

## **AUDITING**

### **B.com – Semester- IV**

## **SYLLABUS**

### **UNIT- I: INTRODUCTION:**

Meaning- Objectives- Importance of Auditing as a vigil mechanism- Characteristics- Bookkeeping Vs Auditing- Accounting Vs Auditing- Role of Auditor in Checking Corporate Frauds.

### **UNIT-II: TYPES OF AUDIT:**

Based on ownership, Time and Objective- Internal, External, Statutory, Independent, IRS Tax, Operational, Compliance, Government, Information System and Payroll Audit.

### **UNIT- III: PLANNING FOR AUDIT:**

Steps to be taken at the Commencement of a New Audit-Audit Programme- Audit Note Book- Audit Working Papers- Audit Evidence- Internal Check, Internal Audit and Internal Control.

### **UNIT- IV: VOUCHING AND INVESTIGATION:**

Definition and Importance of Vouching- Objectives of Vouching- Vouching of Cash and Trading Transactions- Investigation- Auditing Vs Investigation.

### **UNIT- V: COMPANY AUDIT AND AUDITORS**

#### **REPORTS:**

Auditor's Qualifications- Appointment and Reappointment- Rights, Duties, Liabilities and Disqualifications- Audit Reports: Types, Contents- Preparation- Relevant Provisions of Companies Act, 2013.

## **QUESTION BANK**

### **UNIT- I: INTRODUCTION:**

#### **SHORT ANSWERS:**

1. Meaning of Auditing
2. Characteristics of Auditing
3. Detection and Prevention of Errors
4. Detection and Prevention of Frauds.

#### **ESSAYS:**

1. What do you mean by Auditing? Discuss its Objectives.
2. What are the advantages and limitations of Auditing?
3. Distinguish between Accountancy and Auditing.
4. "An auditor is a watch-dog and not a blood- hound." Discuss.

### **UNIT-II: TYPES OF AUDIT:**

#### **SHORT ANSWERS:**

1. Government Audit
2. Interim Audit
3. Statutory Audit
4. Management Audit

#### **ESSAYS:**

1. Explain the various types of audit based on ownership, time and objective.
2. What is Continuous Audit? What are its advantages and disadvantages?
3. What do you mean by Final or Periodical Audit? What are its features, advantages and disadvantages?
4. Distinguish between Continuous Audit and Final or Periodical Audit.

### **UNIT- III: PLANNING FOR AUDIT:**

#### **SHORT ANSWERS:**

1. Audit Note Book
2. Audit Working Papers
3. Audit Evidence
4. Internal Control

#### **ESSAYS:**

1. What are the steps to be taken at the Commencement of a New Audit?
2. What is Audit Programme? What are the advantages and disadvantages of Audit Programme?
3. What is Internal Check? What are its advantages and disadvantages?
4. Distinguish between Internal Check and Internal Audit.

### **UNIT- IV: VOUCHING AND INVESTIGATION:**

#### **SHORT ANSWERS:**

1. Meaning and Definition of Vouching
2. Importance of Vouching
3. Objectives of Vouching
4. Investigation

#### **ESSAYS:**

1. Define Vouching. Explain its Objectives and importance.
2. Write about Vouching of receipts side of Cash Book.
3. Write about Vouching of payments side of Cash Book.
4. Distinguish between Auditing and Investigation.

## **UNIT- V: COMPANY AUDIT AND AUDITORS**

### **REPORTS:**

#### **SHORT ANSWERS:**

1. Qualifications of an Auditor
2. Disqualifications of an Auditor
3. Appointment of an Auditor
4. Types of Audit Report

#### **ESSAYS:**

1. What are the Rights of the Company Auditor?
2. What are the Duties of the Company Auditor?
3. Explain about Liabilities of an Auditor.
4. State the contents and format of Auditors Report.

### **QUESTION PAPER FORMAT**

#### **II B.Com- Semester- IV:: AUDITING**

Time: 3 Hours Max. Marks: 60

#### **Section-A [5 X 4=20]**

Answer any FIVE of the following questions.

1. Contents of Unit-I
2. Contents of Unit-I
3. Contents of Unit-II
4. Contents of Unit-II
5. Contents of Unit-III
6. Contents of Unit-III
7. Contents of Unit-IV
8. Contents of Unit-IV
9. Contents of Unit-V
10. Contents of Unit-V

#### **Section-B [5 x 8=40]**

Answer FIVE questions

11. (a) Contents of Unit-I  
(OR)  
(b) Contents of Unit-I
12. (a) Contents of Unit-II  
(OR)  
(b) Contents of Unit-II
13. (a) Contents of Unit-III  
(OR)  
(b) Contents of Unit-III
14. (a) Contents of Unit-IV  
(OR)  
(b) Contents of Unit-IV
15. (a) Contents of Unit-V  
(OR)  
(b) Contents of Unit-V

### **MODEL PAPER**

#### **II B.Com- Semester- IV:: AUDITING**

Time: 3 Hours Max. Marks: 60

#### **Section-A [5 X 4=20]**

Answer any FIVE of the following questions.

