.

Advantages:

- 1) Cost of audit is less than that of continuous audit.
- 2) Audit work is completed in one continuous sitting.
- 3) Not causing any dislocation of client work.

- 4) No possibility of alteration of figures.
- 5) It is not mechanical and monotonous.
- 6) Less chance for collusion between client staff and audit staff.
- 7) There is no lose the thread of the work.

Limitations

- 1) Errors and frauds remains in the accounts for long period of time.
- 2) Postmortem examination of accounts.
- 3) Little time for checking.
- 4) Rely upon test checking.
- 5) Not suitable for imposing moral check on the client staff.
- 6) Not helpful for preparing interim accounts.
- 7) Not suitable for large size organizations.

3. Interim Audit.

_ It is an audit conducted between two annual audits. In other words, it is the audit conducted in the middle of the financial year. It is carried out for some specific purpose for declaring interim dividend, ascertaining interim profit.

Advantages.

- 1) Quick discovery of errors and frauds.
- 2) Imposes moral check on client staff.
- 3) Helpful for speedup the final audit.
- 4) Useful for publication of interim figures.
- 5) Audit becomes easy and can be completed without lapse of time.

4. **Balance sheet audit :** - Balance sheet audit is a type audit which concentrates mainly on the verification of the items in the balance sheet such as capital, reserves, profit and loss account balance, liabilities and provisions and all the assets of the business.

5. **Occasional Audit:-** An occasional audit is an audit which is conducted once a while, whenever the need arises. In other words , it is a kind of audit which is not conducted on regular basis, but is conducted for a special event, time or purpose.

6. **Complete Audit :** - Complete audit is a kind of audit under which all the records and books of accounts are audited by an auditor.

7. Partial Audit: - It is a kind of audit the scope of which is limited one. It is carried out in respect of only a part of the books of accounts of a business, for a part of whole of the period.

4. **Classification of audit on the basis of specific objectives:** -

1. Cash Audit: - It is a type of partial audit which is undertaken for only cash receipts and cash payment.

2. Special Audit:- It is a kind of audit with some special object in view. It is a fact finding enquiry.

3. Operational Audit: - It is an efficient examination of the various operations of the different functional area of business.

4. Proprietary Audit: - It is an audit in which various actions and decisions are examined to find out whether in public interest and whether they meet the standard of conduct.

5. Efficient Audit: - It is an evaluation of overall efficiency and performance of an organization.

6. Tax Audit: - It means audit for tax purpose. Audit required to be carried out of income tax act of 1961. It is conducted by certified Chartered Accountant.

There are certain circumstances in which tax audit is necessary.

1. Compulsory tax audit under section 44 AB of the Income tax Act 1961
2. Tax audit for claiming deductions and Reliefs under the Income Tax Act.
3. Tax audit for Tax Consultancy and Representation.

7. Cost Audit.

It is a thorough examination of the cost accounting records of a company by a cost auditor to ensure that they are accurate and they also follow to the cost accounting principles, procedures and plans.

Objectives.

- 1) Verifying the accounting entries related in the cost books.
- 2) To find out whether the cost records have been properly maintained.
- 3) To verify whether the cost accounting principles are complied with.
- 4) To find out whether the cost statements are properly dream up.
- 5) To verify the items of cost expenditure are correctly incurred.
- 6) To find out the efficiency and inefficiency of handling of material, labour and other expenses.

- 7) To check up the overall working of the cost accountant.
- 8) To reduce the volume of work of the external auditor.
- 9) To detect errors and frauds.

8. Management Audit.

It is the critical examination, scrutiny and appraisal of plans, policies, procedures, objectives, means and operational area of the organization.

It is the audit of managerial actions and decisions. It is the audit of activities of various level of the managers.

Objectives of Management audit: -

1. To identify the overall objectives of an organization.
2. To pinpoint the deficiencies and defects in functional areas and suggest remedies for improvement.
3. To assist the various level of management in discharge their duties.
4. To help the management in achieving co- ordination among the various departments.
5. To ensure that management objectives are achieved.

Advantages of Management Accounting: -

1. It identifies the overall objectives of the organization.
2. It reviews plans, policies, procedures and controls.
3. It assesses the performance in each functional area
4. It also ascertains the motivational system in operation in the business.
5. Suggesting ways and means for the attainment of management goals.

Criticism against management audit: -

1. It is argued by some managers and accountant that management audit is a vague concept and so, it serves no material purpose.
2. Management audit may discourage the managers from undertaking tasks which are useful to the organization.
3. It is argued that it will adversely affect to the efficiency and production.

9. Social Audit: - Social audit is a systematic study and evaluation of a business enterprise's social performance as distinguished from its economic performance. Social audit is intended to evaluate the social performance or social contribution of a business organization. TISCO firstly adopted social audit.

Preliminary stage of audit work or Preplanned activities of the audit work or Steps to be taken by the auditor before commencement of the audit or audit planning : -

An auditor must prepare well before he actually commences a new audit. He has to take certain steps or bear in mind certain considerations before commencing a new audit. These steps are known as preliminary steps or general steps.

The following are the important preliminary or general steps to be taken by an auditor in all types of concerns before the commencement of a new audit:

- I. Obtaining letter of appointment.
Auditor should satisfy himself that he has properly appointed.
- II. Knowing the scope of his studies.
- III. Ascertaining the nature of the business undertaken by the client enterprise.
- IV. Knowledge of the organizational structure of the client business.
Pattern of authority and responsibility are revealed through the organizational structure.
- V. Obtaining the list of principal officers of the client business.
- VI. Knowledge of internal check, internal control and internal audit
- VII. Knowledge of system of accounting of the client business.
- VIII. List of books maintained in the organization.
- IX. Detailed study of important documents of the organization.
- X. Study of prospectus, preliminary contracts etc of the organization.
- XI. Study of the previous year financial statements.
- XII. Enquiry about the reason for the change of the auditor.
- XIII. Giving instructions to the client.
 - a) The books should be closed before the audit.
 - b) Voucher should arranged date wise.
 - c) Schedules should be kept for ready reference such as schedules of debtors and creditors, list of bad and doubtful debts, schedule of investment, schedule of depreciation etc..
- XIV. Division of audit work among the auditors.
- XV. Preparation of audit program.

Audit techniques

Techniques of audit are the methods or means adopted by an auditor for the collection and evaluation of audit evidences for his audit work.

Important audit techniques are

1) Vouching

2) Confirmation

It is the technique through which an auditor communicates with outside parties.

3) Enquiry

Enquiry is the technique of making enquiries with the responsible officials of the client and obtaining in depth information.

4) Reconciliation

It is the technique of identification and explanation of the items which cause the difference between two related items.

5) Physical examination

It is the technique of ascertaining the actual existence.

6) Test checking

7) Analysis of financial statements

8) Scrutiny or scanning

It is the technique of making a quick and overall examination of books of accounts to verify whether the transactions are correctly and completely recorded in the books of account.

9) Extension verification

It is the technique of multiplying two or more amounts to verify whether the totals have been correctly arrived at.

10) Posting verification

11) Documentary examination

12) Observation

It is the technique by which an auditor observes or witnesses an act performed by others.

13) Footing

Footing is the technique of adding the columns of different accounting figures to test the accuracy of the total.

14) Flow charting

It is the technique of using flow chart to describe graphically the cause of the transactions through different stages from the beginning to the end.

Auditing and Assurance standards: - An auditor Should have a thorough understanding of the auditing practices that are generally accepted as standards to conduct his audit effectively. For this purpose , he has to study and understand the professional announcement on auditing.

The objective of auditing and assurance standards issued by the ICAI is to secure compliance by the members of the institute on matters which are important for the proper discharge of their audit work.

Various Auditing and Assurance Standards issued by ICAI :

1. AAS 1 : Basic principles governing audit
2. AAS 2 : Objective and Scope of financial Audit
3. AAS 3: Documentation
4. AAS 4: Fraud and error
5. AAS 5 : Audit Evidence
6. AAS 6 : Risk Assessment and Internal Control
7. AAS 7 : Relying upon work of an Internal Auditor
8. AAS 8 : Audit planning
9. AAS 9: Using the Work of an Expert.
10. AAS 10 : Using the work of another Auditor.
11. AAS 11 : Representation by Management.
12. AAS 12 : Responsibility by joint Auditors.
13. AAS 13 : Audit Materiality
14. AAS 14: Analytical Procedures.
15. AAS 15 : Audit Sampling.
16. AAS 16: Going Concern Assumption.
17. AAS 17: Quality Control for Audit work.
18. AAS 18 : Audit of Accounting Estimate
19. AAS 19 : Subsequent events.
20. AAS 20 : Knowledge of the Business
21. AAS 21: Consideration of Laws and regulations in an Audit of Financial Statement.
22. AAS 22 : Initial Engagement

23. AAS 23 : Related Parties
24. AAS 24: Audit Consideration relating to Entities using Service Organisations.
25. AAS 25: Comparatives
26. AAS 26 : Terms of Audit Engagement
27. AAS 27 : Communication of Audit Matters with those entrusted with Governance.
28. AAS 28 : Auditor's Report on Financial Statements.
29. Audit in Computer information system Environment

AAS – 1 :Basic principles governing an audit: - The basic principles governing an audit are:

1. Integrity, objectivity and independence: - This principle suggests that an auditor must be straight forward, honest sincere, fair and objective in the performance of his professional duties.
2. Confidentiality: - This principle implies that the auditor must not disclose any information acquired by him in the course of his audit work to any person.
3. Skills and Competence: - This principle means that an audit should be performed and the audit report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.
4. Work performed by Others : - This principle implies that when an auditor delegates his work to his assistants or uses the work performed by other auditors and experts , he will continue to responsible for performing and expressing his opinion on the financial statement.
5. Documentation : - This principle implies that all matters which are important in providing evidence that audit was carried out in accordance with basic principles should be adequately documented.
6. Planning : - This principle suggest that an auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.
7. Audit evidence : - This principle implies that an auditor should obtain sufficient appropriate evidence to draw reasonable conclusions.
8. Accounting system and Internal Control : - This principle suggests that an auditor should reasonably assure himself that the accounting system and internal control are adequate.

9. Audit conclusion and reporting : - This principle implies that an auditor should review and assess the conclusions drawn from the audit evidence obtained.

AAS – 2: Objective and scope of Financial Audit: - This Standard deals with (a) the objective of an audit, namely, the expression an opinion on the financial statements and (b) the scope of audit, which is determined by the terms of his engagement, requirement of the law and the pronouncements of the ICAI. As per these standards an auditor is required to satisfy himself as to reliability and sufficiency of information as contained in the accounting records.

AAS – 3: Documentation: - This standards deals with documentation of important evidentiary matters. It provides detailed guidance on the form, content and custody of working papers.

Working papers are the written private materials which an auditor prepares for each audit. They describe the accounting information which he has received from his client, the method of examinations used and conclusions about the financial statement

AAS – 4 : Fraud and Error : - This standard deals with an auditor's responsibility for detection of fraud and error, while carrying out an audit.

AAS – 5: Audit evidences: - This standard deals with an auditor's duty to obtain sufficient appropriate evidence which enables him to draw reasonable conclusions.

AAS-6: Risk Assessment and internal control: - This standard deals with the procedures to be followed by an auditor to obtain an understanding of the accounting and internal control system and audit risk.

AAS – 7 : Relying upon work of internal auditor: - This standards seeks to provide guidance regarding the procedures to be followed by the external auditor in assessing the work of an internal auditor.

AAS – 8 : Audit Planning: - This standards lists the advantage of audit planning which is necessarily to conduct an effective audit in an efficient manner.

AAS – 9 : Using the work of an expert: - This standard recognizes the need for an auditor to use the work of an expert for any work.

AAS – 10: Using the work of another auditor: This standard highlights the procedure to be followed be principal auditor while using the work .

MODULE 2

INTERNAL CONTROL

Internal control is the whole system of control established by the management for the proper conduct of various activities of the organization. It is not only internal check and internal audit but also the whole system of control financially and otherwise established by the organization in order to carry out the business in orderly and efficient manner.

It is useful for the organization to safeguard the assets and serve the reliability of accounting records. In other words, it is the overall control adopted by the organization.

Features: -

- 1) It is the overall control adopted by the management.
- 2) It comprises of plans, methods and procedures for the effective control of the operations of the business.
- 3) It comprises of internal check, internal audit, accounting system and administrative control.
- 4) It is established by the management.
- 5) It intended to help the management to run the business efficiently.

Objectives: -

- 1) To ensure that transactions are recorded proper books of account.
- 2) See that all transactions are carried out only on account of a sanction of authority.
- 3) See that management policies and decisions are properly implemented.
- 4) To ensure efficient conduct of business.
- 5) To evaluate the efficiency of performance of the various personnel.
- 6) To safeguard the assets of the organization.
- 7) To safeguard the interest of the organization.
- 8) To ensure reliability of accounting records.
- 9) To ensure the periodical verification of assets.

Scope or Area of internal control.

