UCM-52 PRACTICAL AUDITING
Unit-I – INTRODUCTION TO AUDITING
100% Theory
Question and Answers Bank

Syllabus: [New Regulation: CBCS 2012]


1. What is an Audit? (April 2013)

The word audit is derived from the Latin word “AUDIRE” which means to hear. Initially auditor was a person appointed by the owners to check account whenever the suspected fraud, he was to hear explanation given by the person responsible for financial transactions. The emphasis now is clearly on the verification of accounting date with a view on the reliability of accounting statement.

2. What is definition of Auditing? (Nov- 2013)

Spicer and Peglar define auditing as “An examination of the books, accounts and vouchers of a business’s shall enable the auditor to satisfy himself whether or not the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the business according to his best of the information given to him and as shown by the book.

Mautz: defines auditing as being “Concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements and reports.”

3. Write the meaning of Auditing? (Nov-2014)

Auditing is systematic examination of books and records of an organisation to confirm whether the prepared financial statements are giving true and fair view or not.

• Example 1: Mr. X is a sole trader. One of his staff member has misappropriated a sum of Rs. 10000/-. Mr. A is an experienced chartered accountant he is requested by it’s to conduct investigation for the purpose of finding out the thief. Here purpose is catching the thief.
4. **What is investigation? (Nov-2013)**

   Investigation is the act of detail examination of activities so as to achieve certain objectives. Systematic investigation of books and records to fulfill a specific purpose is called investigation.

   **Example:** A, B and C partners in ABC Company. They have requested Mr. B to join as partner. Mr. Z is an experienced chartered accountant and he is requested by B to conduct investigation on ABC and Company to know about profitability and financial position. So here purpose is to know about profitability, financial positions etc.

5. **What is Statutory Audit? (April 2013)**

   Statutory Audit is any audit carried on as per the requirement of law is called as a statutory audit. Eg: all companies have to get their accounts audited as per the provision of the company’s Act of 1956.

6. **What is Continuous Audit?**

   Continuous audit is one in which the auditor visits his clients office at regular intervals throughout the year to verify the account.

   The objective of Continuous audit may be-
   a. To get final account audited immediately after the closure of accounting year.
   b. When the business is very large.
   c. When interval control system is into effective.
   d. When regular final accounts are required.

7. **Mention any two objectives of Audit? (Nov-2012)**

   **Primary Objectives:** The above definition itself indicates primary objective of auditing which is conforming whether financial statements are in accordance with books and records or not.

   **Secondary Objectives:** The Secondary objectives of auditing includes: Detection and prevention of errors, Detection and prevention of frauds.

8. **What do you mean by Internal Audit? ? (Nov-2011)**

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


Error of Principle are the errors committed by not properly following the accounting principles. These arise mainly due to the lack of knowledge of accounting. Eg: Revenue expenditure may be treated as Capital Expenditure.

10. What is External Audit?

An external audit, defined as a company audit which is performed by a party which is not a department or employed by business to be audited, are very commonly performed. The external audit approach has 2 main purposes: The company believes an outside party will be more efficient at the work or because a governmental entity, such as the IRS, is auditing the business.

PART - B

1. What are the advantages of Audit?

ADVANTAGES OF AUDIT: (Nov-2013)
1. Audited account are detected as an authentic record of transaction.
2. Errors and frauds are detected and rectified.
3. It increases the morale of the staff and thus it prevents frauds and errors.
4. Because of his expertise the auditor may advise on various matters to his clients.
5. An auditor acts as a trustee of his shareholders. Hence he safeguards their financial interest.
6. For taxation purpose auditing of account is amust.
7. In case of any claim is to be made from the insurance company only audited account should be submitted.
8. Even in case of partnership firm auditing of accounts helps in the settlement of claim at the time of retirement/death of a partner.
9. Auditor account helps in managerial decisions.
10. They are useful to secure loan at the of amalgamation, absorption, reconstruction etc.
11. Auditing safeguards the interest of owners, creditors, investors, and workers.
12. It is useful to take certain financial decisions like issuing of shares, payment of dividend etc.

2. What are the Limitations of Auditing?

Generally following are the Limitations of auditing
1. **Non-detection of errors/frauds:** Auditor may not be able to detect certain frauds which are committed with malafide intentions.

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

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

4. **Conflict with others:** Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal 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 can not be measured. Audited statements due to these limitations can not exhibit true position.

9. **Detailed checking not possible:** Auditor cannot check each and every transaction. He may be required to do test checking.

### 3. Distinction between Auditing and Accounting?

#### Differences between Accounting and Auditing.

<table>
<thead>
<tr>
<th>Accounting</th>
<th>Auditing</th>
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<tbody>
<tr>
<td>1. It’s a continuous process carried out throughout the year.</td>
<td>1. It’s a one time activity after the closure of accounting year.</td>
</tr>
<tr>
<td>2. No prescribed qualification is required to be an accountant.</td>
<td>2. He must be the member of Institute of Chartered Accountants of India to become an auditor.</td>
</tr>
<tr>
<td>3. An accountant is a employee of the company.</td>
<td>3. An auditor is an independent professional.</td>
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<tr>
<td>4. An accountant gets regular salary for his work.</td>
<td>4. He gets remuneration for his professional work. Audit fees.</td>
</tr>
<tr>
<td>5. Accounting is concerned with recording of</td>
<td>5. Its concerned with verification of accounts</td>
</tr>
</tbody>
</table>
4. Write the different types of audit? (Nov-2013)

2. **Statutory Audit:** any audit carried on as per the requirement of law is called as a statutory audit. eg: all companies have to get their accounts audited as per the provision of the company’s Act of 1956.

3. **Periodical/Annual Audit:** it is a kind of audit where the auditor verifies the account at the end of the financial year. He starts the audit work after the closure of financial year. This is a common audit and is mostly used by small organizations.

4. **Interim audit:** it’s an audit conducted in the middle of the accounting year before the accounts are closed. In other words, any audit conducted between two financial audit is known as interim audit. The objective is to get periodical results, to declare interim dividend.

5. **Partial Audit:** when an auditor is asked to audit only a part of the account system. Its called partial audit. Eg: he may be asked to audit only the payment side of cash book.

6. **Balance sheet audit:** it’s a kind of partial audit and is concerned with the verification of only those items appearing in the Balance Sheet. It is more popular in the USA. In fact while verifying BS items the auditor verifies/checks all related items/accounts.

7. **Cost audit:** cost audit is defined as the verification of cost accounting records. Data and techniques for its accuracy and authenticity. It gets as effective managerial tool for the detection of errors and frauds in cost accounting records. The companies act implies the central government to order cost audit in case of specifies companies.

8. **Management audit:** Management audit may be defined as a comprehensive examination of an organizational structure of a company, institution/government and its plans and objectives it means of operations and use of human and physical facilities. The main objective of mgt audit is to see how far the objectives of mgt are fulfilled. It aims to ascertain whether sound mgt prevails throughout the organisation and evaluates its efficiency in the system of its operation.

9. **Continuous audit:** a continuous audit is one in which the auditor visits his clients office at regular intervals throughout the year to verify the account. The objective of CA may be-
   a. To get final account audited immediately after the closure of accounting year.
   b. When the business is very large.
   c. When interval control system is into effective.
   d. When regular final accounts are required.

**ADVANTAGES:**
1. Errors and frauds are discovered and rectified quickly.
2. The chances of fraud are reduced.
3. The workers will be careful in their work.
4. Continuous audit acts as a valuable morale check on the staff.
5. Final audit becomes easier and faster.
6. If the company wants to declare interim dividend its easier to prepare interim account.
7. It increases the efficiency and accuracy in the accounts.

**DISADVANTAGES:**
1. After the auditor’s visit is over, alternative may be made.
2. It affects the regular work.
3. Its not suitable for small organizations.
4. The auditor may lose the line of work if he does not complete his work in a visit.

5. **What are different between Auditing and Investigation?**

Comparison between Audit and Investigation:

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<th><strong>Audit</strong></th>
<th><strong>Investigation</strong></th>
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<tbody>
<tr>
<td><strong>Description</strong></td>
<td>Audit means the inspection, examination or verification of a person, organization, system, process, enterprise, project or product.</td>
<td>Investigation means an inquiry, or is the act of detail examination of activities so as to achieve certain objectives.</td>
</tr>
<tr>
<td><strong>Owners</strong></td>
<td>Audit is conducted on behalf of owners only and they make the appointment.</td>
<td>Investigation may be conducted either by owner of the undertaking or by an outsider.</td>
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<tr>
<td><strong>Purpose</strong></td>
<td>To determine the true and fair view.</td>
<td>Varies from business to business</td>
</tr>
<tr>
<td><strong>Process</strong></td>
<td>Routine process</td>
<td>Investigation is not a regular process</td>
</tr>
<tr>
<td><strong>Scope</strong></td>
<td>It includes only an examination of the accounts of a business</td>
<td>It covers an examination of the accounts but also covers an inquiry into other matter that are connected with the purpose for which it is undertaken</td>
</tr>
<tr>
<td><strong>Period</strong></td>
<td>Year or six months</td>
<td>May cover several years</td>
</tr>
<tr>
<td><strong>Employees</strong></td>
<td>Does not examine</td>
<td>May examine personally</td>
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6. What are the features of Auditing?