1. Meaning of Auditing
2. Detection and Prevention of Errors
3. Interim Audit
4. Management Audit
5. Audit Note Book
6. Internal Control
7. Objectives of Vouching
8. Investigation
9. Qualifications of an Auditor
10. Types of Audit Report

#### **Section-B [5 x 8=40]**

Answer FIVE questions.

11. (a) What do you mean by Auditing? Discuss its Objectives.  
(OR)  
(b) "An auditor is a watch-dog and not a blood- hound." Discuss.
12. (a) Explain the various types of audit based on ownership, time and objective.  
(OR)  
(b) What is Continuous Audit? What are its advantages and disadvantages?
13. (a) What are the steps to be taken at the Commencement of a New Audit?  
(OR)  
(b) Distinguish between Internal Check and Internal Audit.
14. (a) Define Vouching. Explain its Objectives and importance.  
(OR)  
(b) Distinguish between Auditing and Investigation.
15. (a) What are the Rights of the Company Auditor?  
(OR)  
(b) State the contents and format of Auditors Report.

## **UNIT- I: INTRODUCTION**

### **SHORT ANSWERS:**

#### **Q.1. Meaning of Auditing:**

The word 'Audit' is derived from the Latin word 'Audire' which means 'to hear'. In olden days persons who are responsible for maintaining accounts would read the accounts in the presence of some responsible and experienced persons, ordinarily judges.

#### **Definitions of Auditing:**

"Auditing is the examination of the books, accounts and vouchers of the business. The purpose is to satisfy that the balance sheet shows a true and fair view of the state of affairs of the business and the profit or loss derived by the business during the financial period. The auditor, to satisfy himself of the above facts, may obtain such information and explanation that would be necessary in the matter. Further, if he is not satisfied with the position of the business as shown in the balance sheet and profit and loss account, he must report as to why he is not satisfied".

- **SPICER AND PEGLER.**

Auditing is verification of financial position as is disclosed by the Balance Sheet and the Profit and Loss Account.

#### **Q.2.Characteristics of Auditing**

- a) It is a systematic examination of the accounting records of the client.
- b) The accounts are to be prepared by others, and not by the auditor.
- c) The auditing is to be carried on by independent and duly qualified persons.
- d) The examination of accounting records may be made throughout the year or periodically.
- e) The auditor examines the accounting records with the help of relevant records, vouchers, documents, information and explanation etc. following accepted tools and techniques of auditing.
- f) The auditor has to satisfy himself and report with regard to the truth and fairness of the profit or loss of the period and financial position of the concern, as reflected in its Balance Sheet.
- g) The scope of audit is not limited only to the business concerns but it may be duly extended to non-commercial concerns also.

#### **Q.3.Detection and Prevention of Errors**

Errors are the result of carelessness on the part of the person preparing the accounts. Errors are committed innocently. Errors may be divided into following categories:

- i. **Clerical Errors:** These errors arise due to wrong posting, totalling and balancing. They are subdivided into the following two types:
  - a. **Errors of omission:** If some transaction is completely omitted from books of accounts, such types of errors are known as 'errors of whole omission'. If transaction is partially omitted, such types of errors are known as 'errors of partial omission'. Where transaction is totally omitted, it will not affect trail balance and is more difficult to detect. It can be done only by careful scrutiny.
  - b. **Errors of Commission:** When incorrect entries are made in books of accounts either wholly or partially such errors are called errors of commission. Usually these errors arise due to negligence in recording of some business transactions in books. These errors may or may not affect trail balance, profit & loss account and balance sheet.  
Ex: Cash received from 'Shah' is wrongly credited to 'Shaw'.

- ii. **Compensating errors:** When an error set off the effect of another error, such error is known as compensating error. These errors do not affect the agreement of trial balance, hence can't be located by it.  
Ex: A sale of Rs. 500 worth of goods to Ram is debited to Ram account as Rs. 50. A sale of Rs. 50 to Venu is debited to Venu's account Rs. 500.
- iii. **Errors of principle:** When principles of book-keeping and accountancy are not followed in recording of a transaction, it is known as error of principle. Such errors are not disclosed in trail balance and can be detected by thorough checking of each and every transaction.
- iv. **Errors of Duplication:** When a transaction is recorded twice and also posted twice in ledger, it is known as error of duplication. Such an error will not affect trail balance. It is more difficult to locate such errors only thorough checking and comparing of vouchers with entries in books of original entry will reveal such errors.