1) Accounting Control.

It ensures the reliability of accounting transactions. Accounting transactions are recorded by using accounting principles.

2) Administrative Control.

It is concerned with distribution of authority and decision making process of management. Overall operation efficiency of the organization is ensured.

Essentials of Good internal Control: -

1) It should be clear and well developed plan of organization.

2) There should be competent and trust worthy personnel for the success of the business.

3) There should be segregation of duties: - Operational duties are separated from recording duties. Physical handling of asset must be separated from accounting records.

4) There should be administrative traditions and practices for the performance of the duties.

5) There should be well developed and adequate accounting system.

6) There should be a sound system of maintenance and recording of accounts.

7) There should be effective internal check system.

8) There should be good audit system.

9) Periodical review of internal control.

Advantages.

A. Advantages to the business.

1) Provide accurate and reliable data to the management for taking correct decisions.

2) Ensure that policies and procedures are complied with.

3) Promotes operational efficiency.

4) Help to attain organizational goal.

5) To safeguard the assets of the organization.

6) To ensure the reliability of accounting records.

B. Advantages to the auditors

- 1) Helps the auditor in framing the audit program.
- 2) To ascertain extent of test check can apply.

Limitations of Internal control

- 1) Expensive.
- 2) Transactions of unusual nature may not be subject to internal control.
- 3) Human errors remain in any system of control.
- 4) Limitation of preventing frauds committed through collusion between persons.
- 5) It may not be keep pace with the change in the condition.

Internal check

It is an arrangement of accounting work under which the work of one person comes under the security of another person. So, that it is not possible to commit fraud without collusion between two or more persons. In other words, it is an arrangement of accounting system under which no one person is allowed to carry out one work completely

Specialization & division of work is important one. The work of one staff is automatically checked by another person in order to locate errors and frauds.

Advantages.

A. Advantages to business

1. Proper division of work
2. Fixation of responsibility
3. Greater efficiency of the staff.
4. Increased carrying capacity.
5. Early detection of errors and frauds.
6. Easy preparation of final account.
7. Truth and accuracy of accounting can be available.

B. Advantages to Owners.

1. Genuineness and accuracy of the account.
2. Overall efficiency, economy in operations, increased profit etc..

C. Advantages to Auditor

1. There is no need for detailed examination of book of accounts.
2. It reduces burden.

Objectives.

- 1) Proper division of work.
- 2) Minimization of errors and frauds.
- 3) Easily detection of errors and frauds.
- 4) Ensures the reliability of accounts.
- 5) Easily preparation of final accounts.
- 6) Simplification of the external auditors work

Limitations.

- 1) Suitable only for big concerns.
- 2) Sacrifice of quality for quickness.
- 3) Certain type of disorder, confusions etc... in the working of the organization.
- 4) Useful only when there is no collusion between employees.
- 5) Risky for the auditor.

Principles and essential of good internal check system.

- 1) Simple, easy workable and effective.
- 2) Not be too expensive.
- 3) Carefully devised and properly regulated.
- 4) Authority should be clearly defined.
- 5) Proper division of responsibility.
- 6) Division of work among the staff.

- 7) Work of similar nature should be entrusted with one person to ensure specialization.
- 8) No individual should be allowed to perform one work completely.
- 9) Work should be distributed in such a way that the work of one staff is automatically check another.
- 10) No employee should be allowed to remain a particular job for a long period.
- 11) No employee of the concern should be rely upon too much.
- 12) Proper reporting to the management.
- 13) Proper system of filing vouchers.
- 14) Safeguards should be prescribed for the safe custody of unused cheque book, securities etc...
- 15) There should be a self balancing ledger system.
- 16) All incoming letter should be opened by responsible officers.
- 17) The receipt of cash and disbursement should be entrusted to different personnel.
- 18) Cashier should have no access to ledger.
- 19) All remittance received should be deposited in a bank immediately.
- 20) All cash payments should be made by a cheque.
- 21) Cash and bank balance should be verified frequently.
- 22) Petty cash payment should be on imprest system.
- 23) There should be effective control of receipts and issue of goods.
- 24) There should be a perpetual inventory system.

Difference between internal control, internal check and internal audit

Internal Control.	Internal check.	Internal audit.
It is the whole system of control established by management.	It is the arrangement of accounting work under which the work of one person comes under another.	Continuous review of records by staff appointed for the purpose.

<p>Scope of internal control is very wide. it includes internal check and internal audit. The objective is to safeguard the asset of enterprise.</p> <p>There is no separate staff.</p> <p>Internal control is exercised when the work of employees in progress.</p> <p>Any organization can adopt internal control.</p>	<p>Scope of internal check is less.</p> <p>Objective is to locate errors and frauds.</p> <p>There is no separate staff</p> <p>Internal check is exercised when the work of employee is in progress.</p> <p>Any organization can adopt internal check.</p>	<p>Scope of internal audit is less that of internal control wider than internal check. The object of internal audit is to assure the management that the system of internal control and internal check in operation are in effective in design and operation.</p> <p>It is conducted by the staff specially appointed for the purpose called as internal auditor.</p> <p>It is undertaken by the auditor after the work has been completed.</p> <p>Internal audit is adopted only those concerns which really need it</p>
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Procedure of Audit: -

The way in which the audit work should be conducted by the auditor.

- 1) Routine checking
- 2) Test checking
- 3) Surprise checking.
- 4) Audit in depth.
- 5) Adoption of distinctive tick mark, check mark etc...

1. Routine checking.

It is the checking and casting common books of accounts by the auditor. It involves following activities.

- a) Checking, casting and sub casting of such books.
- b) Checking of posting into ledger book.
- c) Checking the balances transferred from one book to another

Common Books.

Sales ledger, private ledger, wage sheet , general ledger, debit note, credit note, all subsidiary books like cash book, purchase book, journal proper etc..

Advantages of routine checking

- 1) It facilitate through checking of books of original entry.
- 2) Posting under routine checking, posting are completely checked.
- 3) Thorough checking of casting and posting are involved.
- 4) Verifying the arithmetical accuracy in the entries.
- 5) Clerical errors and ordinary frauds are located through routine checking.
- 6) It constitutes the basis of entire audit.
- 7) It ensures there is no alteration of figures.

Limitations of routine checking

- 1) It is purely a mechanical checking.
- 2) It is not important in an organization where self balancing system is in operation.
- 3) Simple type of errors and frauds can be located

2. Test Checking.

Testing of test checking means to select and examine a representative sample from large number of similar items. The main objective of test checking is to select representative item and examining it and conclusion is drawn from all of the items.

Essentials of Test Checking

- 1) The success of test checking depends upon the system of internal check in operation.
- 2) The sample should be selected at random.
- 3) Transaction should be selected only representative of the whole of the group.

- 4) Homogeneous transactions are taken into account.
- 5) Selection of sample should be made without bias.
- 6) Test checking is not applicable in cash book transactions.
- 7) No indication should be given to small organization.
- 8) It is not applicable to first month and last month transactions.
- 9) It is not applicable to checking of opening and closing balance.
- 10) If the transactions are non-recurring in nature it is not applicable.

Advantages.

- 1) Complete the audit work in a short time.
- 2) The volume of work of the auditor is reduced to certain extent.
- 3) It ensures better accuracy of the book of account if selection is made on properly.
- 4) It ensures examination of efficiency of the internal check system of the organization.

Limitations

- 1) All of the errors and frauds cannot be detected.
- 2) Test checking increase the responsibility of the auditor.
- 3) The staff of the client may become careless.
- 4) The current financial position cannot be revealed.

3. Surprise checking.

A system under which the auditor make surprise visit to the organization and check the important items i.e. the verification of the cash book, investment, examination of entries related to stock and stock items and examine the book of original entry.

4. Auditing in depth: - Examination of selected item in depth or to the origin to conclusion. Generally it is adopted where internal control is not effective.
5. Adoption of distinctive tick mark, check mark etc: -

For the purpose of audit the auditor can use the ticks, tick marks, check marks etc to indicate the work done by the auditor.

- 1) Different type of tick should be used in different type of audit work.

- 2) It is better to use ballpoint pen instead of pencil.
- 3) Tick of different colours for different audit.
- 4) Tick should be too small.
- 5) Tick should be clear and simple.
- 6) Tick should not be mixed up with the figures shown in the book of account.
- 7) Clear instructions must be provided to the client for the use of tick mark.
- 8) Tick of client staff and audit staff should be distinctive.

MODULE 3

PROCEDURE OF AUDIT

Audit procedure refers to the way in which the audit work should be conducted. It is the procedure followed by an auditor for the actual conduct of his audit work.

There are certain aspects of audit procedure which are common in all audit works. They are:

1) Routine checking:- The checking of castings and postings of the common books of the organization is called routine checking. In other words it is the checking of subsidiary books and ledger accounts by an auditor. Routine checking involve the following operations,

- a) Checking of the castings, sub castings, carry forward and other calculations in the books of original entry
- b) Checking of the postings into the ledgers
- c) Checking of the casting and balances in the ledgers
- d) Checking of the transfer of the balances from the ledgers to the trial balance.

Generally, routine checking is conducted for the following books

- a) Cash book
- b) Petty cash book
- c) Purchase book
- d) Sales book
- e) Purchase return book
- f) Sales return book
- g) Bills receivable book
- h) Bills payable book
- i) Journal proper
- j) Sales ledger
- k) Purchase ledger
- l) Private ledger
- m) Wages and salaries book

n) Stock sheet

Advantages of routine checking

- 1) It facilitates thorough checking of the books original entry
- 2) Under routine checking, postings are completely checked
- 3) It helps in verifying arithmetical accuracy of the entries in the books of accounts
- 4) Clerical errors and simple frauds are located by routine checking
- 5) Checking of posting and casting is helpful in preparation of trial balance
- 6) It is easy and simple job which can be done by any audit clerk

Disadvantages of routine checking

- 1) It can reveal only arithmetical errors and ordinary frauds
- 2) It is a mechanical checking, so it causes monotony
- 3) It is not important in the audit of a concern where self balancing system is in operation

2). **Test checking** or **sample checking** or **selective verification**:-

Test checking means checking by an auditor, a few transactions selected at random here and there so as to form his final judgement on the whole set of transactions. It means to select and examine representative sample from a large number of similar items. Test checking involves sampling.

One objective of test checking is to arrive at characteristics present in the mass transactions from the checking of representative sample.

Conditions or essentials or precautions of test checking:-

- 1) The success of test checking largely depends upon the system of internal check in operations the business.
- 2) The sample selected for test checking should be at random.
- 3) It should be applied only to homogeneous transactions.
- 4) The sample of test checking should be selected without bias.
- 5) One selection of sample should be made in such a way that it covers the work of each of the staff of the client.

Test checking should not be applied to cash book items.

No indication should be given to client as regards the method of test checking.

One sample for test checking should be selected by the auditor himself.

There are certain transactions which are not suitable for test checking. They are;

- 1) Opening and closing entries.
- 2) Cash book entries.
- 3) Transactions of seasonal industry.
- 4) Non recurring transactions.
- 5) Bank reconciliation statement.
- 6) Items which are significant.
- 7) Transactions which are required by law is to be checked carefully.

Advantages:-

- 1) It helps the auditor to complete the audit work in a short time.
- 2) It helps in reducing the cost of audit.
- 3) It enables the auditor to undertake the audit of many concerns simultaneously.
- 4) It keeps the client staff alert and conscious.
- 5) If selection is done intelligently, test checking ensures the accuracy of books of account.
- 6) It ensures the periodic examination of the system of internal check.

Disadvantages:-

- 1) Test checking may fail to detect errors and frauds, if selection is not done intelligently.
- 2) Test checking increases the responsibility of the auditor.
- 3) Where there is test checking, the staff of the client may become careless.
- 4) Through test checking, an auditor may not get a true position of the financial state of affairs of an undertaking.

Surprise checks

Surprise checks constitute a system under which an auditor makes a surprise checking of some of the important items. Surprise check, wholly cover;

- a) Verification of cash.
- b) Verification of investment.
- c) Verification of records relating to stocks and stores.
- d) Verification of books of original entry.

Audit in Depth:-

Audit in depth means the examination of the selected items in depth or in detail from the origin of the transactions to fair conclusions. In other words, it

means step by step verification of selected items or transactions from the beginning to the end.

Adoption of distinctive ticks ,tick ,marks or check marks:-

In the cause of audit work, an auditor uses variety of marks or symbols to indicate the work that has been done. These marks or symbols are known as ticks or check marks or check signs.

Ticks are much significant to an auditor. They are useful to the auditor in the following respects;

- a) Ticks help the auditor to know the checking that has been done by the earlier.
- b) By means of ticks made earlier, an auditor can easily find out the alterations in the books account made subsequent to the audit.
- c) Ticks facilitates tracing of processes and documents connected with the transactions and thereby increase the efficiency of audit.