FEATURES OF AUDITING

a. Audit is a systematic and scientific examination of the books of accounts of a business;

b. Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

c. Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

d. Audit is a critical review of the system of accounting and internal control.

e. Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

f. The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

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

7. What are the objectives of Auditing?
Objectives of Auditing.
Auditors are basically concerned with verifying whether the account exhibit true and fair view of the business. The objectives of auditing depends upon the purpose of his appointment.

Primary Objective.
The primary objective of an auditor is to respect to the owners of his business expressing his opinion whether account exhibits true and fair view of the state of affairs of the business. It should be remembered that in case of a company, he reports to the shareholders who are the owners of the company and not tot the director. The auditor is also concerned with verifying how far the accounting system is successful in correctly recording transactions. He had to see whether accounts are prepared in accordance with recognized accounting policies and practices and as per statutory requirements.

Secondary Objective:
The following objectives are incidental to the main objective of audting.

1. Detection and prevention of errors: errors are mistakes committed unintentionally because of ignorance, carelessness. Errors are of many types:
   a. Errors of Omission: These are the errors which arise on account of transaction into being recorded in the books of accounts either wholly partially. If a transaction has been totally omitted it will not affect trial balance and hence it is more difficult to detect. On the other hand if a transaction is partially recorded, the trial balance will not agree and hence it can be easily detected.
   b. Errors of Commission: When incorrect entries are made in the books of accounts either wholly, partially such errors are known as errors of commission. Eg: wrong entries, wrong Calculations, postings, carry forwards etc such errors can be located while verifying.
   c. Compensating Errors: when two/more mistakes are committed which counter balances each other. Such an error is know an Compensating Error. Eg: if the amount is wrongly debited by Rs 100 less and Wrongly Credited by Rs 100 such a mistake is known as compensating error.
   d. Error of Principle: These are the errors committed by not properly following the accounting principles. These arise mainly due to the lack of knowledge of accounting. Eg: Revenue expenditure may be treated as Capital Expenditure.
   e. Clerical Errors: A clerical error is one which arises on account of ignorance, carelessness, negligence etc.
**Location of Errors:** It is not the duty of the auditor to identify the errors but in the process of verifying accounts, he may discover the errors in the accounts. The auditor should follow the following procedure in this regard.

1. Check the trial balance.
2. Compare list of debtors and creditors with the trial balance.
3. Compare the names of account appearing in the ledger with the names of accounting in the trial balance.
4. Check the totals and balances of all accounts and see that they have been properly shown in the trial balance.
5. Check the posting of entries from various books into ledger.

**Deduction and Prevention of Fraud:** A fraud is an Error committed intentionally to deceive/to mislead/to conceal the truth/the material fact. Frauds may be of 3 types.

a. **Misappropriation of Cash:** This is one of the majored frauds in any organisation it normally occurs in the cash department. This kind of fraud is either by showing more payments/less receipt.

   The cashier may show more expenses than what is actually incurred and misuse the extra cash. Eg: showing wages to dummy workers. Cash can also be misappropriated by showing less receipts

   Eg: not recording cash sales. Not allowing discounts to customers. The cashier may also misappropriate the cash when it is received. Cash received from 1st customer is misused when the 2nd customer pays it is transferred to the 1st customer’s account. When the 3rd customer pays it goes forever. Such a fraud is known as “Teaming and Lading”. To prevent such frauds the auditor must check in detail all books and documents, vouchers, invoices etc.

b. **Misappropriation of Goods:** here records may be made for the goods not purchase not issued to production department, goods may be used for personal purpose. Such a fraud can be deducted by checking stock records and physical verification of goods.

c. **Manipulation of Accounts:** this is finalizing accounts with the intention of misleading others. This is also known as “WINDOWS DRESSING”. It is very difficult to locate because its usually committed by higher level management such as directors. The objective of WD may be to evade tax, to borrow money from bank, to increase the share price etc.

to conclude it cab be said that, it is not the main objective of the auditor to discover frauds and irregularities. He is not an insurance against frauds and errors. But if he finds anything of a suspicious nature, he should probel it to the full.
PART – C

1. Discuss the advantages and disadvantages of Auditing?

Auditing has become a compulsory task in the business organization. All the organizations like business, social, industries and trading organizations make audit of books of accounts. Now-a-days, owner of business and its management are separate. So, to detect and prevent frauds, auditing has become essential. Its advantages are as follows:

**ADVANTAGES OF AUDIT**

1. Audit Helps To Detect And Prevent Errors And Frauds
   An auditor's main duty is to detect errors and frauds, preventing such errors and frauds and taking care to avoid such frauds. Thus, even though all organizations do not have compulsion to audit, they make audit of all the books of accounts.

2. Audit Helps To Maintain Account Regularly
   An auditor raises questions if accounts are not maintained properly. So, audit gives moral pressure on maintaining accounts regularly.

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

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

5. Audit Facilitates The Sale Of Business
   Valuation of assets is made by the auditor. On the basis of valuation of assets and liabilities, businessman can sell his business. It helps to determine the price of business.

6. Audit Helps To Assess Tax
   Tax authorities assess taxes on the basis of profit calculated by the auditor. In the same way sales tax authority calculates sales tax on the basis of sales shown in the audited statement.
7. Audit Facilitates To Compare
An auditor instructs an accountant in the same way which helps to compare books of accounts of current year with the accounting of the previous year. So, comparing the accounts of current with previous years helps to detect errors and frauds.

8. Audit Helps To Adjust Account Of Deceased Partner
Valuation of all the assets and liabilities of the business is made by the auditor while auditing books of account. Such valuation helps to clear the amount of deceased partner.

9. Audit Helps To Present A Proof
If any case is filed against the auditor regarding negligence, auditor can present audited report as a proof to settle such case. So, it helps to present proof to settle such cases.

10. Audit Provides Information About Profit Or Loss
A businessman wants to know profit or loss of his business after a certain period of time. So, the owner of the business can get information about profit or loss after auditing the books of accounts.

11. Audit Helps To Prepare Future Plan
All the audited statements remain true and correct. Such true and correct account helps to prepare for the future plans.

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

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

DISADVANTAGES OF AUDITING:
1. Management auditor cannot understand the practical problems. So, the suggestions provided by them is theoretical but not practical.

2. Scope of management audit is vague. So, it does not help to achieve specific goal.
3. Generally management gives more emphasis on maintaining books of accounts rather than concentrating on other factors. So, it consumes time of farsighted management.

2. What are types of audit?

There are following types of audit

- Statutory Audit
- Periodical/ Annual Audit
- Interim audit
- Partial Audit
- Balance sheet audit
- Cost audit
- Management audit
- Continuous audit
- Nonstatutory Audit
- External Audit
- Internal audit
- Final Audit
- social audit
- performance Audit

1. Statutory Audit: any audit carried on as per the requirement of law is called as a statutory audit. e.g. all companies have to get their accounts audited as per the provision of the company’s Act of 1956.

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   - When the business is very large.
   - When interval control system is into effective.
   - When regular final accounts are required.

9. **Non statutory audit**: This are the audit not specially required by law this scope of the audit will be outline by the contract between the auditor and the clients.

10. **External audit**: external audit is that which is critical review of the representation of the published financial statements it is compulsory for all company;s which are listed in the stock exchange.

11. **Internal Audit**: this is a review of operation carried out sometimes continuously specially assigned staff with in the client business.

12. **Final Audit**: final audit is commenced when all account has been closed and final accounts is been prepared.

13. **Social Audit**: social audit is performed to know the corporate social responsibility.
1. **What is an Audit Programme? (Nov-2013)**

   Audit Programme before commencing the audit he should plan his work so that is over without delay. For this purpose the auditor chalks out a detailed programme explaining the procedure to be followed for audit. It explains the work to be done by the audit staff.

2. **Define Audit Programme. (Nov-2013)**

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

   Hence an audit programme is a statement giving instructions and guidance to the audit staff as to the audit procedure. It arranges and distributes the work among the audit staff.

3. **Write the meaning of Audit File? (Nov-2012)**

   An audit file is a file that contains records of audit events and provides an audit trail.


   Audit Note Book is one of the most important document maintained by the auditor. It is defined as a record used mainly in recording audit, containing data on work done and comments made. Audit Note book contains information regarding the day to day work performed by the audit staff, notes about errors, explanations required etc. the auditor can use it as an authentic evidence in the court if there is any case against him.


   RAAK/B.COM/S.ANURADHA/PRACTICAL AUDITING /III YEAR/ V Sem/UCM-52/UNIT-2/ANSWERS /VER 1.0
Audit working papers are those papers which contain essential facts about accounts, which are being audited. Its defined as the file of analysis, summaries, comments and correspondence build up by the auditor during the course of audit.

The auditor maintains papers as supporting evidence to the audit work. Usually, audit working papers contains a copy of the trial balances, schedule of debtors and creditors, reconciliation statements important correspondence etc.

6. What is Internal Check?

Internal check is a system under which accounting methods and details of an establishment are laid out that the accounts and procedures are not under the absolute and independent control of any one person or the contrary the work of one employee is complementary to that of another.