#### Q.4. Detection and Prevention of Frauds.

When something is being done with an intension to deceive to mislead or to conceal truth, it is an art of fraud. Frauds may be divided into following categories:

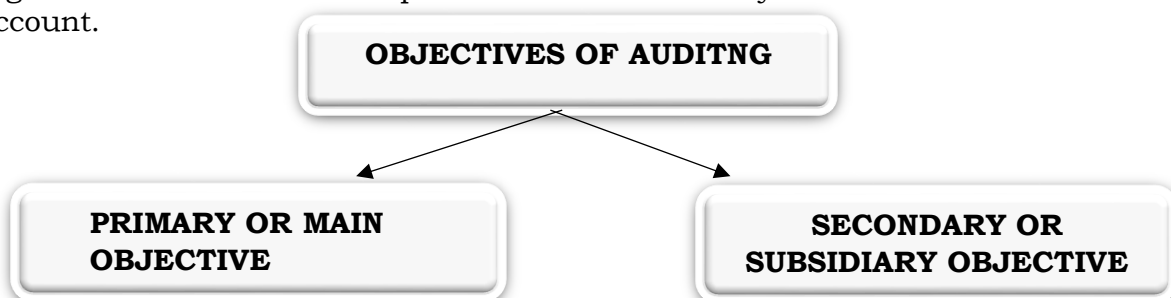
- i. **Misappropriation of cash:** The paid employees are dealing with cash hence there is more opportunity of committing frauds by inflating payments and suppressing receipts, entering fewer amounts than what has been actually received. Such frauds can be detected by vouching of all items of receipts and payments.
- ii. **Misappropriation of goods:** The chances of misappropriation of goods are more in case of less bulky and more valuable goods. This type of fraud can be prevented by maintaining proper records of goods inwards and outwards, establishment of efficient system of internal check and arrangement of adequate external security.
- iii. **Manipulation of accounts:** This type of fraud is usually committed by directors or managers with a view to get more commission on profit, sell the shares at higher price, obtain further credit, and avoid payment of tax and to give wrong impression about success of business.

#### ESSAYS:

#### Q.1. What do you mean by Auditing? Discuss its Objectives.

The word 'Audit' is derived from the Latin word 'Audire' which means 'to hear'. In olden days persons who are responsible for maintaining accounts would read the accounts in the presence of some responsible and experienced persons, ordinarily judges.

Auditing is verification of financial position as is disclosed by the Balance Sheet and the Profit and Loss Account.



- A. **Main Objective:** As per section 227 of Companies Act, 1956 main object of auditing is to state whether the accounts give a "true and fair view" in case of balance sheet, of company at the end of financial year and in case of profit and loss account, of the profit or loss for its financial year.

**B. Subsidiary Objective:** Detection and prevention of errors and frauds can be regarded as subsidiary object.

1. **Detection and prevention of frauds:** When something is being done with an intension to deceive to mislead or to conceal truth, it is an art of fraud. Frauds may be divided into following categories:
  - i. **Misappropriation of cash:** The paid employees are dealing with cash hence there is more opportunity of committing frauds by inflating payments and suppressing receipts, entering fewer amounts than what has been actually received. Such frauds can be detected by vouching of all items of receipts and payments.
  - ii. **Misappropriation of goods:** The chances of misappropriation of goods are more in case of less bulky and more valuable goods. This type of fraud can be prevented by maintaining proper records of goods inwards and outwards, establishment of efficient system of internal check and arrangement of adequate external security.
  - iii. **Manipulation of accounts:** This type of fraud is usually committed by directors or managers with a view to get more commission on profit, sell the shares at higher price, obtain further credit, and avoid payment of tax and to give wrong impression about success of business.
  
2. **Detection and prevention of errors:** Errors are the result of carelessness on the part of the person preparing the accounts. Errors are committed innocently. Errors may be divided into following categories:
  - i. **Clerical Errors:** These errors arise due to wrong posting, totalling and balancing. They are subdivided into the following two types:
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## Q.2.What are the advantages and limitations of Auditing?

Importance of auditing can be judged from the fact that even those organizations which are not covered by Companies Act, 1956 get their financial statements audited. People are interested to know the true facts about their business which are helpful to them for future planning and improvements in operations.

### Advantages of Auditing:

#### I. For the Businessmen and shareholders:

1. In case of sole trader, he can depend on audited accounts for the purpose of sale of business or for admitting a new partner. He is interested in knowing whether the business is conducted efficiently or not.
2. To maintain healthy relations among partners, and disputes over the correctness of profits can be avoided. In case of valuing goodwill at the time of admission and retirement of a partner, audited accounts will be useful in Partnership firm.
3. Shareholders can value their shares on the basis of audited financial statements.

#### II. For the Management:

1. It helps management in detecting and preventing errors and frauds.
2. It keeps the accountants and staff vigilant while preparing books and records as they know in advance that all the accounts are to be audited
3. Claims due to fire, theft and accident can be estimated from audited accounts.
4. Management gets advice on financial affairs from auditors who have expert's knowledge.