Points to be noted or precautions to be taken while using ticks:-

- 1) Different types of ticks should be used for different audit works.
- 2) Ticks should be small.
- 3) It should be clear.
- 4) It is advisable to use only pens or ball pens.
- 5) It is advisable to use ticks of different colours for different purposes.
- 6) Tick should not get mixed up with the figures shown in the books of account.
- 7) Ticks used by the client staff are not used by the audit staff.
- 8) Special ticks must be used for items which require special attention.

Vouching:-

Vouching is the act of checking or examining the entries made in the books of account with the supporting the documentary evidences or vouchers.

In the words of .L.R DICKSEE ,”Vouching is an act of comparing entries in the books of account with the documentary evidence in support thereof”.

Objectives of vouching:-

- 1) The principal objective of vouching is to ensure that the transactions, as recorded in the books of accounts, are acceptable, genuine, properly authorised and correctly recorded.
- 2) Another objective of vouching is to ensure that all the entries made in the books are supported by necessary documentary evidence.

- 3) To see that all the transactions connected with the business have been recorded in the appropriate books of account.
- 4) To ensure that no transactions, which is not connected with the business, has been recorded in the books of accounts.
- 5) Detection of errors and frauds.

Importance of vouching:-

Vouching constitutes the foundation upon which the super structure of auditing is erected. It is the back born of auditing. In the words of F.R.M De Paula, vouching is the essence of audit.

Vouching can be regarded as the essence or back bone of auditing for the following reasons.

- a) The success of an audit largely depends upon the care and attention with which vouching is accomplished.
- b) Vouching is the most potent tool in the hands of an auditor to ascertain the accuracy of the transactions recorded in the books of account.
- c) To see that all the transactions connected with the business have been recorded in the appropriate books of account.
- d) To ensure that there are no transactions, which are not connected with the business, has been recorded in the books of accounts.
- e) Detection of errors and frauds
- f) Vouching ensures the arithmetical accuracy of the books of account.
- g) If vouching is done with care and caution, the auditor can smoothly proceed further in his work.

Vouchers:-

A voucher is the documentary evidence in support of a transaction recorded in the books of account. It is a documentary evidence of an entry in a book of account. The following are the some of the examples of vouchers:

- a) Receipt obtained from a payee.
- b) Counter foil of a receipt.
- c) Purchase invoice.
- d) Sales invoice.
- e) Cash memo.
- f) Bank pay-in-slip.
- g) A contract or an agreement.
- h) A resolution passed at the meeting of the board of directors.

- i) Minutes of a meeting.
- j) Bought notes.
- k) Sold notes.
- l) Debt note.
- m) Credit note.
- n) Wages sheet.
- o) Salary register
- p) Goods inward book.
- q) Goods outward book.

Types of vouchers:-

- 1) Primary vouchers:- a primary voucher is written evident in original. Purchase invoice, cash memos for goods purchased etc. are examples.
- 2) Collateral or secondary vouchers:- even evidences in original are not available, copies of the evidences are produced in support. Again, sometimes, subsidiary evidences are also provided for the purpose of audit. Such vouchers are usually known as collateral or secondary vouchers.

Essentials of vouchers or points to be noted by the auditor while vouching the vouchers:-

- 1) Vouchers are consecutively numbered, arranged serially in the order of the entries and are properly filed.
- 2) Vouchers are in the name of the client.
- 3) See the teach voucher is genuine on its face.
- 4) Voucher is certified as correct by a responsible official.
- 5) The amount of each voucher is written in words and figures.
- 6) Every voucher, which is a receipt for cash payment over Rs 5000, bears a revenue stamp of Rs 1.
- 7) Alteration made in a voucher is properly signed by the maker and approved by a responsible official.
- 8) Any explanation is desired with to any voucher, the same should be noted in the audit note book.
- 9) Missing vouchers produced, the auditor should do,
 - a) Prepare a list of all such missing vouchers
 - b) Call for explanation from the concerned official from the loss of original vouchers

- 10) If any voucher requires a special scrutiny, the auditor should proceed cautiously and use special ticks for checking.
- 11) As far as possible the auditor should complete the vouching work relating to a particular period in continuous sitting.
- 12) The auditor should not take the help of any staff while vouching the vouchers.
- 13) Test checking may be resorted only in exceptional circumstances.

Vouching of cash book or cash transactions.

Cash transactions take place almost every day in business. An auditor should give care and attention to the vouching of cash transactions.

The main objectives of vouching of cash transactions are,

- 1) To ensure that all receipts of cash are duly accounted for.
- 2) To ensure that no improper payments are made.
- 3) To see that all receipts and payments of cash are actually and properly recorded.
- 4) To see that all payments have been made to proper persons and the payments are true payments.
- 5) To see that cash and bank balance correct and really exist.

Vouching of cash book or cash transaction covers the vouching of receipt side and vouching of payment side.

Vouching of receipt side or debit side of cashbook or cash receipt transactions:-

Vouching of cash receipt transactions is more difficult than that of cash payment transactions, since there is greater chance of manipulation in regard to cash receipt.

The auditor should bear in mind the following points, while vouching the cash receipt transactions.

- 1) The auditor should carefully examine the system of internal check in operation with regard to cash receipt transactions.
- 2) An auditor can resort to test checking only if he has satisfied himself that there is an efficient system of internal check.
- 3) He should ascertain whether a diary of cash receipt or rough cash book has been in use. If a rough cash book has been in use, he should examine the entries in the rough cash book and compare with the entries in the ash book.

- 4) He should examine the methods of depositing daily receipts into the bank.
- 5) He should check the bank pass book with the entries in the cash book.
- 6) He should vouch cash receipts by reference to documentary evidences.
- 7) He should enquire into the system of allowing discounts, the rate of discount allowed etc.
- 8) He should enquire into the bad debts written off. He should satisfy himself the bad debt written off are authorized by a responsible person.

He should ensure whether there is a proper control over use of receipt book. In this context, he should keep in mind the following points:

- a) All receipts are on printed forms.
- b) See that receipt book should be consecutively numbered.
- c) The receipts have to be signed by a responsible officer.
- d) The unused receipt book should be kept in safe custody.
- e) All spoiled receipts should remain attached to the counter foils.

Vouching of the important items on the debit side of the cashbook or cash receipt transactions.

1) **Opening balance:-**

The opening balance of the cash book should be vouched by comparing it with the closing balance of cash book as shown in the audited copy of the balance sheet of the previous year,

2) **Cash sales:-**

The vouching procedure in regard to cash sales should be on the following lines:

1. He should examine the system of internal check in operation in regard to cash sales.
2. After ascertaining the efficiency of the internal check system as regards cash sales, auditor should vouch the cash sales as follows:
 - a) Cash memos written by the salesman should be checked with the summary sales prepared at the end of the day.
 - b) He should examine the rough cash book, if any.
 - c) He should check up the rough cash book with the main cash book.
 - d) The summaries of daily sales should be checked with the entries in the stock register.

- e) He should verify the daily deposit of cash received into the bank, pay-in-slip also should be vouched.

3) **Receipts from debtors:-**

While vouching the receipts from debtors, an auditor should bear in mind the following points:

1. He should enquire into the system of internal check in operation in regard to the receipt from debtors.
2. After satisfying himself about the efficiency of internal check in operation in regard to the receipt from the debtors, the auditor should conduct the vouching of receipts on the debtors on the following lines:
 - a) He should check the total cash received from the debtors by verifying the rough cash book with the counter foils of the receipts issued to customers.
 - b) He should check the cash book with the rough cash book.
 - c) He should check the details of cash and cheques paid into the bank.
 - d) He should enquire into whether bad debts are written off by a competent authority.
 - e) He should verify the balances due as per the schedule of debtors with letters of confirmation received.
 - f) He should be alert to the possibility of teeming and lading.

4). **Receipts from bills receivable:-**

Bills receivable include bills of exchange, promissory notes, and I.O.U's received from debtors. The receipts from bills receivable can be in two ways:

1). Receipts from bills discounted

The vouching of receipts from bills discounted should be as follows:

- a) The amount of cash received from bills discounted should be checked by comparing the bills discounted book with the cash book, pass book, B/R book.
- b) See that proper records have been made in the books for discount on bills discounted.
- c) He should determine the contingent liability in respect of bills discounted but not matured on the date of the balance sheet.

2). Receipts from bills matured

- a) The auditor should check the cash received from bills matured by comparing the bills receivable book with the cash book and the pass book.
- b) Special attention should be given to bills which have matured but remain unpaid.

5). Receipts from sale of investment

Vouching of receipts from the sale of investment should be on the following lines:

- a) Investments are usually sold through brokers, as such, broker's sold notes or contract notes should be examined to vouch the amount from the sale of investments.

If the sale of investment has been effected through the bank, then, the bank advice should be examined to vouch the amount received from the sale of investments.

- b) The sale proceeds of the investments should also be checked with the related investment account with the stock market quotations.
- c) If the investment has been sold cum-dividend, the auditor should see that the sale proceeds are properly apportioned between capital and revenue receipt.
- d) If the investment has been sold ex dividend, the auditor should see that the dividend is received and recorded.
- e) He should see that the profit or loss on the sale of investment is properly adjusted.
- f) If the investments are pertain to some ear marked funds, the auditor should see that the profit or loss on the sale is transferred to the ear marked fund a/c.

6). Receipt from the sale of fixed assets

Vouching of receipts from the sale of fixed assets should be on the following lines:

- a) The auditor should see that the sale of fixed asset is properly sanctioned.
- b) If the sale of fixed assets is through a broker, the proceeds of the fixed assets sold should be vouched with the help of sold notes. In the case of sale of fixed assets is through an auctioneer, the sale proceeds should be vouched with the help of the auctioneer's note. He can verify the cash receipt in the cash book with the counter foil or carbon copy of the receipt issued to the party. He may also vouch the sale proceeds of fixed assets

with the correspondence with the parties and the sale contracts and the fixed asset a/c.

- c) He should see that proper fixed asset a/c has been credited with the sale proceeds.
- d) If there is any profit, the auditor should see that it is credited to capital reserve.
- e) In the case of certain prepaid expenses in respect of fixed assets, the auditor should check whether suitable adjustments are made in the expenses accounts.

7). **Loan received**

Vouching of loan received should be on the following lines:

- a) He should ascertain that whether client is empowered to borrow money.
- b) In the case of a joint stock company, he should verify whether the legal provisions have been complied with.
- c) He should verify the loan agreement to ascertain the terms and conditions on which the loan has been received.
- d) If the loan is secured, he should ascertain what security has been offered and the value of security offered.
- e) He should ensure that the loan amount received is recorded in the books of account.
- f) If the interest on loan is unpaid, the auditor should see that it is properly adjusted.

8). **Dividend on investment**

- a) The auditor should verify the dividend received is recorded in the cash book with the counter foils of the dividend warrants.
- b) To see that dividends have been received in the dates.
- c) If the dividend is sold ex-dividend, see that dividends are subsequently received are entered in the cash book and credited to dividend account.

9). **Subscription received**

10). **Insurance claim received**

11). **Commission received**

12). **Rent received**

13). **Royalty received**

Vouching of cash payments or credit side of the cash book.

While vouching cash payments, an auditor should pay attention to the following points.

- 1) All vouchers relating to cash payments should be serially numbered and properly arranged.
- 2) He should insist that the vouchers are properly dated.
- 3) He should evaluate the system of internal check in operation with regard to cash payments and satisfy himself as to the efficiency of the internal check.
- 4) He should see that:
 - a) The cash payments are for the purpose of the business.
 - b) Payments are related to the period under audit.
 - c) The payments is properly sanctioned or authorized.
 - d) The payments are made to the right person.
 - e) The payments are supported by proper vouchers.
 - f) The payments are properly recorded in the cash book.
- 5). Examine the rough cash book items and compare it with the main cash book.
- 5) See that the payments made are posted to the concerned accounts.
- 6) See that the amount appears in the vouchers both in words and figures and it agrees with the amount in the cash book.
- 7) Ensure that the payments have been passed as correct by a responsible official.

Vouching of different items on the payment side or credit side of the cash book

1)Opening credit balance

The opening credit balance in the bank column can be verified from the previous year's audited balance sheet.

2)Cash purchases

The vouching of the cash purchases should be on the following lines.

- 1) The auditor should examine entries in the cash book with the help of cash memos or invoices issued by the supplier and also goods inward book.
- 2) Special attention should be paid to trade discount, which should be deducted from purchase.

- 3) See that the cash paid for the goods have actually received.
- 4) He should see that the purchases are duly authorised.
- 5) He should see that the amount paid is debited to the appropriate account.
- 6) To ascertain whether payment made for cash purchases relates to the business.

3). **Payments to creditors**

Vouching of payment to creditors should be on the following lines.

- 1) Payments to creditors may be vouched with the receipts issued by the creditors.
- 2) He should check the amount due to the creditors with the accounts of the creditors.
- 3) Examine the goods inward book and see that goods have actually been received.
- 4) The auditor should verify the periodical statement of accounts.
- 5) In the case of purchase made before the close of the year, see that goods not actually received are kept out of the closing stock of the year.