The system of IC is based upon the principle of division of labor, where in performance of each individual is automatically checked by another. This is possible by proper allocation the work and integration of function of the employees in such a manner their work complements each others.

7. Define Internal Check?

"DePaula has defined internal check as "a continuous internal audit carried on by the staff itself by means of which the work of each individual is independently checked by another member of the staff."

8. What do you mean by Internal Audit? (Nov-2011)

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

9. What is an objective of Internal Check? (Nov-2011)

- Eliminates frauds and errors to prevent misappropriation of goods in cash.
- To encourage specialization of labor.
- To reduce the time spent on a particular work.
To exercise moral pressure over staff members.

- To make accounting system more reliable.

10. What is External Audit?

An external audit, defined as a company audit which is performed by a party which is not a department or employed by business to be audited, are very commonly performed. The external audit approach has 2 main purposes: The company believes an outside party will be more efficient at the work or because a governmental entity, such as the IRS, is auditing the business.

11. What is definition of Audit Working Papers?

It defined as the file of analysis, summaries, comments and correspondence build up by the auditor during the course of audit.

The institute of chartered accountants of India states that “an auditor is expected to maintain evidence of work done by him and his staff”. Usually, audit working papers contains a copy of the trial balances, schedule of debtors and creditors, reconciliation statements important correspondence etc.

12. What is Auditors Lien?

The auditors if has into been paid his audit fees has the right to keep the books of accounts and other related documents in his possession till his dues are paid. Such a right is known as Auditors Lien.

13. Why does an auditor use a tick mark? (Nov- 2012)

Audit tick marks are abbreviated notations used on audit work papers to denote auditing actions taken. These tick marks are useful from the audit manager's perspective, to see which activities have been completed. They are also useful as evidence, to show which audit steps were completed to support the audit opinion given to the financial statements of a client.

14. Write any two limitations of audit Programme. (Nov- 2014)

- The audit work becomes mechanical.
- It kills the creativity of the audit staff.
• Chances of work not done properly high as the scope is to be completed within a scheduled time.

• A rigid programme may not be suitable for all kinds of business.

15. Define Internal Control?

Internal Control is defined as “the whole system of controls, financial and otherwise established by the management in the conduct of a business including internal check, internal audit and other forms of control.

16. What is the meaning of Internal Control?

Internal control is a broad term which is normally used to control financial and non-financial activities. It involves a number of checks and controls exercised in a business to ensure efficient and economic working.

PART - B

1. What are the advantages of Audit Programme?

ADVANTAGES OF AUDIT PROGRAMME (Nov-2012)

• It provides the audit staff clear instructions about their duties.

• It promotes division of work in a well organized manner.

• It helps the auditor to monitor the progress of the work.

• It will be easier to fix responsibilities for omissions and commissions.

• It serves as a valuable evidence for the work done.

• It serves as a guide for future audit.

• It ensures that audit process in a systematic manner.

• It eliminates in efficiency and saves time.

• In case if any audit assistant goes on leave, his work can be easily continued by others.
• It avoids duplication of work.

2. What are the disadvantages of Audit Programme?

DISADVANTAGES OF AUDIT PROGRAMME.

• The audit work becomes mechanical.
• It kills the creativity of the audit staff.
• Chances of work not done properly/ high as the scope are to be completed within a scheduled time.
• A rigid programme may not be suitable for all kinds of business.

3. What is the content of Audit Note Book? (Nov-2011)

CONTENTS OF AUDIT NOTE BOOK:

• Nature of business and important documents such as MOA, AOA, Partnership deed etc.
• List of books of accounts.
• List of officials, their duties and responsibilities.
• Copy of the audit programme.
• Information on missing receipts, vouchers etc.
• Details of errors discovered.
• Explanations sought from the officials.
• Points to be included in the audit report.
• An audit note book should be preserved by the auditor as it contains valuable information in respect of the work done by its staff.

4. What are the objectives of Internal Check? (Nov-2013)

• Eliminates frauds and errors to prevent misappropriation of goods in cash.
- To encourage specialization of labor.
- To reduce the time spent on a particular work.
- To exercise moral pressure over staff members.
- To make accounting system more reliable.

Points to be Considered in Framing a Good Internal Check.

- No single employee should have independent control over any important aspect of the business. In other words, the work of employed should be automatically received by another.
- The duties of the employees should be changed from time to time without prior notice.
- Employees who control physical assets should not have assets to goods of account.
- It’s better to follow a system of self-balancing ledger.
- Account must be periodically verified.
- The allocation of work must be carefully done and the position must be reviewed periodically.
- While stock taking the pricing and evaluation of stock should be done by the people who are not connected to stores department.
- A cashier should not be in charge of maintaining accounts complete bank transactions etc.

5. Explain the importance of Audit Note Book? (Nov-2013)

- Audit notebook is a diary on which auditor scribble down all important inquiries to avoid the possibility of unquestioned material facts. Justice William throws light on the importance of audit notebook in the following words,

- The audit notebook that contained detailed information proved to be very helpful to the auditor in every critical moment.
For preparing the audit report it is very useful for that auditor. In case of negligence charge against the auditor, but note book good evidence can be presented. It may be also used for future guidance and reference. It also enables to auditor to know that what work his assistant at each audit has done.

6. What are the difference between internal check and Internal Audit?

<table>
<thead>
<tr>
<th>INTERNAL CHECK</th>
<th>INTERNAL AUDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal check is not a specific check but the duties of different persons are so arranged that a person’s work is automatically checked by another person while carrying out the normal duty</td>
<td>Internal audit is specifically done to check that the accounts are properly maintained and the systems are in control.</td>
</tr>
<tr>
<td>Internal check does the preventive job i.e. internal check is derived so that frauds and errors are prevented.</td>
<td>Internal audit does the detective job of identifying frauds and errors and rectifying them.</td>
</tr>
<tr>
<td>It is more of process in a day to day functioning of the business.</td>
<td>It is specific defined job.</td>
</tr>
<tr>
<td>All the persons in the organization are involved to maintain the internal check system.</td>
<td>Specific persons are appointed to the internal audit.</td>
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7. What are the auditors duty with regards to Internal check Control?

**Internal check and the Auditor:**

1. The auditor before starting audit work evaluates the system of internal check. If it is efficient he may avoid detailed checking of the transactions and he can carry out a few test check of the transactions to what extent should an auditor rely upon the system of internal check will depend upon the degree of effectiveness with which, the system is followed as well as the size of the business.

2. If the internal check system is inefficient, he had to check in detail all transactions. It should be remembered that even if the internal check system is efficient he should still test its existence and efficiency.
3. Efficient internal check system reduces his work but not his responsibility. If in the process of examination of accounts if he finds any weakness in his system, he should report it to his client.

4. Thus the existence of a good internal check system may help an auditor to a great extent, but does not reduce his legal liability.

5. If any fraud is discovered subsequently he may be held guilty of negligence. He can’t defend himself saying that he relied upon the efficient internal check system that existed in the business.

8. What are the features of Internal Check? (Nov-2011)

Spicer and Pegler have defined a system of internal check as “an arrangement of staff duties whereby no one person is allowed to carry through and record every aspect of a transaction such that without collusion between two or more persons, fraud is prevented and at the same time possibilities of errors are reduced to a minimum”.

Thus, under internal check system the staff duties are so arranged that no one person is allowed to record every aspect of the transactions and the entire work is distributed among the various members of the staff in such a manner that the work of one person is automatically checked by others.

The essential elements of internal check are as under-

- Existence of checks on day today transactions.
- The check is to be carried out continuously as a part of the routine system.
- The work is divided among the staff and each staff is assigned a specific task.
- The work of each staff though independent is complementary to the work of another.
- The system of internal check is increasingly recognized by the auditor especially when the size of the concern is large. The existence of effective internal check system relieves the external auditor of detailed checking to a larger extent.
- The extent to which an external auditor can depend upon the system of internal check is based on the procedural tests applied by him to find out the effectiveness of the system.
• However the auditor cannot be relieved of his responsibility if he was found guilty of negligence regardless of the fact that the had tested the internal check in existence in the organization before he had accept edit as correct.

PART-C

1. What is Internal check system? Explain its characteristics and Objectives? (Nov-2014)

Essentials of good internal check system

• No single staff shall have absolute control over recording of all the aspects of business transactions by himself.
• The same staff shall not be allowed to have access to all books of accounts as well as physical custody of the assets.
• Each member of the staff should be made responsible for as specific work.
• All officials and employees holding responsibility towards cash, securities or Stock should be encouraged to proceed on annual leave to prevent the concealed fraud.
• The duties of them members of the staff should be changed from time to time.
• Attempt should be made to introduce mechanical devices to prevent mis-appropriation of cash.
• Each transaction should pass through a definite route and through several hands.
• All books, vouchers, documents should be classified and made available for easy reference.
• Proper record must be maintained of the incoming and outgoing of goods from the business premises.
• Self balancing ledger system should be introduced to make the system more efficient and effective.
• No undue importance should be given to any staff member and too much reliance on any staff member should be avoided.
• Division and allocation of duties among the staff members must provide for an automatic check by others.