**III. For the Creditors:** Long-term and Short-term creditors can depend on audited financial statements while taking decision to grant credit to business houses.

**IV. For the Government Bodies:** Audited accounts can be produced in court to provide as evidence. Audited accounts are useful for government while granting subsidies etc.

#### V. For Others:

1. It can be used by insurance co. to settle claims arising on account of loss by fire.
2. In case of amalgamation and absorption, purchasing company can calculate purchase consideration on the basis of audited accounts.
3. It safeguards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

### Disadvantages of Auditing:

1. The audit may not give complete picture. If accounts are prepared with bad intentions.
2. Sometimes the auditor has to depend on explanations, clarifications and information from staff and client. He may or may not get correct or complete information.
3. Under law, shareholders appoint auditors with the consultation of directors. Under such situation he may be under the influence of directors.
4. Auditor has to seek opinion of experts on certain matters on which he may not have expert's knowledge. Such reports which may not be always correct.
5. The auditing may not serve its purpose unless the auditors are independent and bold.
6. Auditing is considered as a mechanical work. Auditors may not frame audit programme from the view point of particular situation.
7. Auditing is a post-mortem examination. There is no use of such examination when events have already happened.
8. An audit cannot give a guarantee that everything in the accounts is correct. The auditor can only ascertain and state whether accounts show a true and fair view or not.
9. The auditor as to do merely checking and vouching the books.

### Q.3.Distinguish between Accountancy and Auditing.

**Book - Keeping:** It is the art of recording day-to-day transactions systematically in books of accounts. This part of work is performed by book-keeper. His job includes journalizing, posting, totalling and balancing of ledger accounts.

**Accountancy:** The work of accountant is to check arithmetical accuracy of accounts prepared by book-keeper. If any error or omission arises, it should be rectified. Finally, accountant is to prepare Trail balance, Trading and profit & loss A/c and Balance Sheet, incorporating necessary adjustments there in.

**Auditing:** He is concerned with critical examination and verification of accounts prepared by others. After completing his work, auditor has to submit a report of fact whether or not profit & loss a/c and balance sheet exhibit true and fair position of business.

#### ACCOUNTING VS. AUDITING:

The point of difference between Accountancy and Auditing can be as follows:

Basis of Difference	Accountancy	Auditing
<b>1. Nature</b>	It is constructive in nature as it is concerned with compilation of accounting information for preparing Profit and Loss Account and Balance Sheet.	It is analytical in nature and is concerned with checking and verification of financial statements.
<b>2. Scope</b>	Its scope is restricted to preparation of financial statements and their interpretation.	It is determined by the agreement between auditor and his client.
<b>3. Qualification</b>	No formal qualification has been recommended.	An auditor must be a qualified Chartered Accountant.
<b>4. Object</b>	The main object is to find out operating results and financial position of the business.	The main object is to ascertain truth and fairness of financial statements and comment there on.
<b>5. Commencement</b>	It starts where book-keeping ends.	It starts where accountancy ends.
<b>6. Reporting</b>	The Accountant is not required to submit a report on the accounts and statements prepared by him.	The Auditor has to submit a report about correctness and presentation of accounts audited by him.
<b>7. Basis of Remuneration</b>	The Accountant is paid monthly salary.	The Auditor gets a fixed amount as per agreement with his client.
<b>8. Appointment</b>	The Accountant is employee of the business.	The Auditor is an independent outsider appointed on contractual basis for a year.
<b>9. Level of Knowledge</b>	An Accountant is not required to have knowledge of audit techniques and procedures.	An Auditor must have knowledge of accounting as well as audit techniques and procedures.
<b>10. Duration</b>	The accounting work is conducted throughout the year.	The Audit may be conducted at the end of the year or throughout the year.

#### Q.4. "An auditor is a watch-dog and not a blood- hound." Discuss.

The auditor's duty in regard to the detection of errors and frauds is clearly pointed out by a learned judge in the case of **Kingston Cotton Mill & Co., 1896**. The judge stated that '**an auditor is only a watch dog and not a blood hound**'.

There are **two points** in this judgement.

1. **An auditor is a watch dog** which means that he is appointed to look after the interests of those who happen to be the owners of the business. A watch dog is kept and fed by the owner and so he has to look after his owners' interest. Like that the auditor must protect the interest of the client sincerely, honestly and faithfully.
2. **An auditor is not a blood hound**. An auditor should not be malicious towards those whom he finds to be responsible for any act of negligence, manipulation or misappropriation. He has to be sincere, honest and methodical in the approach, but in no way cause any harm to anybody. At the same time, he must inform the material facts to the owners of the business.