4). **Payment of bills payable**

Payment of bills payable on their maturity should be vouched on the following lines.

- 1) The payment of bills payable, as recorded in the cash book, should be vouched with the bills payable book and also with the bills payable returned by the payees.
- 2) If the bills payable are through the bank, the auditor should examine the bank pass book for the payment.
- 3) He should see that bills payable paid and returned by the payees are cancelled.

5). **Vouching of loans advanced**

Loans advanced should be vouched by the auditor on the following lines.

- 1) He should see that loans advanced are properly authorised.
- 2) He should examine the loan agreement.
- 3) He should vouch the loan advanced as recorded in the cash book with the loan agreement also with the receipt given by the borrower.

- 4) If the loan is advanced against any security, the auditor should examine the security and its title deeds.
- 5) Examine the mortgage deed, if the loan is advanced against mortgage.
- 6) See that the provisions of the companies Act as regards the granting of loans to directors and officers of the company are complied with.

6). **Purchase of investment**

Vouching of purchase of investment should be on the following lines.

- 1) The auditor should see that the purchase of investment is properly authorised.
- 2) If the investments are purchased through a broker, he should vouch the investments purchased with the broker's note.
- 3) If the investments are purchased through the bank, he should examine the bank pass book to check the payment.
- 4) He should make a physical verification of the investment purchased.
- 5) If the investments are purchased cum interest, he should see that the payment made is properly allocated between capital and revenue.
- 6) See that investments purchased are registered in the name of the client.
- 7) In the case of accompany, the auditor should see that investments have been purchased in accordance with the provisions of the companies Act.

7). **Payment of capital expenditure**

The payment of capital expenditure refers to the payment made for the acquisition of the fixed assets such as land & building, plant & machinery, patent, copy right, furniture etc.

Vouching of payment of capital expenditure should be on the following lines.

- 1) The auditor should see that the payment of capital expenditure is properly authorised.
- 2) He should examine the document pertaining to the purchase and ownership of the fixed assets.
- 3) He should examine the invoices and the receipts obtained from the suppliers to ensure that payments have been made.
- 4) He should see that all expenses incurred for the acquisition are capitalised.
- 5) He should see that repairs and maintenance expenses incurred are charged to revenue account.

- 6) He should physically examine the fixed assets purchased.
- 7) He should vouch the cash boom entries for the payment of capital expenditure with the concerned ledger account.
- 8) See that property purchased is registered in the name of the client.

Vouching of payment made for the acquisition of patents

Vouching of payments made for the acquisition of patents should be on the following lines.

- 1) If the patent has been purchased, the auditor should vouch the payment made for the patent with the help of the contract for sale and the receipts for the payment obtained from the seller.
- 2) If the patent has been purchased through an agent, the auditor should vouch the agent commission with the help of agents account and receipt given by the agent. He should see that the agent's commission is capitalized.
- 3) He should see that expenses incurred on the purchase of the patent are capitalized.
- 4) Where the patent is acquired through research, the auditor should see that all the expenses incurred on the experiments and the research connected with patents are capitalized.
- 5) He should see that payments made towards the renewal fee are charged to revenue account.
- 6) He should actually see the patent.

Vouching of wages

The object of vouching wages is to ensure that the payment for wages as recorded in wage sheet and cash book, were actually made properly authorised and were correctly maintained.

Vouching of payment of wages should be done in the following lines.

- 1) He should enquire into the system of internal check in force in regard to the maintenance of wage records, preparation of wage sheet and payment of wages.
- 2) If the internal check is effective, the auditor can conduct the vouching of wages on the following lines.
 - a) He should check a few items of wage sheets here and there to ensure that the calculations are correct.
 - b) He should check totals of wage sheet with the cash book.

- c) He should see that the amount of cheque drawn for wages tallies with the totals of wage sheet.
- d) He should see that deduction from wages have properly adjusted and recorded in the books.
- e) He should see that wages recorded in the cash book have actually been paid.
- f) He should examine the system of employment of casual labour and check the payment made to casual labour.
- g) He should see that proper record is maintained for unpaid wages.
- h) Wages for the current months should be compared with the wages of the previous month. If there is a material difference, the auditor should enquire into the reason for the difference.

Vouching of salaries

Vouching of payment made for salary should be on the following lines.

- 1) An auditor should enquire into the system of internal check in operation in the concern in regard to the payment of salaries.
- 2) If the internal check system in regard to the payment of salaries is sound, an auditor can conduct the vouching of salaries on the following lines.
 - a) He should see that the salary bill is prepared with the sanction of a responsible officer.
 - b) He should see that the salary register is duly signed by each employee and counter signed by a responsible official.
 - c) He should check the salary register with the entries in the cash book.
 - d) He should see that the deduction for provident fund, life insurance premium, income tax etc have been correctly made and properly recorded in the books.
 - e) For vouching salaries of the secretary, manager and other important officials, the auditor should examine the board's minutes book.
 - f) He should check the attendance register.
 - g) He should compare the salary bill for the current month with the salary bill of the previous month. If there is any material difference, enquire into the reason for the difference.
 - h) He should see that the total of the salary book for a particular month agrees with the cheque drawn for salaries.

Vouching of petty cash book.

Vouching of petty cash book should be on the following lines.

- 1) He should examine the system of internal check in force in the business in regard to the petty cash transactions.
- 2) If he finds that the system of internal check is sound, he should adopt the following lines.
 - a) He should find out find out the system of petty cash book.
 - b) He should ascertain the name of the petty cashier to the amount of the imprest.
 - c) He should check some petty cash payments at random with the vouchers to ensure the correctness of the petty cash payments.
 - d) He should see that all petty cash payments over a certain amount are supported by proper vouchers.
 - e) He should see that petty cash payments not supported by proper vouchers are supported by slips by the officer who have spent the amounts.
 - f) See that the petty cash book is periodically checked and initiated by some responsible officer.
 - g) See that the petty cash balance as shown in the petty cash book agrees with petty cash balance as shown by petty cash account.
 - h) He should check the casting of total payment column and the individual expenses column.
 - i) He should physically count the petty cash balances on the balance sheet date. If he fails to do so, he will be held liable for damages. This was upheld in the case of London Oil Storage Company Limited v/s Sears Hasluck and Company.
 - j) He should see that I.O.U.s are not included in the petty cash balances.

Vouching of trading transactions

Vouching of trading transaction is concerned with credit purchases, credit sales, purchase returns, and sales returns are entered in the purchase book, sales book, purchase return book and sales return book respectively. So vouching of trading transactions also means that vouching of purchase book, sales book, purchase return book, and sales return book.

One main object of vouching of trading transaction is to detect misappropriation of goods, if any.

Vouching of credit purchases or vouching of purchase book.

The main objective of vouching of purchase book or credit purchases is to ensure that all purchase invoices are entered in purchase book, that goods entered in the purchase book are actually received and the business pays only for those goods which are delivered by the suppliers.

Firstly, an auditor should examine the system of internal check in force in the business in regard to credit purchases. If the system of internal check is not sound, he should check all the entries in the purchase book in detail. If the system of internal check is sound, he need not check all the entries in the purchase book in detail. He has to vouch the credit purchases on the following lines:

- 1) He should examine the inward invoices from which entries are made in the purchase book. While examining an inward invoice, an auditor should pay attention to the following points:
 - a) The invoice is in the name of the client.
 - b) The date given in the invoice relate to the period under audit.
 - c) The invoice is related to the business in which the concern deals.
 - d) The invoice is initiated by a responsible officer.
 - e) The trade discount has been deducted from the amount of invoice and then only net amount has been entered.
 - f) Quantity mentioned in the purchase invoice tallies with the quantity recorded in the purchase book.
- 2) He should check the purchase invoices with the purchase book, where the credit purchases are recorded.
- 3) He should see that only credit purchases are recorded in the purchase book.
- 4) He should see that purchases not made for the business are not recorded in the purchase book.
- 5) He should see that purchases of capitals assets are not included in the purchase book.
- 6) He should see that all goods received prior to the date of closing and taken into stock are recorded in the purchase book.
- 7) He should see that goods entered in the purchase book but not received are included in the closing stock.
- 8) He should verify some of the purchase invoices with the goods inward book, stock records and the challans from the suppliers to see that the goods have actually received.

- 9) He should compare some of the entries in the purchase book with the order book and goods inward book to ensure that no fictitious purchases are recorded and no invoice is entered twice.
- 10) To ensure that all invoices are included in the purchase book, the auditor should obtain the statement of accounts from the creditors and examine them.
- 11) He should make a list of all invoices missing or not available.
- 12) Where contracts for forward purchases are entered into, the auditor should see that they are not abnormal. If they are abnormal in amount, he should see that it is mentioned in the balance sheet by way of note.
- 13) He should check the casts and carry forwards to the purchase book.
- 14) He should check the postings from the purchase book to the purchase account as well as to the creditors account.
- 15) He should check carefully the purchase made in the first month and the last month of the accounting year, because, sometimes, purchases made in the last month of the last year may be included in the purchase of the current year or purchase made in the last month of the current year may be included in the purchases of the first month of next year.

Vouching of credit sales or vouching of sales book.

Outward invoices, which are the vouchers for the credit sales, are not completely reliable, as they are prepared by the staff of the business. So an auditor has to be very careful in vouching credit sales.

Firstly he should examine the following lines:

- 1) He should examine the outward invoices from which entries are made in the sales book. While examining the outward invoices, he should pay attention to the following points:
 - a) See that name of the customer stated in the outward invoice agrees with the entry in the sales book.
 - b) The date given in the outward invoice relate to the period under audit.
 - c) The invoice is initiated by a responsible officer.
 - d) See that trade discount allowed is deducted from the sales price and net amount has been entered.
- 2) He should check the outward invoices with the sales book, where the credit sales are recorded.
- 3) He should check the sales book with the order received book and see that the sales are genuine and all the sales are included in the sales book.

- 4) After the examination of outward invoices, the auditor should see that they are cancelled by stamping out and all the cancelled invoices are kept together for verification.
- 5) He should see that only credit sales are recorded in the sales book.
- 6) He should see that sales of capital assets are not included in the sales book.
- 7) See that good sent on sales or return or on consignment are not entered in the sales book.
- 8) He should see that good sold, but not delivered are not included in the closing stock.
- 9) He should check the casts and carry forwards of the sales book.
- 10) He should check the postings from the sales book to the sales account and customer accounts in the ledger.
- 11) He should check carefully the sales made in the first month and the last month of the accounting year, because, sometimes, sales made in the last month of the last year may be included in the sale of the current year or sale made in the last month of the current year may be included in the sales of the first month of next year.
- 12) If the trade discount allowed during the current year is exceptionally high, the auditor should enquire in to the reasons for the same.
- 13) Where the sales are subject to sales tax, the auditor should see that the sales tax collected is separated from the sales price, and is shown in a separate column in the sales book.
- 14) Sometimes, fictitious sales are included in the sales book to inflate the sales and the gross profit, an auditor has to take necessary steps to discover such fictitious sales.

Vouching purchase returns or purchase returns book.

An auditor should undertake vouching of purchase returns on the following lines:

- 1) He should enquire into the system of recording of purchase returns.
- 2) He should vouch the purchases returns book with the credit notes received from the creditors.
- 3) He should examine the goods outward book and the related correspondence to ensure that there is no suppression of purchase returns.
- 4) He should check the casts and carry forwards of purchase returns book.

- 5) He should check the postings from the purchase returns book to the purchase returns account and customers account in the ledger.
- 6) He should check carefully the entries in the purchase returns book for the first month and for the last month of the year to ensure that there is no manipulation of accounts.

Vouching of sales returns or sales returns book

- 1) He should enquire into the system of recording sales returns.
- 2) He should vouch the sales returns book with the credit notes issued.
- 3) He should examine the goods inward book and the related correspondence to ensure that there is no suppression of sales returns.
- 4) He should check the casts and carry forwards of sales returns book.
- 5) He should check the postings from the sales returns book to the sales returns account and customers account in the ledger.
- 6) He should check carefully the entries in the sales returns book for the first month and for the last month of the year to ensure that there is no manipulation of accounts.

Vouching of journal proper

Journal proper is meant for recording all those transactions which cannot be recorded in the other subsidiary books viz purchase book, sales book, purchase return book, sales return book, cash book, B/R book, B/P book. The following entries are recorded in the journal proper:

- 1) Adjusting entries.
- 2) Transfer entries.
- 3) Closing entries.
- 4) Rectification entries.
- 5) Entries for purchase and sale of assets on credit.
- 6) Opening entries.
- 7) Entries for consignment.
- 8) Entries for application for shares, allotment on shares and calls on shares.

An auditor should vouch the journal proper on the following lines:

- 1) He should see that every entry in the journal proper is supported by a voucher or evidence.

- 2) He should see that every entry in the journal proper is explained by narration.
- 3) When the evidences are not available for some entries in the journal proper, the auditor should check those entries from the evidence of parties.

Verification of assets and liabilities.