Objectives of internal check

• To reduce chance of fraud and errors that may be committed by any member of the staff and make it more difficult. If any fraud is to be committed two or more persons must collude together.
• To detect fraud and errors easily and correct them promptly.
• To exercise moral pressure among the members of the staff.
• To allocate duties and responsibilities of every person in such a way that he can be taken to task for any lapse on his part.

• To increase overall efficiency of the members of the staff by assigning duties based on the principle of division of labour.

• To have an accurate and reliable record of all business transactions.

2. What is internal check system? Explain system of internal check as to cash receipts and cash payments? (April 2013)

Internal check regarding CASH SALES.

Sales over the counter. The following is the internal check system regarding sales over the counter.

• Each counter should have a separate salesman.

• Each salesman should be given a separate sales memo book. Usually different color is used for different counters,

• Sales memo should be prepared by the salesman in 4 copies.

• The sales memo is checked by another clerk before being handed it over to customer. A copy is retained by the clerk.

• Payment is made at the cash counter.

• One copy of cash memo is returned to the internal duly stamped as cash paid 2 copies are return the cashier.

• The cashier records days total sales in cash sales register.

• Every salesman should prepare total sales summary of the respective counters. At the end of the day total sales as recorded by salesman, total cash received and total sales as per register must agree with each other.

Postal Sales:

A separate register should be maintained to record details of postal sales. Cash may be received either with order (cwo) or at the time of delivery (cod). Proper records
will be made in this regard for cash received and due. Usually, goods are sent by VPP (value payable post). The sales register must be checked in detail by a senior officer.

**Sales by Traveling Agents:**

- Traveling salesman should not be allowed to issue final receipts to customers.
- Amount received must be remitted to H.O. account on daily basis.
- Salesman should not be allowed to deduct their expenses or commission from the sale proceeds.
- The salesman should submit periodical sales report which must be examined in detail.

**Internal check regarding Wages:**

- In a large organization, expenses on wages with form one of the major portions of expenses. The chances of frauds are also high in this regard. In this background, a good system of internal check assumes significance.
- Frauds might be in the form of recording more wages than actually paid.
- Payment of wages to dummy/ghost workers.
- Recording wages for which no payment has been made etc.

**Internal Check as Regards Purchase.**

The purchase dept, will be responsible for proper control over purchases as far as possible. Purchases must be centralized for the purpose of internal check. The purchase process may be divided as:

- Purchase.
- Storage.
- Issues of Materials.

**Internal Check regarding Purchase of Materials:**
The concerned dept, head will send requisition letter to the purchase dept, for each dept, a separate file must be maintained for requisitions. Based on the requisition the purchase committee, purchase dept, calls for tenders from approved suppliers. These tenders must be opened by the purchase committee and the least bidder will be chosen.

Purchase order has to be sent to the selected suppliers. Usually, purchase order will be prepared by the purchase dept, a copy of which will be sent to the supplier, second to the stores, third to the accounting dept, and the fourth is retained by the purchase dept.

When goods are received the stores keeper inspects them and compared with the purchase order. If goods are acceptable he enters them in goods inward book and issues the acceptance letter. A copy of the acceptance letter will go to the accounts dept, which will again compare goods approved letter with the purchase order. The accounts manager if satisfied authorizes for its payment.

Internal Check Over Storage of Goods:

The stores keeper should maintain proper records, regarding storage of goods. He usually maintains bin cards and stores ledger surprise.

Internal Check as regards to issue of Materials: Materials should always be issued against material requisition note. After each issue, and purchase proper record must be made in bin cards and stores ledger.
SCM 52–PRACTICAL AUDITING
UNIT –III (VOUCHING)

Type: 100% Theory

PART – A (Questions& Answers)

1. What is voucher? (Nov 2012)
   A voucher may be a receipt, an invoice, an agreement, a written requisition slip or in short, any suitable written evidence which confirms a written transaction.

2. State the meaning of Vouching? (Nov/Dec 2013)
   Vouching is the essence of auditing. Vouching is a potential tool in the hands of auditors to ascertain the accuracy of various transactions entered the books of accounts.

   “Vouching is the backbone of auditing” This statement seems to be true and correct. As the human structure is affected with the weakening of the backbone, similarly the structure of auditing is adversely affected in the absence of proper vouching.

4. What are the two types of Voucher? (Nov 2014)
   - Cash voucher
     Cash book is an important financial book for a business concern. Mostly errors and fraud arise in connection with receipts and payments of cash by making misappropriations wherever possible.
   - Credit voucher
     He should check the debtors ledger intelligently to find out any outstanding. The auditor should correspond with the debtors and ascertain the correct position.

5. What are the objects of vouching?
   - Vouching involves the collection of vouchers and related evidences.
   - Vouching involves evaluating the collected evidence and vouchers.
   - Vouching involves finding out that there is no omission of any records.
   - It is to verify the cash in hand and cash at bank.
6. **What is payment of wages?**
   The wage sheets duly signed by the partner or the director of the company or by some responsible officer should be sent to cash payment. Since the wage sheets are complete in all respects, the cash department has nothing to do with their preparation.

7. **What is a cash sale?**
   ★ To check all the available evidences exhaustively.
   ★ To check cash memo and daily sales summary
   ★ To check the number of cash memo

8. **What is vouching of sales returns?**
   The entries in the sales return book, should be vouched with the credit note issued and goods outward book, in case goods are dispatched to customers to make up for any short delivery earlier, or as replacement for damaged goods.

9. **What is Debtors ledger?**
   The auditor should ensure that the work of each Ledger Clerk is independently checked. The auditor should see that entries in the Ledger are made by some other person who is not the ledger clerk.

10. **Explain the importance of vouching?**
    Vouching is an important aspect of auditing. Auditing without vouching shall be incomplete. Vouching consists in comparing entries in the books of accounts with documentary evidence in support thereof. Vouching has been said that the essence or backbone of auditing as it is one of the most potent tools in the hands of auditors.

11. **What are the objects of vouching payments side of cash book?**
    - To ensure that all receipts are accounted for.
    - To ensure that no fraudulent payments have been made.
    - To verify the cash in hand.
    - To verify the cash at bank

12. **How will you vouching of cash payments?**
    - The payments are concerning the transactions relating to the business.
    - The payments are relating to the period under audit.
    - The payments have been duly received by the payee alone.
    - The correct records have been made in cash book.

13. **How will you vouch proceeds from sale of fixed assets?**
    Whenever the fixed assets, such as land, building, machinery, furniture etc. are sold, correspondence is made with the parties who are willing to purchase them. Usually, fixed assets are sold through a broker or an auctioneer.
14. How will you vouching of sales returns?

The Procedure as to compilation of records upon the goods from customers should be carefully examined. The entries in the sales return book, should be couched with the credit note issued and goods outward book, in case goods are despatched to customers to make up for any short delivery earlier or as replacement for damaged goods.

15. What is mechanized accounting?

It has, therefore, been felt that the accounting methods should be reorganized and modernized with a view to speed up and to simplify this work. It has also been thought desirable not to give the details of each transaction in the books of account. “Shortcut” Methods have been adopted by dispensing with a number of book keeping operations.

PART – B (Questions & Answer)


- Responsible officer for cash received and authority to sign check should not be given to the cashier and a copy of counterfoil should be kept for record of office. The receipts should be numbered serially.
- All the receipt of cash should be recorded in the cash book.
- Amount of cash received should be deposited into bank daily.
- The cashier should not have any control over ledgers.
- Drawer of check should present it to responsible officer to sign.
- All unused receipt books and check books must be kept under lock.
- System for recording cash sales and miscellaneous income should be different.
- All the payments except petty cash expenses must be made by check.

2. Explain about the vouching of petty cash book? (Nov 2014)

- Auditor will commence his work by ascertaining the name of the petty cashier, the amount of the imprest, by whom it was fixed and when. He should also ascertain as to who handles petty cash during the absence of the petty cashier.
- Auditor will require the entire voucher to be numbered consecutively and filed in that very order. He will also ascertain the name of the person who
is authorised to approve vouches for payments out of petty cash and also the replenishment of the imprest.

- Auditor should carry out surprise counting of petty cash in the hands of the petty cashier and reconcile it with the balance shown by the petty cash book. All petty cash books, if more than one are used, must be produced at the same time.

- Auditor should also compare a few of the entries for petty cash cheques drawn with the entries in the petty cash book, with special reference to the dates.

- All vouchers over a certain amount must be thoroughly examined by the auditor. Posting of the totals of the impersonal ledger must also be checked.

- Auditor should also inspect the postage books to see that they are regularly balanced and the expenditure appears to be reasonable. Stamps in hand must also be counted.

- If the audit takes place sometime after the date of the balance sheet auditor must check the petty cash transactions to the date of audit and verify the petty cash balance on that date.

3. Discuss the vouching of trading transactions? (Nov 2014)

**Internal Check as regards Purchases**
- All the orders sent out should be recorded in Purchases ; order Book which should have who carbon copies one to be sent to the supplier of the goods and the other to be retained for reference purposes.

- The invoice should then be checked with the Goods Inward Book maintained by the store-keeper and the delivery note.