**In brief, the auditor has to do the following in connection with detection and prevention of errors and frauds.**

1. An auditor should check the internal check system in force and examine its working in practice.
2. He should ensure how far accounting principles have been followed in recording business transactions and whether the work of recording has been made in pursuance with the policies of the management.
3. He has to see that the accounts have been drawn in conformity with the Companies Act.
4. He should check that the Balance Sheet exhibits a true and fair view of the state of affairs.

**However, his responsibility for non-detection of errors and frauds will rest upon the following factors:**

1. He has fulfilled his duty with the prevailing standards of performance adopted by the profession.
2. He has exercised reasonable care, skill and intelligence in his work.
3. He has not overlooked the materials which would have aroused his suspicion about fraud and errors.
4. The loss has not actually arisen on account of his negligence.
5. He has seen the substantial accuracy of the statement of accounts besides checking the arithmetical accuracy.

## UNIT-II: TYPES OF AUDIT

### **SHORT ANSWERS:**

#### **Q.1. Government Audit**

Government Audit may be broadly classified into:

1. **Audit of Government Department:** For the audit of Government Departments, a separate department known as Accounts and Audit Department headed by the Comptroller and Auditor General - Government of India has been established as per Article 149 of the Constitution of India.
2. **Audit of Statutory Corporation:** For the audit of statutory corporations, in most of the cases the Comptroller and Auditor General is required to audit the books of accounts. But in some cases, like LIC, SBI, IFC etc., the accounts are audited by the Professional Chartered Accountants.
3. **Audit of Government Companies:** According to Sec.619 and Sec. 224 to 233 of the Companies Act, auditor for a Government Company is to be appointed by the Company Law Board on the advice of the Comptroller and Auditor General of India. The auditor of a Government Company shall submit a copy of his audit report to the Comptroller and Auditor General.

Objectives of Government Audit is to ensure that every payment is made as per rules and regulations and payments have been sanctioned by the proper authority.

#### **Q.2. Interim Audit**

An audit conducted in between two annual audits is called interim audit. It is conducted for a part of the accounting year with some interim purposes. Such purposes may be declaration of interim dividend, fixing the prices of shares etc. In partnership firm, interim audit is conducted in the event of admission, retirement or death of a partner.

Advantages of Interim Audit:

1. It facilitates early completion of the annual audit.
2. It helps in quick detection and rectification of errors and frauds.
3. It exercises an effective moral check on the staff of the enterprise.
4. It is helpful where interim figures are to be published.

Disadvantages of Interim Audit:

1. Figures audited up to the date of the interim audit may subsequently be altered by the accounting staff.
2. The staff conducting an interim audit has to make extensive notes about the figures in the books of accounts. This involves unnecessary additional work.
3. It is expensive as it involves additional work on the part of the auditor.

#### **Q.3. Statutory Audit**

Where audit in the case of an enterprise is made compulsory by law, it is called statutory audit. In case of many concerns, audit is compulsory under statute. Undertakings subject to statutory audit are:

- a. Companies governed by the Companies Act, 1956.
- b. Banking companies governed by the Banking Regulation Act, 1949.
- c. Electricity supply companies governed by the Electricity Supply Act, 1948.
- d. Co-operative societies registered under the Co-operative Societies Acts.
- e. Public and charitable trusts registered under Religious and other Endowments Acts.
- f. Societies registered under the Societies Registration Act, 1860.
- g. Corporations set up under an Act of Parliament or State Legislatures, such as the Life Insurance Corporation of India.

#### Q.4. Management (Efficiency) Audit

In management audit an attempt is made to evaluate various management functions and processes. A detailed and critical review of all the objectives, policies, procedures and functions of management is made with a view to bring about an overall improvement in managerial efficiency.

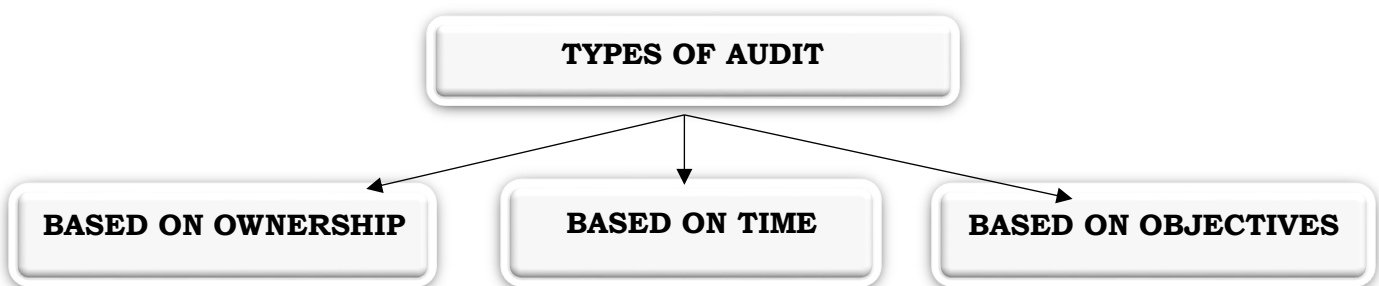
##### Definition of Management Audit:

“Management audit is an investigation of a business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organisation and smooth running of internal organisations”. - **Leslie R. Howard**

Only such persons should be appointed as management auditors who are having a good knowledge and experience of management techniques.