Verification means 'proving the truth' or 'confirmation of the truth'. Verification of assets and liabilities means proving the truth about the existence and the correctness of the money value of the assets and liabilities appearing in the balance sheet of the business. In other words, it means establishing the actual existence of the assets and liabilities appearing the balance sheet, ownership and possession of the assets and proper classification and valuation of assets and liabilities.

Objects of verification of assets and liabilities.

- 1) To find out whether assets and liabilities shown in the balance sheet actually exist.
- 2) To ascertain whether the assets and liabilities appearing in the balance sheet are shown at their correct values.
- 3) To confirm the possession and ownership of the assets appearing in the balance sheet.
- 4) To find out whether there is proper classification of assets and liabilities.
- 5) To check the arithmetical accuracy of the books of accounts.
- 6) To ascertain whether the balance sheet gives a true and faire view of the financial position of the business.

Difference between vouching and verification.

- 1) **Nature:-** vouching is the examination of the business transactions recorded in the books of original entry, where as verification is the examination of assets and liabilities appearing in the balance sheet.
- 2) **Objectives:-** vouching is done to examine the correctness and the authenticity of the business transactions recorded in the books of original entry. But verification is undertaken to confirm the values of assets and liabilities of the business as shown in the balance sheet.
- 3) **Work begins:-** verification of assets and liabilities are undertaken after the vouching of the books of accounts. In other word, verification begins where vouching ends.
- 4) **Time:-** vouching is done throughout the year, whereas verification is done at the end of the year after the balance sheet is prepared.

- 5) **Scope:-** vouching does not include valuation of assets. But verification of assets includes the valuation of assets.
- 6) **Utility:-** vouching of books would only indicate that a particular assets or liabilities ought to exist. It does not indicate whether a particular assets or liabilities really exist at the date of the balance sheet. But verification proves whether the assets or liabilities really exist at the date of the balance sheet.
- 7) **Basis:-** vouching is based on documentary examination. On the other hand verification is based on physical as well as documentary examination
- 8) **Personnel:-** vouching is done by the staff of the auditor. But verification is done mostly by the auditor himself.

Valuation of assets.

Valuation of assets means the determination of or the ascertainment of the money value at which the assets are shown in the balance sheet. However in audit it implies critical examination and testing of the determined values of the assets on the basis of generally accepted accounting principles. In short, it is the process of ensuring that the money value of the asset as shown in the balance sheet has been properly determined.

Objectives.

- 1) To verify whether the assets shown in the balance sheet have been properly valued.
- 2) To indicate that the balance sheet represents a true and fair view of the financial position of the business.
- 3) To indicate that there is no manipulation of account to inflate or reduce the profit.

Auditors duty in regard to valuation of assets

Valuation of assets is a difficult task. It requires technical knowledge. But an auditor has neither technical knowledge nor the time required for the valuation of assets. So an auditor can't be expected to do the valuation of assets. In short an auditor is not a valuer. The valuation of assets is done by the officials of the business. Auditor has only to make an enquiry into the valuation of assets and satisfy himself that the value of assets are properly determined. This view was upheld in many cases. For example, the Kingston Cotton Mills company's case, it was held, it is no part of an auditor's duty to take stock. He must rely on other people for the details of the stock.

An auditor has to critically examine the valuation and satisfy himself that valuation of assets has been properly made to satisfy himself that the values of assets are correct, an auditor should do the following:-

- 1) He should obtain all information available in respect of the valuation of assets.
- 2) He should critically examine and analyze the all figures of the valuation of assets.
- 3) He should verify whether the principles and practice of valuation of assets have been consistent from year to year.
- 4) He should verify whether the value of assets have been determined properly in accordance with the generally accepted accounting principles.
- 5) Wherever necessary he should take the assistance of technical experts for valuing the assets.
- 6) He should ascertain whether current values of assets are fair and reasonable.

If the auditor does not exercise proper care and skill in the matter of enquiry into the valuation of assets. He will be held guilty of negligent or fraud. This was upheld in many cases-

For example, in the case of Lease Estate Building & investment v/s shepherd, the auditor was held liable for the dividend paid out of the capital for several years, based on the wrong financial statement.

Classification of assets/types of assets for the purpose of valuation & mode of valuation

1) Fixed assets

They are acquired for permanent use in the business. It is not for resale in the ordinary course of business but for the purpose of enabling the business to earn profit. These assets will be in use for a pretty long period. Examples are land, building, plant, machinery, etc. Fixed assets are to be valued at original or historical cost less total depreciation written off (Going concern value).

2) Current assets (circulating or floating assets)

Current assets are those assets, which are acquired for resale or produced for the purpose of sale or converting them in to cash. Examples are stock, semi-finished goods, book debts, cash and bank balance, etc.....

Cash and bank balance- no valuation required

Book debts and bills receivable- valued at book value

Raw materials- first in first out or last in first out or average cost method

Closing stock-at cost price or market price whichever is lower.

3) Intangible assets

Intangible assets are those assets, which cannot be seen or touched. Examples are good will, copy rights, patent etc. these assets are shown at cost price.

4) Wasting assets

Wasting assets are of fixed nature, which are depleted gradually or exhausted in the process of earning income. Examples are mines, quarries, oil wells etc. These assets are valued at original cost less provision for depletion.

5) Fictitious assets

These are neither physically visible nor realizable into cash. They are revenue expenditure that have been temporarily capitalized with the object of generating the amount over a period of years the benefit of which accrues. Examples are preliminary expenses, discount on issue of shares, advertisement suspense account etc.

6) Contingent assets

These are assets the existence, values and ownership of which depends up on the occurrence of a specified event. Examples are claim for refund of income tax, sales tax.

Various values used for valuation.

- 1) Cost price.
- 2) Market price.
- 3) Replacement.
- 4) Realized value.
- 5) Book value.
- 6) Breakup value.
- 7) Going concern value.

Difference between verification and valuation

Nature: - In verification of assets, an auditor verify not only the actual existence of the assets but also their proper valuation . But in the case of valuation of assets, an auditor has to merely ensure that the values of the assets as shown in the balance sheet is correct.

- 1) Scope: - Verification includes valuation also. Valuation is a part of verification of assets.
- 2) Work begins: - Verification of assets comes in before the valuation of assets but valuation of assets follows verification of assets.

- 3) Responsibility: - In the case of verification of assets, the auditor is entirely responsible for the work. But in the case of valuation of assets is done by the owners. The auditor merely ensures that the values of the assets as shown in the balance sheet are correct.
- 4) Guarantee: - In the case of verification of assets, the auditor gives guarantee that the assets have been properly verified. But in the case of valuation of assets he does not give any guarantee.
- 5) Basis : -Verification of assets can be made by an auditor on the basis of physical inspection as well as documentary evidences. But for valuation of assets, he depends up on the estimates of the proprietor.
- 6) Chance of fraud : -In verification of assets, the chances of manipulation of accounts to inflate or deflate profit is less, but in valuation of assets, there is more chance of such frauds.

Classification of liabilities for valuation.

Current liabilities

Current liabilities are those liabilities of the business, which are short-term liabilities. They are to be settled within a period of one year. Examples are trade creditors, bills payable, outstanding expenses.

Fixed liabilities

These are of long-term nature. Examples are long term loans borrowed, long term deposit received.

Contingent liability

It is not an actual liability. It may become a liability on the happening or non-happening of certain events in future. In short it is a liability which may or may not arise in the future for payment. Examples are liabilities in respect of bills discounted, guarantee given, compensation pending.

Verification and valuation of different assets.

1)Freehold property

Freehold property refers to the land and building which is absolutely the property of the business.

While undertaking the verification and valuation of freehold property an auditor should observe the following points:

1) Examine the title deeds

He should examine the title deed relating to freehold land& building to ensure that they are in the name of the client. If there is any doubt relating to title of property, he should consult solicitors of the client.

2) Examine the conveyance or brokers account

If the freehold property has been purchased, he should examine the correspondence, conveyance deed and broker's or auctioneer's account

If the freehold property is consist of building constructed by the client the auditor should ask for and examine the architect's and the builder's certificates.

3) Capitalization of expenses

He should see that if legal expenses, brokerage and other expenses are incurred for the acquisition of freehold property, they are capitalized.

4) Mortgage of freehold property

If the freehold property mortgaged, auditor should get a certificate from mortgagee stating that the title deed are in his possession

He should also make proper enquiry to ensure that there is no second mortgage on the freehold property

If the title deeds of the freehold property are with a bank or solicitors for safe custody the auditor should get a certificate from the bank or the solicitor stating that they are held by him for safe custody and not as a security for any loan.

5) Additions to free hold property

He should check additions to the freehold property, if any, made during the year with the help of relevant vouchers. He should also see that the cost of additions is capitalized.

6) Sale of freehold property

If any freehold property sold during the year, an auditor should check such sales and see that profit or loss thereon is correctly dealt within the accounts.

7) Repairs and renewals

He should see that repairs and renewals of freehold property are charged to revenue account.

8) Provision for depreciation

He should examine the adequacy of provision for depreciation on free hold building.

9) Appreciation of freehold building

If any appreciation of freehold building is taken into account, the auditor should see that appreciated value is clearly disclosed in the balance sheet. He

should also obtain a certified copy of valuation of the property from a professional valuer.

10) Shown in the balance sheet

See that the freehold property are shown separately in the balance sheet under the head fixed asset

He should also see that freehold property are shown cost less depreciation

In case freehold property is shown in the balance sheet in market value, the auditor must see that they are clearly mentioned in the balance sheet.

2). **Leasehold property**

Lease hold property refers to land and building acquired by a business for a fixed period on lease. While undertaking the verification and valuation of lease hold property an auditor should observe the following points.

1) Examine the lease deed

He should examine the lease deed to ascertain the cost of leasehold property, the duration of the lease, terms and condition of the lease.

2) Registered

If the lease is for more than one year the auditor should see that the lease deed is registered.

3) Amount capitalized

He should see that amount paid for lease property is capitalized.

4) Examine the receipt for the lease

He should see that the lease rent is paid regularly and lease is existing. For this purpose he should examine the last receipt of the payment of rent.

5) Examine the agreement with subtenant

He should see that the agreement with the subtenant is if it is sublet to others.

6) Addition to lease hold property: -

Verified with relevant vouchers that see that amount paid is capitalized.

7) Repairs and Renewals: - See that it is charged to revenue.

8) Provision for depreciation

9) Shown in the balance sheet

3). **Plant and machinery**

While undertaking the verification and valuation of plant and machinery an auditor should observe the following points.

1) Examine the plant register

He should examine the plant register if it is maintained by concern.

2) Examine the schedule of plant and machinery

He should call for and examine the schedule of plant and machinery signed by the engineer.

3) Verify the plant and machinery purchased

He should verify the plant and machinery verified, plant and machinery purchased with the original invoice ----- and agreement with the ventures.

4) Check the plant register with plant and machinery account

To ensure plant and machinery account and satisfy himself as to the value of plant and machinery.

5) Addition to the plant machinery

6) Sale and plant and machinery

7) Repairs and renewals

8) Provision for depreciation

9) Shown in the balance sheet

4). **Furniture and fixtures**

While undertaking the verification and valuation of furniture and fixtures an auditor should observe the following points.

1) Examine furniture stock register

2) Verify the price of furniture purchased with invoices and receipts

3) Physical verification

He should verify the physical existence of furniture by personal inspection.

4) Addition to the furniture and fixture

5) Sale of furniture and fixtures

6) Provision for depreciation

7) Method of depreciation

He should enquire into the method of depreciation as the amount on depreciation depends upon the use of the asset and the method of depreciation adopted.

8) Unserviceable furniture written off

He should see that the unserviceable furniture and fixtures are written off under proper authority.

9) Shown in the balance sheet

4) Valuation of goodwill

Goodwill is the value of reputation of an organization which enables the business to earn more than the normal rate of profit.

While under taking verification and valuation of goodwill an auditor should observe the following points;

1) Goodwill purchased along with running business

When goodwill has been purchased along with running business from some vendors the amount of goodwill should be verified by the auditors from the purchase agreement with vendors, showing the price paid for the goodwill.

Where the price paid for the goodwill is not specifically fixed, auditor should ensure that the amount of goodwill taken into account is the amount of purchase consideration, i.e, amount of purchase consideration over net assets taken over.

2) Goodwill arise by writing up the value of assets

When goodwill account has been arise by a company by writing up the value of its assets or the revaluation of assets, the auditor should examine the basis on which assets have been revalued and satisfy himself that the amount of goodwill brought into account is proper.

3) Goodwill created in the books of partnership firm

The amount of goodwill created in the book of partnership firm on the admission of a new partner or on the retirement or on death of an existing partner, should be verified by the auditor with the help of with the help of the partnership deed. The auditor can also verify the changes made in the goodwill account from time to time on the basis of the provisions of the partnership deed.

4) Valuation of goodwill

Valuation of goodwill is a matter of financial policy, to be decided by the management of the business. The auditor can't interfere in the valuation of goodwill, though he may give his advise on the valuation of goodwill. For the

valuation of goodwill the auditor is just to see that the goodwill is shown in the balance sheet at its proper value.