- The departmental head will then pass over the invoice to the clerk who will record the same in the purchased Book.

**Internal Check regarding Credit sales**
- Whenever an order is received, it should be recorded in the order received book, giving details regarding the date on which the order was received the name of the customer, the particulars about the goods, date of delivery, mode of transport, etc.

- The order or a copy of it is sent to the Dispatch Department.
When the Dispatch Department has packed the goods, another clerk should compare the goods so dispatched with the order to see that the whole of the order is complied with or another list is prepared showing the goods in the package which list is sent to the counting House.

**Vouching of sales returns**

- The procedure as to compilation of record upon the return of goods from customers should be carefully examined.
- The entries in the sales Return book, should be vouched with the credit note issued and Goods Outward Book, incase goods are dispatched to customers to make up for any should delivery earlier, or as replacement for damaged goods.
- The auditor should ascertain whether records as to sales returns are being maintained by persons who are independent of cash and sales departments.

4. **What kind of internal check is suggested for purchases?**

**Requisition:**

- The procedure for issuing purchase requisitions should be specified. The head of the department, who is in the need of goods, should fill in a requisition slip duly signed and then should send it to the purchases department.

**Enquiry:**

- Purchase department makes an enquiry about the terms and conditions of purchases from different suppliers. For this purpose tender are generally invited. But, who shall open and accept the tenders, should be clearly specified. At a rule, the lowest tender should be accepted and accordingly a decision be taken.

**Purchase Order:**

- The Purchase Department places orders which should be recorded in the Purchase Order book. Four copies of purchase order should be prepared. One copy will be sent to the vendor, second to the store department, third copy to the Accounts department and fourth one will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.

**Receipt of Goods:**

- On receipt of goods, the purchase department should be properly inspecting them, and thereafter an entry in the goods inward (Receipt)
book, the same should be sent to the stores. Concern need department should be informed about the receipt of the goods.

Making the Payments:

- The Purchase Department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with the purchase order and Incoming Inspection Report and should also verify the calculation.

5. What is the role of an auditor in mechanized accounting?

- If the mechanical system tends to change by audit programme.
- If the machine in use give out satisfactory services.
- If the machines are operate able by any person
- If the machines are in working order or out of order.
- If the machines need repairing, the calculations may be wrong.
- If the results are reliable and can be checked by any other method.

6. Suggest an Internal check regarding credit sales?

- Whenever an order is received, it should be recorded in the order Received Book, giving details regarding the date on which the order was received the name of the customer, the particulars about the goods, date of deliver, mode of transport, etc.,
- The order or a copy of it is sent to the Despatch Department.
- When the Despatch Department has packed the goods, another clerk should compare the goods so dispatched with the order to see that the with order of the order is complied with or another list is prepared showing the goods in the package which list is sent to the counting house.
- A responsible official will now mark the rate at which the goods re to charged.
- A clerk will now make the extensions.
The invoice will then be prepared in duplicate; or triplicate by means of

One copy of the invoice will be sent to the invoice clerk who enters it the sales Book and later on this is sent to the customer, another copy will be sent to the gate-keeper who will record in the Goods outward book that such and such goods left the premises: the third copy will be retained for further reference.

7. How will you vouch the bought ledger of a manufacturing concern?

- Opening Balance of different account may be checked with the Audited Balance sheet of the previous year.

- All supporting books i.e., Purchases Book, Goods outward book, cash book Allowance book, discount register, bills payable books etc should be thoroughly investigated.

- If there self-balancing system is in use, the auditor should call for a schedule of creditors from the client and total of the schedule be tallied with the creditor’s ledger adjustment account in the ledger account.

- The auditor should examine all the creditors’ statements and with their help, the purchase ledger balances should be checked. It should be seen that the balances of the purchases ledger whether debtor credit are shown on the proper side of the balance sheet.

- If provision for reserve for discount on creditors is made, it should been sure that it is not excessive.

- It should be seen that the balances of the Purchases Leger whether debtor credit are shown on the proper sided of the Balance sheet.

PART – C (Questions & Answers)

1. Describe the Procedure relating to Vouching of cash sales and receipts from debtors (Apr/May 2013)

1. Cash sales
   - To check cash memo and daily totals or receiving cashier’s cash book with the General Cash Book.
   - To check the number of cash memo.
• If cash register is used in the concern, the auditor should check the daily totals recorded in the Cash Book with till rolls.

2. Interests and Dividends:
   • He should check the cash Book, interest account and personal account.
   • He should examine that all the interests and dividends have been received at due dates and they have been duly accounted for
   • In case the rates of interests and dividends are fixed, he should calculate and check them.
   • If the collection of interests or dividend is made through the bank, the pass book should be checked.

3. Rent receivables:
   • In case the client has a large number of properties given out on rent, the auditor should ask his client to prepare Rent Register or maintain Rent Rolls in which the account of every tenant is maintained.
   • Rent received through the collecting agents shall be vouched with statement or summaries prepared by the collecting agents.

4. Commission Received:
   • He should check the commission account with the accounts of the parties from whom commission had been received.
   • He should examine the agreements with the parties for the rate of commission.
   • He should make calculations to check the accuracy of the amount.

5. Sales of Investments
   • The auditor should examine the Broker’s sold notes to vouch the proceeds from the sale of investment.
   • If the investments have been sold out cum-dividend, the auditor should see that the proceeds have been properly apportioned between revenue and capital receipts.

6. Insurance claims:
   • The auditor should examine the insurance policies carefully to ascertain the terms of claims.
   • He should examine the insurance money received from an insurance company against the claim of the firm with the help of correspondence.

7. Subscription Received:
   • The auditor should check the subscription
   • He should compare a reasonable number of entries with the register of subscribers or members
   • Care should be taken to see subscriptions Register of subscriptions, counterfoils)
2. **Vouching the receipt side of the Cash book. Explain.** (Nov 2014)

   The vouching of the receipts side of the Cash Book is more difficult than the payment side, since only indirect evidence can, as a rule, be obtained. The auditor has to guard against the omission of cash receipts and has to rely considerably on the system of internal check in force. Therefore, he should carefully examine the system of internal check relating to the receipts and should pay special attention to its weak points.

Auditor may proceed with the work of vouching cash receipts on the following lines:

1) **Opening Balance**
   
   It should be compared with the balance shown in the audited balance Sheet of the previous year to ensure that actual balance has been brought down.

2) **Cash Received from A / Receivables**
   
   The auditor should see that the persons handling remittances received take no part in the preparation and sending out of statements to Debtors. Vouch counterfoils of the receipts issued with the entries in the Cash Book, and ascertain that the issue and custody of Receipt Books is in the hands of a responsible officer of the firm.

3) **Cash Sales**
   
   In this case records available will largely depend upon the nature of the business, but the auditor should see all available evidence when vouching Cash Sales, because this forms a most likely avenue for frauds.

4) **Capital Receipts**
   
   Capital contributed can be vouched by obtaining confirmation from the proprietors of the business. Where any capital assets, such as plant and machinery, investments, etc, are sold, auditor should vouch the sale proceeds with contracts of sale, correspondence or other documents and see that the proceeds less any expense incurred have been fairly accounted for.

5) **Proceeds of Bill Receivable**
   
   Check cash receipts from bills discounted or matured with the Bills Receivable Book and see that all matured bills have been accounted for.

6) **Income from Interest, Dividends etc**
   
   Interest received on accounts of fixed Deposits in the bank should be vouched with the bank Pass Book, the genuineness of Pass Book must be ascertained. Dividends received can be checked from the counter-foils of “tops” of the Dividend Warrants or the letters covering cheques. Interest received on Securities can be vouched from the securities themselves or from the investment ledger as to the date of the receipt of interest, amount, rate, etc.
7) **Commission**  
   It can be checked with the account of the parties from whom commission is to be received. Agreements regarding rate of commission should also be inspected.

8) **Miscellaneous Receipts**  
   Any other receipt, such as rents, bad debts, dividends, subscriptions, contributions, insurance claim money share capital, income from hire purchase agreements etc., can be checked from relevant evidence available, such as leases, correspondence, agreements, receipts etc.

The auditor should consider the following points while vouching payment side of cash book

**Cash purchases**  
The auditor should see that goods paid for actually been received.  
- He should examine the entries in the cash book with the help of Cash Memos or receipted invoices issued by the suppliers and also the goods inwards book or stock ledger.  
- For cash purchases, he has especially to examine the genuineness of purchases, receipts of goods and also the relevant vouchers.  
- It is to been seen that only net amount

**Payments to creditors for goods purchased:**  
While vouching payment to creditors for goods purchased, the auditor should consider the following.  
- He should see that purchases are duly authorized and vouch them with cash Memos  
- He should see that the invoices are duly checked.  
- For vouching the payments to creditors for credit purchases the receipts from creditors acknowledging the amounts received by them should be checked by the auditor.

**Wages**  
- The vouching of payments of wages is of great importance in case of a large manufacturing concern.  
- The amount of payment involved is also very large. Therefore, the vouching of this item requires special attention on the part of the auditor.  
- There are many chances of fraudulent payment under this head. Before vouching the amount of wages paid, the auditor should carefully examine the system of internal check in force in the business.
He should also examine the system regarding the preparation of wages sheets and the system of payment of wages.