#### ESSAYS:

#### Q.1. Explain the various types of audit based on ownership, time and objective.



##### I. Based on Ownership:

1. **Sole Proprietorship Audit:** In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. The auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.
2. **Partnership Firms Audit:** Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of the auditor are defined in the mutual agreement. While conducting audit of partnership firm the auditor must refer to the Partnership Deed or Partnership Act, 1932.
3. **Audit of Companies:** Under Companies Act 1956, audit of accounts of companies in India is compulsory. Independent Chartered Accountant who is professionally qualified is required for audit of accounts of companies.
4. **Audit of Trusts:** The primary objective of audit of trusts is to detect errors or frauds by the staff. At times such institutions avail grant from Government or International agencies, in such cases, audit of utilization of grants becomes essential.
5. **Audit of Co-operative Societies:** The auditor should have an expert knowledge of the Co-operatives Societies Act, 1912. Audit is conducted usually once in every financial year.
6. **Audit of Government Department:** For the audit of Government Departments, a separate department known as Accounts and Audit Department headed by the Comptroller and Auditor General - Government of India has been established as per Article 149 of the Constitution of India.

## II. Based on Time:

1. **Interim Audit:** An audit conducted in between two annual audits is called interim audit. It is conducted for a part of the accounting year with some interim purposes. Such purposes may be declaration of interim dividend, fixing the prices of shares etc.
2. **Final Audit/Periodical Audit/Annual Audit/Complete Audit:** Final audit is done at the close of the financial or trading period after the close of books of accounts and preparation of Final Accounts. The audit is commenced and completed in a single uninterrupted session. It is convenient for small concerns.
3. **Continuous Audit:** Audit work done in an enterprise continuously throughout the course of the accounting year at regular intervals is called continuous audit. The external auditor makes a thorough and detailed examination of the books of accounts with the help of relevant documents.
4. **Balance sheet Audit:** It is an audit concerned only with items appearing in the Balance sheet. The procedure under this audit is to follow a backward process. First the item is located in the balance sheet, then it is located in the original records for the purpose of verification.

## III. BASED ON OBJECTIVES:

1. **Independent Audit/External Audit:** An independent audit is conducted by an independent, professionally qualified person who is not an employee of organization by hiring his services.
2. **Internal Audit:** Internal audit is conducted by employees of organization to enable better exercise of managerial control.
3. **Cost Audit:** Cost audit is the complete checking and verification of cost accounts, to see whether the concern has followed cost accounting principles or not.
4. **Tax Audit:** Profits for accounting are ascertained as per accounting policies and standards. Under Income Tax Act, profits shown by the profit and loss account have to be adjusted as per provisions of the Act.
5. **Government Audit:** Government Audit may be broadly classified into, Audit of Government Department, Audit of Statutory Corporation, Audit of Government Companies. Objectives of Government Audit is to ensure that every payment is made as per rules and regulations and payments have been sanctioned by the proper authority.
6. **Secretarial Audit:** Secretarial Audit is concerned with verification compliance by the company of various provisions of Companies Act and other relevant laws, any default thereof may attract heavy penalties for the company directors and other officials.

### Q.2. What is Continuous Audit? What are its advantages and disadvantages?

Continuous audit is conducted throughout the year or at regular short intervals of time. Auditor visits his clients regularly and checks each and every transaction.

#### Definition of Continuous Audit:

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

### **Continuous audit is useful in the following situations:**

1. Where periodical statements are required after a short interval.
2. Where internal check is not effective.
3. Where business is very large and number of transactions are to be checked.
4. Where audited statements are required immediately after the close of financial year.
5. Where final accounts are prepared immediately after the last day of financial year.

### **Advantages of continuous audit:**

1. **Complete checking of all the records:** Since audit is carried out throughout the year, sufficient time is available for detailed checking. Any enquiry and doubt arising in course of audit can be tackled in a better way.
2. **Proper planning:** Auditor can plan his audit work in a systematic manner. He can evenly spread his work throughout the year. It will improve the efficiency of auditor.
3. **Preparation of Interim accounts:** Interim accounts can be prepared without much delay. It will help the board of directors to declare interim dividends.
4. **Early detection of frauds ad errors:** The work of auditor becomes easier for detecting frauds and errors otherwise it will involve more time.
5. **Up-to-date Accounts:** The efficiency of accounts staff will increase and their work will be up-to-date and accurate.
6. **Valuable suggestions:** Continuous audit will help auditor to understand technicalities of business. This will help auditor to make suggestions for improvement of business.
7. **Early presentation of accounts:** Audited accounts can be presented just after end of financial year.
8. **Moral check:** Continuous audit provides preventive and moral check against frauds.