5) Insist upon writing off goodwill

If it appears to him that the future benefit associated with the goodwill does not exist, he should insist on writing off the goodwill.

6) Shown in the balance sheet

An auditor should see that goodwill valued at cost less amount written off and shown in the balance sheet.

7) Verification and valuation of patent right

1) Examine the schedule or list of patent right.

2) Verify the patent right with the help of certificates of patents.

3) Ensure that the patents have registered in the name of the client.

4) Patent right are developed by the research work

If the patent right are developed by concern by doing some research work, the cost of research and development should be capitalized. Similarly if the patent right have been purchased, the cost of purchases of patent should be capitalized.

5) Renewal fee should be charged to revenue.

6) Cost of patent written off

An auditor should see that the cost of patent written off. If a patent becomes obsolete, the entire book value should be written off.

7) Shown in the balance sheet.

See that the patents are shown in balance sheet

7). Verification of investment

1) Examine the schedule of investment

He should call for and examine the schedule of investment held by the client with reference to the relevant ledger accounts.

2) Physical verification

If investment is in the hand of the client, auditor should verify the existence of the investment by personal inspection.

If it is entrust to a bank for safe custody, he should get a certificate from the bank, giving the details of the security in its hand and stating that they are free from any charge.

If an investment is held by a trustee on behalf of the company, the auditor should call for and examine the trust deed.

If the securities are held by the client brokers, the auditor should call for securities for personal inspection.

If the securities deposited with bank or any other creditor as a security towards loans borrowed, an auditor should get a certificate from bank or creditor to this effect.

3) Purchase of investment

If securities are purchased during the year, he should verify the purchase by examining the certificate. If no certificate is available he should examine purchase with the help of transfer deed and broker's bought note.

4) Transfer fee, stamp duty etc.

He should see that transfer fee, stamp duty etc incurred on the purchase of investment are properly capitalized.

5) Sale of investment

If the securities are sold during the year, the auditor verify the sale price with the help of broker's sold note.

See that the sale is approved by board of directors.

See that whether the profit or loss made on sale is properly adjusted in the accounts.

6) Registered in the name of the client

He should ensure that the investment is registered in the name of the client and they are free from charges other than those disclosed.

7) Properly valued

Satisfy himself that investment is properly valued.

8) Shown in balance sheet

See that the investments are shown in balance sheet at market or cost price

9) Verification of cash in hand

1) Physically count the cash in hand

The auditor should actually count the cash in hand by attending the business premise on the last day of the financial year. Actual verification of cash in hand has been considered to be the most important part of an auditor's duty. It was upheld in many cases. For instance, London oil storage company ltd v/s Secer Husluck & co. In this case it was held that the auditor has

committed a breach of duty in verifying the existence of the petty cash balance.

2) Surprise visit to business premises

To prevent manipulations & fraud the auditor can pay a surprise visit to the business premises of the client.

3) Count different kinds of cash balances simultaneously

If there are different kinds of cash balances say petty cash in hand and cash in hand, the auditor should count them simultaneously. Shortage on one account may not be made up from another account.

4) Count currency notes, coins, stamps and I.O.U.s

He should count on closing date not only currency notes and coins but also the stamp and I.O.U.s in hand, as they are also part of cash balance.

5) See that I.O.U.s are genuine.

6) Physically count the stock of the unsold canteen tickets, lunch coupons etc as they are likely to be converted into cash.

7) Compare the cash in hand as revealed by physical counting with the cash balance as shown by the cash flow.

8) Verify cash transactions with the proper documentary evidences and correspondence.

9) Shown in the balance sheet.

9). **Verification of cash at bank**

1) Compare bank balance as shown by the cash book with the bank balance as shown by the bank pass book.

2) Preparation of bank reconciliation statements

If there is some difference between these two balances, he should prepare a bank reconciliation statement.

3) Obtain separate certificate for fixed deposit account, savings bank account, current account etc...

He should obtain separate certificate from the bank to verify balances of the different types of bank accounts.

4) Verify all of the bank accounts individually

In case there are accounts with more than one bank the auditor should verify them individually.

- 5) See that necessary adjustments are made in respect of interest accrued on fixed deposit.
- 6) See that Cheques not yet collected are genuine.
- 7) In case money is kept with other agencies, the nature of interest and the name of the agencies should be disclosed by the auditor in his audit report.
- 8) Where large amounts are held in foreign banks, the fact should be disclosed by the auditor in his audit report.

9) Shown in the balance sheet

10). **Verification of bills receivable**

- 1) Examine each bill in hand to ensure that it is properly drawn, sufficiently stamped and duly accepted by the acceptor.
- 2) Verify the bills receivable given in the balance sheet by obtaining certified schedule of bills in hand.
- 3) Compare the schedule of bills in hand with bills receivable book and bills receivable account.
- 4) See that overdue bills are not included in the bills in hand.
- 5) Bills discounted should be examined by referring the cash book and pass book.
- 6) See that bills discounted or endorsed but not yet met are treated as a contingent liability and are indicated by way of foot note in the balance sheet.
- 7) See that proper provisions are made for contingent liability on bills discounted.
- 8) Shown in the balance sheet

11). **Verification of debtors**

- 1) Examine the schedule of debtors.
- 2) Verify the schedule of debtors with the help of sales ledger or debtor's ledger.
- 3) Verify the sales ledger balances with the help of sales book, sales returns book, cash book etc.
- 4) See that the book debt shown in the balance sheet is recoverable.
- 5) Obtain a certificate from a responsible officer in respect of statement of book debt.
- 6) See that adequate provisions are made against book debt. The adequacy of the provisions for the bad & doubtful debt made by the management can be checked by the auditor by considering the following points,

- Age of debt
 - Regular payment
 - Heavy dishonoured bills
 - Comparison of actual bad debt with budgeted bad debt
- 7) See that proper provision is made for discount on debtors.
- 8) In case, where certain amounts of debts are written off, the auditor should enquire into the details.
- 9) Debts due from subsidiary company should be carefully inspected by the auditor.
- 10) In case of debt in a foreign company, the auditor should find out, by converting the amount into home currency.
- 11) In case the client is a company, the auditor should see that the book debts are classified for balance sheet purpose as required by the companies Act 1956. That is book debts are classified as follows,
- Debts considered good in respect of the company is fully secured.
 - Debts considered good for which the company holds no security other than the debtor's personal security.
 - Debt considered doubtful.

Further debt due by directors or officials of the company either severally or jointly with any other person shown separately.

Again debt due from other company under the same management should be disclosed with the names of the companies.

12) **Verification of loans advanced**

Generally loans advanced will be of the following types:-

- 1) Loans against the security of land & building.
- 2) Loans against the security of stock & shares.
- 3) Loans against the security of goods.
- 4) Loans against the security of life policies.
- 5) Loans against the security of guaranty of a third party.
- 6) Loans against the personal security of the borrower.

While verifying the loan advanced, an auditor should keep in mind the following points:-

- 1) Examine the schedule of loans granted.
- 2) Verify the loans advanced with the help of loan agreement, application of loans, acknowledgements of receipts, and loan account in the ledger.
- 3) Examine the authority of person granting the loans.
Ensure that the loans advanced are within the powers of the person granting the loans.
- 4) Ascertain the worth of the securities
In the case of secured loans, the auditor should ascertain the worth of securities offered and see that sufficient margin is maintained.
- 5) Examine the credit worthiness of the borrower
In the case of unsecured loans, the auditor should examine the credit worthiness of the borrower and ascertain the possibility of their recovery.
- 6) See that outstanding loans are confirmed by the borrowers.
- 7) See that interests on loans are regularly collected.
- 8) See that provisions are made for doubtful loans.
- 9) In the case of joint stock Company, the auditor should see that the loans are properly classified.
- 10) See that loans to directors and officials of the company are shown separately in the balance sheet.
- 11) See that the advances to subsidiary companies are shown separately in the balance sheet.
- 12) See that loans are shown separately in the balance sheet.
 - 1) Loans against the security of land and building
 - 2) Examine the loans granted with the help of loan agreements.
 - 3) Examine the powers of the person granting the loan.
 - 4) Examine the memorandum and articles of association, in the case of joint stock companies.
 - 5) Inspect the minutes of meeting of the board of directors and see that loans are properly sanctioned.
 - 6) Verify the details of the loan.
 - 7) See that outstanding loans are confirmed by the borrowers.
 - 8) Examine the title deed relating to the property mortgaged.

9) Interests on loans are collected regularly.

2) Loans against the security of stock& shares

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the list of stocks and shares held by the company.
- 3) See that shares offered as security is transferred to his client.
- 4) Check the value and see that there is sufficient margin between the loan and the present value of the security.
- 5) See that shares accepted as security are fully paid up.

3) Loans against the security of goods

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Examine the godown keeper's receipt, dock warrant if loans are advanced against the goods lying in warehouse.
- 4) See that godown rent is paid regularly by the borrower.
- 5) See that goods offered as security are fully insured.
- 6) See that goods offered as security are easily saleable.

4) Loans against the security of life policies

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Enquire into the class of insurance policy.
- 4) Examine the last receipt for the payment of insurance premium.
- 5) Ascertain the surrender value of the life insurance policy.

6) Loans against the guaranty of a third party

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Examine the guaranty.
- 4) Enquire into the financial position of surety.

5) Loans against the personal security of the borrower

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.

- 3) Examine the credit worthiness of the borrower.
- 4) Finally auditor should discourage the client granting of such loans.

13). **Verification and valuation of stock in trade**

The work of verification and valuation of stock in trade consist of two elements,

- 1) Verification of stock in trade.
- 2) Valuation of stock in trade.
 - i) Verification of stock in trade does not mean merely the checking of stock statements. It is much more than this. It includes the following,
 - Verification of physical existence of stock in trade.
 - Verification of ownership of stock in trade.
 - Verification of guaranties in the statement of stock.
 - Examine the organization's transactions that results in stock in trade.
 - Ensuring that receipts and issues are properly recorded.
 - Ensure that the provision is made for obsolete stock.
 - Examination of system of internal control.
 - Verification of arithmetical accuracy of statement of stock.

While verifying stock in trade, an auditor should keep in mind the following points,

- 1) Examine the system of internal check with regard to the verification of stock in trade.
- 2) Obtain copies of physical layout of all plant, giving names and descriptions of all departments where stocks are held.
- 3) Obtain details as to the quantity and value of stock with each department.
- 4) Secure a copy of stock taking instructions issued to the staff.
- 5) Ensure that proper and adequate records of stocks have been maintained.
- 6) See that goods which are not related to the business are not included in the stock.
- 7) See that goods sold prior to the closing date are not included in the stock.
- 8) See that items of capital nature are excluded from the stock.
- 9) He should test check physical existence at least 5 % of items.

- 10) See that stock held by third party is included in the stock sheet.
- 11) Compute Work out ratio between gross profit and sales of current year and compare it with that of the previous year.
- 12) Compare stock sheet of current year with that of previous year.
- 13) Check calculations, additions and castings in the stock sheet.
- 14) See that stock sheet is initiated by a responsible person.
- 15) See that goods taken into stock sheet are passed through the purchase book.

j) Valuation of stock in trade

Following points are to be noted while valuing stock in trade:

- 1) An auditor should enquire into the basis of valuation.
- 2) See that basis of valuation has been consistently adopted from year to year.
- 3) Check the values of few items in the stock sheet with the corresponding invoice prices and current selling prices.
- 4) See that the totals of stock sheet are correct.
- 5) Compare the percentage of gross profit of current year with that of previous year.
- 6) See that calculations, additions and castings are correct.
- 7) See that stock sheet is signed by a responsible officer.

Methods of valuation of stock in trade

- Actual cost price method
- Simple average cost method
- Weighted average cost method
- FIFO
- LIFO
- Base stock method
- Standard cost method
- Market price method
- Net realized value method

Valuation of different items of stock in trade

- 1) Raw materials are valued at cost price plus proportionate freight and import duty.
- 2) Work in progress: cost price of raw materials plus proportionate amount of manufacturing expenses plus a percentage to cover the establishment charges relating to manufacture.
- 3) Finished goods: principal of “cost price or market price whichever is lower” is applied.
- 4) Spare parts: cost price
- 5) Stores articles: cost price
- 6) Stock of special trade: cost price plus interest at remarkable rate plus expenses of maintaining stock.

Verification and Valuation of liabilities

1. See that the liabilities are neither deliberately omitted nor under stated nor overvalued.
2. See that the liabilities are shown in balance sheet at their correct amount.
3. Obtain a certificate from responsible officer as to the correctness of the amount of different liabilities.