Time Records:
- In case wages are to be paid accounting to the time spent by the worker, the correct and exact time spent by him on the job must be recorded. This can be done by means of “time-recording clocks”
- The preparation of wage sheets must be entrusted to those persons who are in no way connected with the time-keeping office. The total time spent by each worker, as shown by the cards, should be entered in the wage books by a clerk.

Payment of Wages
- The wage sheets duly signed by the partner or the director of the company or by some responsible officer should be sent to the cash department.
- The payment of wages of casual workers should be done by the cashier in the presence of the foreman and appointing officer.
- A separate wage sheet for casual workers working in the various departments should be prepared in the same way as it is prepared for the regular workers.

4. What are the advantages and disadvantages of mechanized accounting?

Advantages of Machanisation:
1. Greater speed: When Accounts are prepared by means of machines instead of by hand, the work can be done with greater speed.
2. Accurate Work: Greater accuracy can be achieved as the machines seldom commit errors as compared to the work done by human beings except
3. Economical: One operator of accounting machine can do the work of several clerks and thus the salary bill of the accounts department will be reduced.
4. Clean and Legible Records: Records prepared by machines are more neat, clean and legible when compared to the records prepared by hand.
5. Multiple copies of the records: A number of carbon copies of the records can be produced at the same time without any extra cost. Thus such statements of records can be sent to the members of the Board of Directors for their consideration at the Board meetings.
6. Preparation of Interim Accounts: If the management wishes to declare an interim dividend or find out the financial position of the company at any time, the interim account can be prepared without any loss of time at the accounts are prepared in such a way that the balance is struck out whenever an entry is made.
7. Avoids Payments of overtime wages:
The statements of accounts can be sent to the customers sooner and thus there is no need for asking the staff of overstay and prepare the statement of accounts.

Disadvantages of Mechanized Accounting
- The auditor may not care to see whether the internal control is effective or not because he thinks that since accounting machines are in use, there is no possibility of any fraud.
- Loose cards or sheets which are in use in mechanized accounting might be lost or destroyed or unintentionally and thus the original documents may not reach the machine operator.
- If there is an error in the original records it may not be possible to detect such an error.
- In order to understand a transaction much time will have to be wasted because practically no narration is provided as is the case under conventional method of accounting.
- Mistakes might be committed by the auditor or the clerical stage in understanding the code numbers assigned to different transactions and account.
- Employment accounting machines may cause unemployment.
- The machine operator’s knowledge of accounting theory being limited as compared to that of a trained book-keeper, there is a possibility of errors of principles may be committed.

5. As an auditor how will you vouch capital expenditure?
Payments made for the purchase of fixed assets are of the nature of capital expenditure. Such expenditure should be carefully recorded in the books of accounts and treated whether as revenue or capital.

1. Freehold and Leasehold property
   - He should examine the document of title of property purchased.
   - If purchased through auction, the auditor should vouch the accounts of auctioneer.
   - Various expenditures incurred, such as, brokerage, commission of auctioneer, legal charges etc. should be vouched by their respective accounts. (Vouchers-Title deed, Lease, Auctioneer’s Note, Brokers Note contract)

2. Purchase of Building:
   In case of purchase buildings, the auditor should examine the following points:
   - In case any buildings has been purchased the auditor should vouch it with agreement for sale
• In case buildings has been constructed under a contract, the under a contract, the auditor should examine the actual contract.
• If the buildings have been constructed by engaging labour, he should properly examine the expenditure incurred on building material purchase, cartage paid, wages paid to the workers.

3. Patents and Copyrights:
• In case of patents and copyrights the auditor should vouch the following points
• He should be examine the receipts from the vendors.
• If purchase from auction, the auditor should examine the auctioneers accounts.
• If purchased under the Hire purchase agreement the auditor should carefully examine the agreement and the related vouchers.

4. Investments
• He should examine the Brokers Bought Note and receipts
• He should examine the securities themselves wherever it is possible
• In case the investment has been made in old shares ,share certificate should be examined.
• He should examine the Pass Book, if payments have been made through the bank.

5. Loans
• He should examine the authority to make loans, etc.,
• He should examine the Title Deed of the security
• If the loans have been given to the directors, he should examine that the approval of Central of Central Government has been obtained under section 295 of the Indian Companies Act 1956 (Vouchers-Agreement, Title Deed etc)
SCM 52–PRACTICAL AUDITING

UNIT –IV (VERIFICATION AND VALUATION OF ASSETS)

Type: 100% Theory

PART A – QUESTIONS AND Answers

1. What is the meaning of verification? (Nov 2012)
   The term verification refers to confirmation or proving the truth. It denotes
   the procedures that are carried out at the end of the period under audit in order to
   confirm the ownership, valuation, and existence of assets and liabilities at the date
   of the balance sheet.

2. What are the objects of verification?
   a) Examining the ownership possession, and title of the assets appearing in
      the balance sheet.
   b) Ascertaining the existence of the assets appearing in the balance sheet.
   c) Detecting the frauds and irregularities, if any, in the books of account of
      the concern.

3. Define verification? (Dec 2012)
   Lancaster: “The verification of assets is a process by which the auditor
   substantiates the accuracy of the right hand side of the balance sheet and must be
   considered as having three distinct objects.”

4. What is the position of an auditor as regards verification of assets?
   a. The auditor should examine the internal check system in operation.
   b. He should study and make himself familiar with the stock taking system
      followed in the organization. He should also see whether the system is
      proper.
   c. He should check the stock sheets with the stock registers.

5. What do you mean by valuation of assets?
   Assets are purchased for the permanent use of industrial concerns. They
   are continuously used in the concerns. Earnings of the concern depend upon these
   assets. The utility of these remains as long as they are in working conditions.

6. What is the importance of valuation of assets?
   a) Valuation of assets is an important step from the point of view of auditing
      It is one of the important duties of an auditor to check that the assets and
      liabilities are accurately and properly valued.
   b) The valuations done by responsible officers but ultimately it is the auditor
      to check that valuation has been done.
c) He must be cautious and take all relevant facts and evidences into consideration while ascertaining fair valuation of assets and liabilities.

7. How would you verify sundry debtors?
   - He should see that debts as disclosed in the balance sheet are recoverable.
   - Obtain a certified statement of Book Debts clearly distinguishing between good debts, secured dents, unsecured debts, current debts etc.
   - The auditor should also write to the parties and get the balances confirmed by them.

8. What are the methods of valuation?
   - Fixed Assets
   - Current Assets
   - Wasting Assets
   - Fictitious Assets
   - Intangible Assets

9. What are current Assets? (Nov 2012)
   Current Assets are those assets, which can’t be put to constant uses. They are also called as floating assets or circulating assets. They are meant for resale. They are either purchased or produced or processed for the purpose of sale.

10. What is the purpose of valuation?
    1. To certify the ownership and title of the assets appearing in the balance sheet
    2. To ascertain the existence of the particular assets appearing in the balance sheet
    3. To verify the ownership and possession of the assets.

Part-B

1. What are the objectives of verification?
   - Examining the ownership, possession, and title of the assets appearing in the balance sheet.
   - Ascertaining the existence of the assets appearing in the Balance sheet.
   - Verifying the fact whether assets are free from charge or not.
   - Detecting the frauds and irregularities, if any, in the books of accounts of the concern.
   - Ensuring the arithmetical accuracy of the books of accounts.

2. What are the methods of valuation? (Nov 2014)
   1) Fixed Assets
Fixed assets are those assets, which are purchased for the permanent use of the industrial concerns. They are continuously used in the concerns.

Earnings of the concern depend upon these assets; the utility of these assets remains so long as they are in working condition. They are neither meant for resale in the ordinary course of business nor consumer totally or partially in the business.

Plant and machinery land and buildings, furniture etc, are some of the examples of fixed assets

2) Current Assets

- Current assets are those assets, which can’t be put to constant uses. They are also called as floating assets or circulating assets. They are meant for resale. They are either purchased or produced or processed for the purpose of sale.
- Closing stock, bills receivable, book debts, cash books, bank balances etc.,
- The closing stock of goods is valued at the date of the balance sheet wither at a cost price or market price whichever is lower.

3) Wasting Assets:

- Wasting assets such mines, queries, oil, wells, etc. are of fixed nature.
- Wasting assets means exhaust by working and hence the process involves depletion of the capital employed. Hence, a charge should necessarily be made to maintain the capital employed so as to exhibit a true and fair value of the assets for the purpose of cost accounting.

4) Fictitious Assets:

- Fictitious Assets are those assets, which are not physically visible, though, of course, money is spent on them.
- The examples of such assets are preliminary expenses in a new company, special advertising expenses, development expenses, debentures discount and issue expenses
- These items are really items of expenditure not represented by actual values and so have no exchange value.

5) Intangible Assets

- Intangible assets do not have their form. Hence they are not visible in their concrete form.
However, they are equally valuable for a business concern like any other assets
There are more or less treated as fixed assets for the purpose of valuation.