### **Disadvantages of continuous audit:**

1. **Expensive:** It is an expensive system as it may not suit budget of small organizations.
2. **Dislocation of routine work:** Frequent visit by auditor may dislocate smooth flow of office work.
3. **Alteration of figures:** After the accounts have been audited, the figures may be fraudulently altered by the staff.
4. **Losing link in the audit work:** As the work is not completed continuously, auditor may lost continuity and certain questions and inquires may be left unanswered.
5. **Monotony:** The work of auditor may become mechanical.
6. **Unhealthy relationship:** Frequent visits by auditor may provide scope for unhealthy relationship between him and clerks.

With the following precautions, shortcomings of continuous audit can be avoided, conduct of surprise checks, review of findings of previous audit, nominal accounts should be checked only in final sitting, special ticks for altered or overwritten figures, alteration of audit work should be strictly prohibited.

### Q.3. What do you mean by Final or Periodical Audit? What are its features, advantages and disadvantages?

Final audit is done at the close of the financial or trading period after the close of books of accounts and preparation of Final Accounts. The audit is commenced and completed in a single uninterrupted session. It is convenient for small concerns.

#### Definition of Final Audit:

"A periodical audit is one where the auditor does not attend until the completion and closure of the financial accounts by the client and the auditor takes the audit task as a whole and the checking is done at one time." - **F.R.M. De Paula**

#### Features of Final Audit:

1. The work in the case of final audit is generally started after the close of the financial year.
2. The audit work is started and completed in one continuous session.
3. It is convenient for small concerns.

#### Advantages of Final Audit:

1. **No dislocation of client's work:** The work of the auditor does not cause any dislocation or inconvenience in the work of the client's staff as the auditor commences his work only after the accounts have been finalised.
2. **Smooth flow of work:** The link in the work is properly maintained as the entire audit is completed in a single continuous session.
3. **Less expensive:** It is comparatively less expensive and therefore, is the only viable form of audit applicable in small business houses.
4. **Little chance of collusion:** The possibility of collusion between the auditor and the client's staff is much less in periodical audit.
5. **No loss of interest:** In periodical audit the possibility of the audit work becoming mechanical or monotonous is very less.

#### Disadvantages of Final Audit:

1. **Detailed checking not possible:** In periodical audit detailed checking is not possible as the work is to be completed in a short time.
2. **Non-detection of errors and frauds:** It is difficult to locate all the errors and frauds due to lack of detailed checking.
3. **Delay in presentation of final accounts:** As the work of audit usually takes a long time to complete, the annual general meeting is likely to be delayed as audited final accounts are to be presented in it.
4. **Unsuitable for large concerns:** In large business concerns where the number of transactions is voluminous and complex, the audited accounts are likely to be delayed beyond a reasonable period. So, it is not practicable in large concerns.
5. **Dependence on management:** As the auditor has to complete the work within very short time, he has to rely on the management in most cases. The auditor cannot avoid the management totally under this type of audit.

**Q.4. Distinguish between Continuous Audit and Final or Periodical Audit.**

<b>Basis of distinction</b>	<b>Continuous audit</b>	<b>Periodic audit</b>
<b>1. Time Period</b>	Continuous audit is done throughout the year.	Periodical audit is done at the end of the year.
<b>2. Visit by the auditor</b>	Auditor visits the client's office frequently.	Auditor visits the client's office at the end of the year.
<b>3. Nature of Business Concern</b>	It is quite suitable for big concerns.	It is suitable for small concerns
<b>4. Checking of transaction</b>	Detailed checking of transactions is possible.	Detailed checking is not possible.
<b>5. Expensive</b>	It is very expensive.	It is not expensive.
<b>6. Interim accounts</b>	It helps in preparation of interim accounts.	It does not help in preparation of interim accounts.
<b>7. Detection of Errors and Fraud</b>	It reduces the opportunities for Fraud.	It does not reduce the opportunities of fraud.
<b>8. Nature of work</b>	Work becomes mechanical and boring.	Work does not become mechanical.
<b>9. Relationship with staff of the client</b>	There is a possibility for developing unhealthy relationship between the audit staff and the client's staff.	There is no possibility for developing unhealthy relationship between audit staff and client's staff.
<b>10. Quick submission of accounts</b>	Financial accounts can be submitted immediately after the close of financial year.	Not possible to do so.
<b>11. Declaration of dividends</b>	It facilitates early declaration of dividend.	It does not facilitate early declaration of dividend.
<b>12. Moral Check</b>	There will be moral check on the staff of the client.	There will not be any moral check on staff of the client.