1) Verification of sundry creditors

While verifying sundry creditors an auditor should bare in mind the following points:

- 1) Obtain a list of creditors.
He should get a schedule or list of creditors from the management and verify whether the schedule contains all the details about creditors.
- 2) Check the schedule of creditors with the balance in the creditor’s ledger.
- 3) Obtain statement of account from creditors.
- 4) Check the purchase book and purchase return book with the help of invoices and credit notes.
- 5) Check the postings from subsidiary books to the creditors account in the ledger.
- 6) Examine the purchase invoices to ensure that these are related to current year.
- 7) Compare the percentage of gross profit of current year with that of the previous year.

- 8) Special attention to the entries made either at the beginning of the year or at the end of the year.
- 9) Check the provisions for the discount on creditors with the help of reference to the creditor's ledger. If the credited amount is unpaid for a long period, enquire the reasons.
- 10) See that creditor's amount shown in the balance sheet are correct.

2) Verification of bills payable

- 1) Obtain a schedule of bills payable
- 2) Check the total of schedule of bills payable with the bills payable book and the bills payable account.
- 3) Verify the payments made to the bills payable with the entries in the cash book.
- 4) Verify the bills payable returned under rebate.
- 5) Satisfy himself with the genuineness of bills payable.
- 6) See that the bills payable which have been paid are not shown as outstanding.
- 7) Check the bills payable paid after the balance sheet date but before the date of the audit with the entries made in the cash book.
- 8) See that the bills payable amount shown in the balance sheet are correct.

3). **Verification of bank overdraft**

- 1) Examine the overdraft agreement with the bank.
- 2) Check the cash book with the bank pass book.
- 3) Obtain a certificate from the bank and verify the correctness.
- 4) Verify the outstanding interest, if any.
- 5) If bank overdraft is secured, see that the assets charged against such loans are clearly stated in the balance sheet.

4). **Verification of loans & advances borrowed**

- 1) Examine the loan agreement.
- 2) Examine the loans and advances with the help of the correspondence and relevant documents.
- 3) Ensure that loans and advances are taken for the use in the business.
- 4) Check the amount of loans and advances with the confirmation letters received from lenders.

- 5) If the loans are secured examine the amount of secured loans, nature and value of securities.
- 6) See that interest on loan is paid or not.
- 7) See that loans are separately shown in the balance sheet as secured and unsecured.

5). **Verification of debentures**

- 1) Examine the memorandum and articles of association to ensure that the borrowing limit is not exceeded.
- 2) Examine the debenture account to verify the debentures issued.
- 3) Examine the debenture trust deed to verify amount of debenture issued and securities offered.
- 4) if debentures are issued at premium or discount, see that premium and discount are properly dealt with in the books of account.
- 5) If debentures are to be redeemed after some years, he should see that arrangements are made for the same.
- 6) See that debentures shown in the balance sheet are correct.

6). **Outstanding expenses**

- 1) Verify the outstanding expenses with the help of statement of outstanding expenses certified by a responsible officer.
- 2) Compare the outstanding expenses of current year with those of previous year to see whether there is any material difference.
- 3) See that outstanding expenses have been subsequently paid.
- 4) Verify the item of expenses such as salaries, wages, rent etc which remain outstanding.
- 5) See that outstanding expenses are clearly shown in the balance sheet.

7). **Income received in advance**

- 1) Verify the item of incomes which are normally received in advance with the help of list of incomes received in advance certified by a responsible official.
- 2) See that these are fully disclosed in the balance sheet.

MODULE 4

AUDIT OF LIMITED COMPANIES

The companies Act not defined the term 'auditor '. But one can define an auditor as a qualified Chartered Accountant within the meaning of the Chartered Accountants Act of 1949 appointed for the purpose of examining the accounts of a joint stock company and giving the report there on to the shareholders every year at the annual general meeting.

QUALIFICATION OF AN AUDITOR

A person can be appointed as an auditor of a company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act of 1949.

In case a firm is appointed as an auditor of a company, all the partners of the firm must be Chartered Accountants.

One holder of a certificate under the Restricted Auditors Certificate Rules 1956 is also qualified to Act as an auditor of a company.

DISQUALIFICATION OF AN AUDITOR

Certain persons are disqualified from being appointed as auditor of a company. They are:

- (1) A body corporate
- (2) An officer or employee of the company
- (3) A person who is a partner or who is the employment of an officer or employ of a company.
- (4) A Person who is indebted to the company for an amount exceeding RS1000.
- (5) A director or a member of a private company.

Besides the above disqualification, certain additional disqualifications are also prescribed by the companies (Amendment) Bill 2003. These are:

- (1) An auditor who has any direct financial interest in the company.
- (2) An auditor who received only loan or guarantee from or on behalf of the company.
- (3) An auditor who has any business relationship in the company.
- (4) An auditor who has been employed in the company
- (5) An auditor whose relative is in the employment of the company

APPOINTMENT OF AN AUDITOR

FIRST AUDITOR

The first auditor of a company is appointed by the Board of Directors within the month of the Registration of the company. The first auditor, appointed by the Board of Directors will hold office till the conclusion of the first annual general meeting of the company.

If Board of Directors fails to appoint the first auditor, the company may appoint the first auditor in the general meeting. The first auditor appointed by the shareholders in the general meeting, will also be reappointed at the first annual general meeting of the company

SUBSEQUENT AUDITOR

Every subsequent auditor is appointed every year at every annual general meeting by the shareholders. A subsequent auditor appointed by the shareholders at any annual general meeting will hold office till the conclusion of the next annual general meeting.

APPOINTMENT OF AN AUDITOR BY THE CENTRAL GOVT

If a subsequent auditor is not appointed by the shareholders at any annual general meeting, the company must bring it to the notice of the central govt. within seven days of the conclusion of the annual general meeting. On receiving the notice, the central govt. may appoint an auditor to fill the vacancy.

APPOINTMENT IN CASE OF CASUAL VACANCY

Any casual vacancy in the office of an auditor can be filled up by the board of directors. However, the casual vacancy caused by the resignation of an auditor cannot be filled up by the Board of Directors; it can be filled up by the shareholders at the general meeting. An auditor appointed to a casual vacancy can hold office only till the conclusion of the next annual general meeting.

REMOVAL OF AN AUDITOR

An auditor may be removed before the expiry of the term for which he has been appointed.

The first auditor appointed by the directors of the company may be removed before the expiry of his term of office and another person may be appointed in his place by the shareholders at a general meeting by passing an ordinary resolution to that effect.

A subsequent auditor appointed by the shareholders at an annual general meeting can be removed from the office before the expiry of his term of appointment by the shareholders in general meeting by passing an ordinary resolution after obtaining previous sanction of the central govt.

For the removal of any auditor before the expiry of his term of office and for the appointment of another auditor in his place, in the following procedure has to be followed:

First, a special notice of the days containing the proposed resolution to remove an auditor before the term of office and to appoint a new auditor in place must be given to the company by any member interested.

On receipt of the notice of such resolution, the company must send a copy of the resolution to the auditor who is sought to be removed.

After receiving a copy of the proposed resolution, the auditor concerned can make his representation to the company.

There after, if the members desire that the auditor should be removed before his term of office and another person should be appointed in his place, an ordinary resolution should be passed by the share holders at the general meeting.

It may be noted that for the removal of a subsequent auditor, the provisions approval of the central government also must be obtained.

REMUNERATION OF AN AUDITOR

The remuneration of the first auditor is fixed by the Board of Directors, if he is appointed by the Board of Directors.

The remuneration of every subsequent auditor, who is appointed by the company, is fixed by the company in the general meeting.

Where a subsequent auditor is appointed by the Central government on the failure of the company to appoint the auditor, his remuneration will be fixed by the Central Government.

LEGAL STATUS OR POSITION OF A COMPANY AUDITOR

- 1) An agent of the shareholders.
- 2) An officer of the company.
- 3) A servant of the company

RIGHTS OF A COMPANY AUDITOR

- 1) Right of access to books of account of Vouchers:

An auditor of a company has a right of access to the books of accounts and vouchers of the company whether they are kept at the head office of the company or elsewhere.

2) Right to examine the cost records:

An auditor of a company has a right to examine the cost records along with the quantitative records relating to production, sales, stocks etc.

3) Right to obtain information and explanations:

An auditor of a company has a right to obtain from the directors and officers of the company such information and explanation as he may think necessary for the performance of his duties as an auditor.

4) Right to correct any wrong statement:

An auditor of a company has a right to correct any wrong statement made by the Directors relating to the accounts to be laid before the company in the general meeting.

5) Right to comment on the inadequacy of the accounting system in his report:

If the system of maintaining accounts is inadequate, he can advise the directors to amend the system of accounting.

6) Right to visit branches:

The auditor of the company can visit the branch and examine the books and accounts and vouchers at the branch.

7) Right to receive notice and other communications of general meeting: -

An auditor of a company has a right to receive notice and other communications relating to any general meeting, in the same way as a member of the company.

8) Right to attend the general meeting of the shareholders

An auditor has the right to attend every general meeting of the shareholders.

9) Right to speak at the general meeting: - An auditor of a company has a right to speak at a general meeting where his certified accounts are discussed.

10) Right to sign the audit report: - An auditor has the right to sign the audit report.

11) Right to report to the members of the company: - An auditor has a right to report to the members of the company, if the accounts audited by him show an unsatisfactory state of affairs.

- 12) Right to report to the members of the company: - An auditor has a right to report to the members of the company, if the accounts audited by him show an unsatisfactory state of affairs.
- 13) Right to be indemnified: - An auditor of a company, being an officer of the company, has a right to be indemnified out of the assets of the company, for any liability incurred by him in defending himself against any proceedings by the company.
- 14) Right to receive any remuneration for his audit work: - An auditor of a company has a right to receive remuneration for his audit work provided he has completed the work which he undertook.
- 15) Auditor's right of lien: - An auditor has particular lien on the books of accounts audited by him for nonpayment of audit fees.

Duties and Responsibilities of a Company Auditor

The various duties of an auditor of a company can be grouped into four categories. They are:

- (1) Statutory duties.
- (2) Contractual duties
- (3) Certain duties imposed by legal or court decisions
- (4) Duties arising out of professional etiquette.

Statutory Duties: - Statutory duties refer to the duties imposed by the statute, i.e., by the Companies Act. The various statutory duties of an auditor under the Companies Act are:

(1) Duty to make certain enquiries: - An auditor of a Company should enquire:

1. Whether loans and advances have been properly secured.
2. Whether loans and advances have been shown as deposits.
3. Whether the transactions of the company are not prejudicial to the interests of the company.
4. Whether the personal expenses have been charged to revenue account.

(2) Duty to Report: - An auditor of a company should make a report to the shareholders on the accounts examined by him and balance sheet and profit and loss account.

(3) Duty to comply with the directives of the Central Government: - The Central has been empowered to issue necessary directives to the auditors

of certain companies to give specific reports on certain matters. When the central government issues any such directions, the auditors are required to comply with those directives.

- (4). Duty to sign his audit report
- (5). Duty to give a statement in prospectus: - A prospectus issued by an existing company should contain a statement from the auditor.
- (6) Duty to certify the statutory report.
- (7). Duty to certify the declaration of the solvency of the company.
- (9). Duty to assist Central Government in connection with prosecution.
- (10). Duty to make report on public deposits.

The important contractual duties of an auditor are:

- 1. An auditor has a duty to see that his appointment is in order.
- 2. He must perform all the duties under common law.

Duties imposed by legal or court decisions: -

- 1. An auditor must make himself fully acquainted with his duties under the Companies Act and the Articles of Association of the company.
- 2. He must not confine himself only to verify the arithmetical accuracy of the balance sheet but should also enquire into its real accuracy and fairness.
- 3. He should satisfy himself about the valuation of assets.
- 4. He should perform his duties with great care and skill.
- 5. It is the duty of a company auditor to check the stock properly.

Duties arising out of Professional Etiquette: -

- 1. Every auditor should carry on his duties with due regard to public interest.
- 2. An auditor should comply with the rules and regulations formulated by the Institute of Chartered Accountant of India.
- 3. He must be honest, sincere, technically competent and independent.
- 4. He should disclose full and fair information about the working and financial position of the company.

Liabilities of a Company Auditor

A Company Auditor is appointed under the Companies Act. So his liabilities are determined by the Companies Act.

Under the Companies Act, the liabilities of a company auditor can be grouped under two heads. They are

1. Civil Liabilities
2. Criminal liabilities

Civil liabilities: - Liability of an auditor to pay damages is known as civil liability. The civil liabilities of company auditor may be grouped under two heads. They are:

1. Liability for negligence
2. Liability for misfeasance

Liability for negligence: - An auditor of a company is appointed by the shareholders. As such, he becomes an agent of the shareholders; he must safeguard the interest of the shareholders and the company. To safeguard the interests of the shareholders and the company he must exercise reasonable care and skill in the performance of his duties. If he fails to do so, and shareholders or company suffers any loss, the auditor will be held liable to make good the loss.

The civil liability of an auditor for negligence has been confirmed in several leading cases. For instance

London Oil Storage Co. vs. Sears Hasluck and Co: - in this case, the auditor failed to verify the existence of assets as shown in the balance sheet; he is liable to pay damages to the company.