3. Explain the sub-functions of verification? (Nov 2014)

- To see that all assets and all liabilities are clearly stated in the balance sheet.
- To see that they are in existence on the date of the balance sheet.
- To see that the assets were acquired for the business and are free from any charge or mortgage and they are in the name of the client.
- To see whether both the assets and liabilities are accurately valued.

4. What is the procedure for valuation of Investment? (Nov 2012)

- Investments include shares, debentures, bonds, government securities, stock, etc. Investments constitute an important asset to banks, insurance companies, financial institutions, investments companies etc., as per companies act.
- If the number of investments is large, the auditor should ask for a schedule of investments held by the client.
- The auditor should see that the asset has been shown distinctly and properly in the balance sheet according to Schedule VI in the part I of the companies Act, 1956.
- In case of investments which have been sold after the balance sheet date but before audit date, the sales should be vouched. Sec 372 of the companies Act provides for ceiling in purchase or sale of investments.

5. Distinction between vouching and verification? (Nov 2012)

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<tr>
<th>Sl.no</th>
<th>Vouching</th>
<th>Verification</th>
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<tbody>
<tr>
<td>1.</td>
<td>Vouching checks the entries as to the transactions recorded in the books of account</td>
<td>Verification examines the assets and liabilities given in the Balance sheet</td>
</tr>
<tr>
<td>2.</td>
<td>Vouching is based only on the documentary examination</td>
<td>Verification is based not on documentary examination but also it carries on</td>
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6. Explain the various kinds of values?
   a. Cost price:
      Cost price refers to the price paid for the acquisition of an asset. It includes
      the expenses incurred in the purchase of an asset and its installation.
   b. Market values:
      Market value is the value, which an asset can fetch in the market when sold.
   c. Replacement Value:
      Replacement value is a price at which a particular asset can be replaced. It
      includes expenses like commission, freight, etc.
   d. Book value:
      This is the value at which an asset appears in the books of accounts. Usually,
      assets appear in the books at cost minus depreciation written off so far.
   e. Realisable value:
      Realisable value is one, which will be realized in the market and received from
      the sale of an asset. It is normally used in the valuation of existing assets.

7. What are the procedures for verification for goodwill?
   Goodwill is an intangible asset it is the value of the reputation of the firm. It
   enables the firm to earn more than the normal rate of profit. It has no physical
   existence as such. It does not diminish in the value with use. It has the potentiality
   of self–growth.
   - At the time of its purchase:
     The amount of goodwill is equal to the difference between the total
     purchase price paid for the business and the net assets.
   - At the time of revaluation of whole of assets:

   RAAK/BCOM/M.MANIKKAVALLI/III YEAR/V Sem/SCM 52/UNIT-3/
   ANSWER /VER 1.1
Sometimes, companies revalue whole of their assets and raise goodwill account in their books.

- **At the time of Admission, Retirement or Death of a Partner in case of partnership**
  
  In case of partnership firms, goodwill is calculated and shown in the books when new partner is admitted or an old partner dies or retires.

1. **What are the Verification and valuation of Different Kinds of Assets?** (Nov/Dec 2013)

1. **Cash in Hand:**

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

2. **Cash at Bank:**

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

3. **Loans:**

   **Loans against Security of Land and Property:**

   - The auditor has not only to examine the loan account in the ledger, but he has to examine the documents relating to the security, promissory note or bond, acknowledgements by the parties.
   - If the land or property has been mortgaged, the auditor should examine the mortgage deed.
   - He should examine the title deeds relating to the property.
   - He should enquire the rate of interest and the date on which it is payable. He should see that the mortgage is duly registered.
   - He should see whether has the power to mortgage the property and borrow money.

   **Loans against Security of Stock and Shares:**

   - The auditor should get a list of such stock and shares which have been held as security. He should see that such shares are transferred to his client.
   - He should inspect such shares and see that they do not belong to his client.
   - The auditor should get a written acknowledgement from the borrower regarding the amount of loan on the date of the balance sheet or examine the agreement.

   **Loans against Security of Goods:**
Where loan has been advanced against a Godown-keeper’s receipt, such a receipt should be examined. He should see that the warehouse rent has been paid by the borrower.

He should examine the inspector’s report from time to time regarding the quantity of goods.

**Loans against Insurance Policy:**

- Last receipt for the payment of the premium paid should be examined.
- The auditor should see the notice of assignment of the policy has been given to the insurance company.

**4. Bills Receivable:**

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

**5. Investments:**

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

**Valuation of Investments:**

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

**Fixed Assets:**

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

**6. Books Debts:**

The auditor should see that the debts as shown in the balance sheet are recoverable. If they are doubtful, provision should be made for them. If they are bad, i.e., they are irrecoverable, they should not shown on the assets side. If the auditor does not pay attention to these points, the balance sheet which he
7. **Endowment Policies:**
   The auditor should physically inspect the policies and see that the premium payable has been paid and that the policy has not lapsed.

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

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

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

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

12. **Loose Tool, Patterns, Dies etc,**
    The auditor should examine the list of the loose tools. He should see that the list has been certified by a responsible officer.

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

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

2. Explain the verification and valuation of different kinds of Liabilities? (Nov 2012)

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

2. Reserve Accounts and Funds:
   For the audit of these two items, the auditor should examine the Minutes Books of directors meeting.

3. Debentures and Mortgage:
   The auditor should enquire into powers of the company to borrow money.

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

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

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

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

8. Contingent Liability:
   The auditors should consider the circumstance and the situation about the occurrence of that type of liabilities.
3. How would you value and verify inventories? (Nov 2012)

1) **First-in-first-out (FIFO):** This means your cost of sales is determined by the cost of the items you purchased the earliest. Inventory is comprised of the cost of the items you purchased the latest.

2) **Last – in – first out (LIFO):** This method is based on the assumption that the goods received at last are sold at first and the unsold stock consists of the earliest purchases and is priced accordingly.

3) **Base stock method:** Under this method, a certain minimum quantity of stock is always carried at the original cost and it is not supposed to be issued unless there is an emergency. This is treated as fixed asset.

4) **Highest-in-First – Out (HIFO):** This method assumes that the closing stock of materials should always remain at the minimum value, so that issues are priced at the highest value of available consignments in the store.

5) **Standard cost method:** Under this method the stock is valued at some predetermine price fixed on the basis of a specification of all the factors affecting the price.

6) **Adjusted selling price method:** Under this method as estimated cost is found out by pricing the unsold stock at the prevailing selling price less a normal margin of profits plus the estimated selling expenses including overhead charges..

7) **Weighted average cost (WAC):** Means that your cost of sales is determined by the average cost of the items you purchased determined at the time of sale.
SCM 52–PRACTICAL AUDITING

UNIT – V (The Audit of Limited Companies)

Type: 100% Theory

PART A – QUESTIONS AND ANSWERS

1. What is need for audit?
   The audit of accounts of the joint stock companies are required to be compulsorily audited under companies Act, 1957. Thus, the study of the principles and procedures of auditing as applicable to Joint Stock Company is of great significance.

2. Who is a first Auditor’s of the Company?
   The members in general meeting may remove the auditors of a company appointed by the Board of directors prior to the first annual general meeting. For this, it is immaterial whether the auditor has completed his place any other person nominated for this purpose by any member of the company.

3. What is Defective Appointment?
   Defective appointment of auditors Subject to the provisions of the Statutes, all acts done by any person acting as an auditor shall, as regards all persons dealing in good faith with the Company, be valid, not withstanding that there was some defect in his appointment or that he was at the time of his appointment not qualified for appointment or subsequently became disqualified.

4. What is Contractual Duties?
   An agreement with specific terms between two or more persons or entities in which there is a promise to do something in return for a valuable benefit known as consideration. Since the law of contracts is at the heart of most business dealings, it is one of the three or four most significant areas of legal concern and can involve variations on circumstances and complexities.

5. What is the meaning of negligence?
   Negligence usually includes doing something that an ordinary, reasonable, and prudent person would not do, or not doing something such a person would do considering the circumstances, situation, and the knowledge of parties involved. In civil liability (see tort), an aggrieved person or entity is entitled to claim
damages in a court. In criminal liability, it is usually an unacceptable defense to claim that one was doing one's best to avoid injury or loss.

6. **What is Auditor report?**
   The main duty of a company auditor is to make a report to the members of the company on the accounts examined by him and on the balance sheet and the profit and loss account of the company and on every document which is annexed to the balance sheet or profit and loss account laid before the company in general meeting during his tenure.

7. **What are kinds of Audit report?**
   The Internal Audit Department performs a wide range of audit services to the University community including: financial audits, compliance audits, operational audits, information technology audits, consulting/advisory services, and special investigations.

8. **What is a clean report?**
   The financial statements are free from material misstatements (in other words, a financially unqualified audit opinion) and there are no material findings on reporting on performance objectives or non-compliance with legislation.

9. **What is qualified report?**
   Annual report of the auditors which contains previous discrepancies or errors discovered by the auditors during the audit is called Qualified Report. In simple words we can say that audit report which contains objections is called qualified report.

10. **What is cost Audit?**
    An internal audit used for enterprise governance to assess operational efficiencies and resource management. Special attention is given to verification of cost records and adherence to acceptable cost accounting procedures.