Liability for misfeasance: - Misfeasance means wrongful performance of a fiduciary duty. In other words, it means breach of duty imposed by law. If an auditor of a company does something wrongfully in the performance of his duties, resulting in financial loss, he is guilty of misfeasance.

If an auditor of a company does not comply with the provisions of section 227 (2) of the Companies Act, which deals with the statements the auditor has to make in his report to the shareholders, he is guilty of misfeasance and is liable to pay fine .

If an auditor signs the auditor's report in violation of the requirements of section 227 and 229 of the companies Act of 1956, he is guilty of misfeasance and becomes liable to pay fine.

An auditor who misapplies any money belong to the company he becomes guilty of misfeasance and liable for damages caused to the company.

If an auditor knowingly authorizes the issue of a prospectus which contains a false statement, he becomes liable to pay a fine and imprisonment.

The civil liability of an Auditor of a company for misfeasance has been confirmed in many cases. For instance:

In *Re London and General Bank Ltd* – in this case the assets of the company were overvalued. As a result, dividend was paid out of capital. The auditor was aware of the over valuation of the assets. But he did not report the matter to the share holders. It was held that an auditor is liable for misfeasance.

An auditor may be granted relief by the court from the liability for misfeasance if he proved that he has acted honestly and reasonably.

Criminal liability of a company auditor

Criminal liability means liability for a crime. It arises out of an act constituting a crime. The criminal liabilities of an auditor may arise under the Companies Act, the India penal Code, the Indian Income Tax Act and Chartered Accountant Act.

Criminal liabilities of an Auditor under the Companies Act

Under the Companies Act an auditor is held criminally liable in the following cases.

1. Under section 63 for misstatement in prospectus.
2. Under section 68 for fraudulently inducing persons to invest money.
3. Under section 233, for on complaints with section 227 and 229 of the company's Act.
4. Under section 240 for failure to assist investigation
5. Under section 242 for failure to assist prosecution of guilty officers.
6. Under section 477, for failure to return property, books or papers.
7. Under section 539 for falsification of books
8. Penalty for deliberate act of commission or omission under section 628.

Criminal liability of an Auditor under Indian Penal Code.

If an auditor issues signs any certificate believing that such a certificate is false in any material point, he becomes punishable.

Criminal liability of an Auditor under the income tax act of 1961.

An auditor may become criminally liable in the following circumstances.

1. If has been committed of an offence in connection with taxation proceedings, he will be disqualified from representing an assessee for a certain period .

2. If an auditor submits knowingly any false statement in the form of account for the preparation income tax returns, he becomes liable for imprisonment

Criminal liability of an Auditor under a Chartered Accountants Act

1. If a person not being a chartered accountant acts as an auditor of a company and signs any document, he becomes liable for criminal prosecution.
2. A member of the Institute will be deemed to be guilty of professional misconduct if he submits any return, statements or form to the council knowing them to be false.

MODULE 5

AUDIT REPORT

An audit report is a statement through which an auditor submits his findings and expresses his opinion on the state of affairs of the company's business. In other words, it is a statement through which an auditor summarizes result of his audit work. In short it is the medium through which an auditor expresses his opinion on the financial statement of a business.

CHARACTERISTICS OF AUDIT REPORT

- 1) It is the medium through which an auditor expresses his opinion on the financial statement.
- 2) It is the end product of audit.
- 3) It is based on factual information.
- 4) The audit report may be short or long.
- 5) The audit report may be in the form of letter or statement.
- 6) The audit report is attached to the balance sheet.

DISTINCTION BETWEEN AN AUDIT REPORT AND AN AUDITOR'S CERTIFICATE

An auditor's report is merely an expression of the auditor's opinion on the financial statement of a business. On the other hand, an auditor's certificate is the declaration as to the truthfulness of a statement given by a person.

An auditor's report is based on facts, estimates and assumptions, whereas auditor's certificate is based only on facts.

An auditor's report is not guaranteed of the absolute correctness and accuracy of the financial statements. But an auditor's certificate is a guarantee of the absolute correctness and accuracy of the financial statements.

If a signed report by an auditor is wrong, the auditor cannot be held responsible. On the other hand, if a duly signed certificate by an auditor is wrong, the auditor will be responsible.

IMPORTANCE OF AN AUDIT REPORT

It is a statutory requirement in the case of a company audit.

It is the end product of audit. It summarizes the result of the audit work done by the audit.

It is the medium through which an auditor submits his findings and expresses his opinion on the state of affairs.

An audit report ensures to the shareholder that the accounts of the company are properly maintained.

It is evidence in the court of law

CONTENTS OF AUDIT REPORT

An audit report has to contain matters as per section 227(3) of the companies act of 1956 the audit report of a company cannot contain the following matters:

- 1) Whether he has obtained all the information and explanation.
- 2) Whether proper books of accounts as required by law have been kept by the company.
- 3) Whether the company's balance sheet and profit and loss account are in agreement with the books, accounts and returns.
- 4) Whether any other statements have been concluded as required by the central govt.
- 5) Whether in his opinion
 - a) Balance sheet represents true and fair view of the state of affairs.
 - b) Profit and loss account represents correct profit or loss for the financial year.

ESSENTIALS OF AN AUDIT REPORT

- 1) It must be a statement of facts.
- 2) The report must contain the auditor's opinion.
- 3) The report should not give vague statement.
- 4) The report should be convincing.
- 5) The report must be coherent.
- 6) It must be simple to understand.
- 7) It must be forceful.
- 8) It should be unbiased.
- 9) The information given in the report should be clear and concise.
- 10) The report must convey to the client the material facts known to the auditor.
- 11) The report must be signed by the auditor.
- 12) The report must be attached to the balance sheet.

TYPES OF AUDIT REPORT

1). Clean or unqualified report

When an auditor is satisfied with the affairs of the company and the fairness of the balance sheet and profit and loss account of the concern, he gives in his report the various matters without any reservations, qualifications or modifications. Such a report is called a clean report or unqualified report.

A clean report is given by an auditor when he is satisfied as to the truthfulness and fairness of the accounts and the financial statements of the company

2). QUALIFIED OR ADVERSE REPORT

When an auditor finds some irregularities in the books of accounts or in the financial statements, the auditor gives a report mentioning the irregularities. Such a report is called a qualified report. A qualified report is a report in which the auditor inserts any qualifications, modifications or reservations.

A qualified report is given by an auditor under the following circumstances:

- 1) When he is not satisfied with the accounts or financial statements.
- 2) When proper books of accounts as required by law have not been maintained.
- 3) When there is a violation of the companies act
- 4) Where report is a material misstatement in the financial statement.
- 5) Where there is an omission of a material disclosure.
- 6) When the explanations sought by the auditor are not made available to him.
- 7) Where the assets are over or under valued.
- 8) Where secret reserve have been created.
- 9) Where there is insufficient provision for depreciation.
- 10) Where there is inadequate provision for bad and doubtful debts.

AUDITING IN ELECTRONIC DATA PROCESSING ENVIRONMENT (EDP)

Computerized information system environment or electronic data processing environment means an environment where computers are extensively used in an enterprise for the processing of significant financial information. In other words, data processing done with the help of electronic computers is popularly known as electronic data processing or computerized information system (CIS) environment.

USES OR BENEFIT OF COMPUTERIZED AUDIT

- 1) Speed : the work of recording of transactions , preparation of books , accounts can be done with greater speed.
- 2) Greater accuracy : the chances of arithmetical errors and human errors are reduced to minimum.
- 3) Greater economy: under the mechanized accounting system, work can be done with minimum staff, with minimum cost.
- 4) Better records: records prepared by machines are neat and clean. It is more legible, systematic and uniform.
- 5) Greater information : various types of information and statistical data regarding the operation of the business can be easily collected.
- 6) Interim accounts : interim accounts can be prepared without delay. This will help the management to declare interim dividend.
- 7) Analysis of data : once the basic information is feed into the computers, it can be sorted in many different ways to provide analysis of statement .
- 8) Avoid overtime : the work of accounts are done quickly , the accounts can be prepared without any loss of time.
- 9) Reduction in audit fee: the work load of audit works is reduced by the computers. Hence the computerized audit reduces audit cost.
- 10) Computerized audit reduces the monotony of audit work:
- 11) Computersised audit enhances the reliability of audit
- 12) Computersied audit ensures flexibility in the audit programme.
- 13) Computersied audit is helpful for the smooth functioning of auditing.

PROBLEMS OR DISADVANTAGES

- 1) It is not suitable for small business forms.
- 2) Difficulties to detect the errors and frauds.
- 3) Absence of supporting vouchers.
- 4) Storage problem
- 5) Computer frauds and computer virus.
- 6) Easy to make alterations
- 7) It creates unemployment.
- 8) Absence of input documents.

- 9) Lack of visible output
- 10) Coding problem.

AUDIT APPROACHES IN AN EDP ENVIRONMENT

There are three approaches to auditing in an EDP environment . They are

- 1) Auditing around the computer
- 2) Auditing with the computer
- 3) Auditing through the computer

AUDITING AROUND THE COMPUTER

Auditing around the computer is an audit approach under which an auditor carries out the audit in the same way as in a traditional or

Manual system except that, instead of examining hand written books, he examines computer printouts.

Auditing with computers: - under this approach, the auditor does the audit work with the help of computers that is general software. Under this approach, audit work is carried on in an traditional manner, but the computer software is used for certain operations.

Auditing through the computer

Auditing through the computer means making use of computer in auditing. Under this approach the auditor evaluates the internal control relating to EDP and on the basis of evaluation , he determines the nature , timing , and extent of his sustentative procedures.

INTERNAL CONTROL UNDER AN EDP ENVIRONMENT

For the control of various problems connected with the installation and operation of computers in accounting and auditing, there should exist an adequate and satisfactory internal control system in the undertaking . The internal control system should be reliable , effective, and should provide timely , authorized and required data from the system.

The various internal controls required to be enforced under an EDP environment may be broadly classified into two categories.

They are,

- 1) General EDP controls
- 2) EDP application controls.

GENERAL EDP CONTROLS.

The purpose of general EDP control is to establish a frame work of overall control over EDP activities. Some of the important general EDP controls are,

- 1) Division of responsibility or duties.
- 2) Control over development and maintenance of software
- 3) Control over operators.
- 4) Control over data access and program access.
- 5) Control over editing of data.
- 6) Storage control.
- 7) Hardware control.

EDP APPLICATION CONTROL

For the smooth working of EDP system, besides the general EDP controls, there should certain special EDP application controls. The important EDP application controls are

- 1) Control over input
- 2) Control over processing
- 3) Output control

COMPUTER ASSISTED AUDITING TECHNIQUES.(CAAT)

Techniques which used computer itself for audit purposes are called computer assisted techniques. The important CAAT are

- 1) Test data
- 2) Integrated test facility
- 3) Controlled processing
- 4) Computer audit program

Recent trend in auditing or current issues:

There are several current issues in auditing. Some of the important current issues or recent trends in auditing are:

1. Audit committees
2. Social audit
3. Inflation audit
4. Human resource accounting and auditing

5. Energy audit
6. Reporting on financial sickness
7. Financial forecast and their audit.

Audit Committees: - An audit Committee is a subcommittee of the board of Directors formed for the purpose of reviewing the annual financial statements before their submission to the Board of Directors, assisting the Board of Directors in discharging their function efficiently and for acting as a liaison between the board of directors and the external auditor.

The setting up of audit Committee has been supported by Stock Exchange, Corporate law authorities, Professional accounting bodies.

The Composition of audit Committee depends mainly up on the nature and the size of the business. An audit committee, generally, consists three to five members.

Functions of Audit Committee are: -

1. To consider questions of appointment, resignation, dismissal, remuneration of the auditor.
2. To discuss the nature and scope of duties of external auditor.
3. To review the half yearly and annual financial statements.
4. To discuss the issues and problems arising from the audits.
5. To assist the Board of Directors in the fulfillment of their duties and responsibilities.
6. To evaluate the efficiency of the working of the Board of Directors

Social Audit: - Social audit is a systematic study and evaluation of a business enterprise's social performance as distinguished from its economic performance. Social audit is intended to evaluate the social performance or social contribution of a business organization

Reporting on Financial Sickness : - The Sick Industrial Companies are those company which satisfies following conditions:

1. It is an Industrial company.
2. It has been registered for a period of not less than five years.
3. Its accumulated losses at the end of the financial year equal or exceeds its net worth.

An auditor is required to assess the financial health of an enterprise, identify initial financial sickness and reporting on the same.

Financial forecasts and their Audit : - A forecast is a statement of events likely to occur. A financial forecast is a forecast of the financial position of an enterprise in the future. Now a day, certified accountants are required to report on their client's profit forecast and financial forecast.

Inflation audit : - The accounting which records the effect of changing price is known as inflation accounting. The auditor is required to consider the price level changes recorded in the books of account.

Human resource accounting and auditing: - It is the accounting and recording of human beings in the organization like other assets. The auditor will be called up on to evaluate the human resource investment.