**PART – B QUESTIONS**

1. **Explain the disqualifications of an auditor**
   **Disqualification of Auditor**
   According to Provisions of Section 141(3) of the Companies Act, 2013, following persons shall not be eligible as auditor of the company: -
a) A body corporate other than LLP registered under the LLP Act, 2008
b) An officer or employee of the company.
c) A person who is partner or who in the employment, of an officer or employee of the company.
d) A person who or his relative or partner
e) A person or a firm who (whether directly or indirectly) has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.
f) A person whose relative is a director or is in the employment of the company as a director or key managerial personnel.
g) A person who is in full time employment elsewhere or a person or a partner holding appointment as its auditor is at the date of such appointment or reappointment holding appointment as auditor for more than 20 companies.
h) A person who has been convicted by a court of an offence involving fraud and a period often years has not elapsed from the date of such conviction.

(i) Any person whose subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting or specialized services in reference to provision of Section 144 of the Companies Act, 2013.

2. **Explain the removal of an auditor?**

The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner.

(1) Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

(2) The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form with the company and the Registrar, and in case of companies referred to in sub-section (5) of section 139, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his signation.
(3) If the auditor does not comply with sub-section (2), he or it shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

(4) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that are tiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years (representation is received by it too late for it to do

(5) Without prejudice to any action under the provisions of this Act or any other law

3. What is the remuneration of the Auditor?

The remuneration of the auditors of a company:

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

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

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

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

4. What are the duties of an auditor?

- Inform the statutory body of the audited entity on subject-matter and purpose of the audit and present written authorization to carry out the audit

- Report audit findings in a true, complete and justifiable manner.
Draw up an audit report, and also an interim report if necessary, as well as their eventual amendments. These documents must contain, in particular, a description of the audit findings and where an infringement of legal regulations has been identified, they must also include a reference to respective provisions that were infringed.

Submit the audit report (interim report) and amendment thereto, if any, to the statutory body of the audited entity to get acquainted with its content.

Enable the statutory body of the audited entity after becoming familiar with the audit report (interim report), to present, within a specified time period, written objections against the truthfulness, completeness and provability of the audit findings.

Verify the justification of the objections and inform the statutory body of the audited entity of the result in writing; such notification shall form an integral part of the audit report (interim report). If verification of the objections reveals that they are completely or partially justified, or if additional facts having a significant impact on the contents of the audit report (interim report) are identified, an amendment to the audit report (amendment to interim report) shall be drawn up.

5. What are the kinds of Audit report?
Audits are conducted to express a true and fair view of a company’s financial statements. Therefore, the auditor’s opinion expressed in the ultimate report is based on the information reviewed and analyzed during the verification of financial statements. Upon completing the report, the auditor may express one of the following four opinions:

(I) Unqualified Opinion
An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements. It indicates that: Generally accepted accounting principles are consistently applied in the preparation of financial statements; Financial statements comply with the relevant statutory requirements and regulations; and There is adequate disclosure of all material matters relevant to the proper presentation of financial information (subject to statutory requirements).

(II) Qualified Opinion
A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed, but that the effect of any disagreement with management is not so material and pervasive as to require an adverse
opinion, or the limitation of scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being “subject to” or “except for” the effects of the matter to which the qualification relates.

Disclaimer of Opinion

A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, therefore, unable to express an opinion on the financial statements.

Adverse Opinion

An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

PART – C Questions

1. What are the powers of auditors?

Sec 227 Powers of auditors.

(1) Every Auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere, and shall be entitled to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor.

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

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

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

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

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

(2) The auditor shall make a report to the members of the company on the accounts examined by him, and on every Balance Sheet and Profit and Loss Account and on every other document declared by this Act to be part of or annexed to the Balance Sheet or Profit and Loss Account, which are laid before the company in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view:

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

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

(3) The auditor's report shall also state

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

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

(c) Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

(4) Where any of the matters referred to in clauses (i) and (ii) of sub-section (2) or in clauses (a), (b), and (c) of sub-section (3) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

(5) The accounts of a company shall not be deemed as not having been, and the auditor's report shall not state that those accounts have not been, properly drawn up on the ground merely that the company has not disclosed certain matters if:
(a) Those matters are such as the company is not required to disclose by virtue of any provisions contained in this or any other Act, and

(b) Those provisions are specified in the balance sheet and profit and loss account of the company.

2. Explain the liabilities of a company auditor?

1. LIABILITY OF NEGLIGENCE:

A person who is appointed auditor, he should perform his duties by using the reasonable skill and diligence. If auditor is found negligent in performing his duty then he may be sued in the Civil Court for damages.

i. Liability In Case of Loss: Auditor will be liable to compensate the loss which is suffered by client due to his negligence.

ii. Liability Case of No Loss: The auditor will not be held liable if no loss is suffered by the client even auditor is proved to be negligent.

iii. Legal Case:

Leeds Estate Building Society vs Shepherded 1887: In this case auditor did not care to see the provisions of carried out articles. Profits were inflated by including the fictitious terms. Due to the auditors negligence dividends were paid out of capital. Action was taken by the company and auditor was held liable for damages.

2. LIABILITY FOR MISFEASANCE:

Misfeasance means the breach of duty breach of trust involving the company in loss. The company may proceed against the auditors by way of regular suit in case of misfeasance. Company can claim damages suffered. Misfeasing proceedings can be taken against die auditor by the directors.

Legal Case: Westminister Road Construction and Engineering Company (Ltd) 1932: The work in progress was over stated and liabilities were understand but auditors did not point out about it to the shareholders. The dividend was paid out of the capital. In regard to the valuation of work in progress.

3. CRIMINAL LIABILITY:

During the course of audit, auditor may commit various offenses and he becomes criminally liable.

Offenses Criminally Liable:
1. If auditor’s report does not comply with the requirements of law.
2. If the default was done knowingly and willfully by the auditor.
3. If it is proved that auditor has falsified the accounts or made any report, statement, balance sheet or any document false he will be held criminally liable.

4. LIABILITY OF HONORARY AUDITOR: -
   Liabilities of paid and honorary auditors are same. In case of negligence or misfeasance honorary auditor cannot relieve himself from the liability. If the negligence is proved then auditor will be held responsible and he has no excuse to say that he is not being paid or receiving less amount.

5. LIABILITY FOR LIABLE: -
   Sometimes auditor criticizes the officers of the company in his audit report. His report should be such type that it may not defame or disgrace any person. On the other hand if the report of the auditor injures the good will and reputation of any person then he will be held responsible on the grounds of the defamation. Auditor is not liable.
   1. It does not miss state the facts.
   2. It is not actuated malice.
   3. It does not go beyond what is relevant to its subject.
   4. Statement should be Bonafide.

6. LIABILITY TO THE THIRD PARTY: -
   Auditor has no contract with the third parties. He is not employed by the third party so he has no duty to them. But the point is that as the accounts are audited by the audit, third party may also see the report, third party rely the report without the further inquiry if they rely on the accounts certified by him and suffered a loss should he compensate the loss.
   1. If the statement signed by the auditor was not true infect.
   2. It was known to the auditor that statement was not true infect.
   3. Third party suffered a loss by relying on the statement of auditor.
   4. If the statement was made with the intention that the other party should act on it.
   5. If auditor gave his consent for the inclusion of such statements in the prospectus.
3. What are the rights of an auditor?

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

1. Right of Access to Books of Accounts:
   - Every auditor of a Company has a right of access at all times to the books of accounts and vouchers of the company whether kept at the head office of the company or elsewhere.
   - Thus, the auditor may consult all the books, vouchers and documents whenever he so likes. This is his statutory right. He may pay a surprise visit without informing the Directors in advance but in practice, the auditors inform the Directors before they pay their visits.

2. Right to obtain Information and Explanations:
   - He has a right to obtain from the Directors and officers of the company any information and explanation as he thinks necessary for the performance of his duties as an auditor.
   - This is another important power in the hands of the auditor. He will, however, decide as to which information or explanations he thinks necessary to obtain. If the Directors or officers of the company refuse to supply some information on the ground that in their opinion it is not necessary to furnish it, he has a right to mention the fact in his report.

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

4. Right to visit Branches:
   - According to section 228, if a company has a branch office, the accounts of the office shall be audited by the company’s auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226. Where the Branch Accounts are not audited by a duly qualified auditor, the auditor has a right of access at all time to the books, accounts and vouchers of the company and thus, may visit the branch, if he deems it necessary.

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

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

- Under section 231 an auditor of a company has a right to receive notices and other communications relating to General Meeting in the same way as a member of the company. He is also entitled to attend any General Meeting which he attends or any part of the business which concerns him as an auditor.
- When his report contains important qualifications directly affecting the management, so that his remarks may not be misunderstood or misinterpreted.
- When he has received a notice from the company that someone else is going to be proposed for appointment as auditor of the company at the Annual General Meeting.

7. Right to have Legal and Technical Advice:

- He has a right to seek the opinion of the experts and, thus, take legal and technical advice. This is necessary to give his opinion in his report. (Re. London and General Bank Case, 1895).
- He has a right to receive his remuneration provided he has completed the work which he undertook to do.