## **UNIT- III: PLANNING FOR AUDIT**

### **SHORT ANSWERS:**

#### **Q.1 Audit Note Book**

**An Audit Note Book is a book, register or diary maintained by the audit clerk during the course of audit for recording his observations of audit, the points to be discussed with the auditor, the points which require further clarification etc.**

An exhaustive record of enquiries made; replies received there to etc. are entered in the Audit Note Book. It is used as a definite record of work performed at each audit.

**Contents of Audit Note Book:** An Audit Note Book usually contains two parts:

- a. For keeping a record of general information as regards the audit as a whole.
- b. For recording special points which the audit staff may come across during the course of audit.

#### **Q.2. Audit Working Papers**

**Audit working papers are the papers and documents which consists of details about accounts which are under audit.**

Notes of important facts and details about the accounts are recorded in the working papers. Current year working papers are used as a base in the next year of audit. It also gives a true picture of the accounts of the concern.

**Contents of working papers:**

The working papers generally include:

1. Schedules of debtors and creditors.
2. Correspondence between the auditor and the client's debtors and creditors.
3. Rough Trial Balance
4. Particulars of Investments
5. Draft Final Accounts etc.,

#### **Q.3. Audit Evidence**

**Audit Evidence is the information that the auditor uses in arriving at a conclusion on the basis of which he forms his opinion.**

The auditor should obtain sufficient and appropriate evidence which enables the auditor to arrive at a conclusion and supports his opinion. Audit evidence forms the basis for forming an opinion whether the financial statements of an entity state true and fair view or not.

Evidence collected by the auditor should support the contents of its audit report. Sufficiency of audit evidence is the measure of the quantity of audit evidence. Appropriateness of evidence is the quality of the evidence, i.e., its relevance and reliability to support the auditor's opinion.

Audit evidence includes information provided in books of accounts as well as information from other sources. For Example - Purchase invoice and material received note prepared by the store's department are evidence to support the purchase.

A good audit evidence must be **sufficient, reliable**, obtained from internal or external **source**, documentary or visual or oral, and **relevant**.

## Q.4. Internal Control

### Meaning of Internal Control:

**Internal Control means whole system of controls established by management to safeguard its assets and secure the accuracy and reliability of its records. Its scope is wider.**

These controls may be financial controls or non-financial controls. They include internal check and internal audit. These controls are again divided into two parts.

1. Administrative controls and
2. Accounting controls.

### Definition:

"Internal Control is best regarded as indicating 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 form of control". - **SPICER and PEGLER.**

### Objectives of internal control:

1. Safeguarding the assets of concern by avoiding frauds, wastes and inefficiency.
2. Measuring the implementation of business policies.
3. Measuring the performance of business activities and the staff.
4. Ensuring maximum accuracy of all data and statements and policy decisions.
5. Aid in the management planning.

## ESSAYS:

### Q.1. What are the steps to be taken at the Commencement of a New Audit?

Before commencing the actual audit work, the auditor has to prepare himself for it. He has to take certain steps or bear in mind certain considerations before commencing the new audit. These are known as preliminary steps for commencing an audit.

- 1. Letter of Appointment:** The auditor should in his own interest satisfy himself that he has been duly appointed to act as an auditor. He must have a proper letter of appointment from authority of concern.
- 2. Scope of Audit:** He should obtain instructions in scope of his work, writing from his clients about the nature and duties.
- 3. Nature of Business:** He should familiarize himself with the nature and technical details of the business of his clients.
- 4. System of Accounting Employed:** He should examine the system of accounting employed in the concern. The system of accounts depends upon the nature of business. If the system is not sound, he should ask the clients to modify the system.
- 5. Condition of Internal Check:** He should obtain a written statement of the internal check, if any, in operation and should decide to rely or not to rely upon it.
- 6. List of Books:** He should obtain a list of all the books maintained by the concern and the name of the in charge of the various books, signed by a responsible officer of the concern.
- 7. List of Officers:** He should ask his clients to prepare a list of debtors and creditors and the officers of the company together with their duties and powers.

- 8. Instructions to Clients:** He should give instructions to his clients to keep ready,
  - a. Trial Balance and Final Accounts
  - b. Schedule on Debtors and Creditors.
  - c. Stock-sheet indicating method of valuation.
  - d. Details of investments with cost and market price
  - e. Legal documents, contracts, etc.
- 9. List of Debtors and Creditors:** He should also ask his clients to prepare a list of debtors and creditors, keep the legal papers, list of contracts securities and other documents ready for inspection.
- 10. Last Year's Financial Statements:** He should study previous Balance Sheet to be familiar with the various assets and liabilities.
- 11. Change of Auditor:** If he is appointed in the place of another, he should find out the reasons for the change of auditor and if possible, contact the removed auditor and check the facts.
- 12. Study of Documents:** The auditor should carefully study all the documents which have a bearing on the accounts.
- 13. Study of Prospectus:** In the 1st audit of a company he must go through the prospectus, contracts with vendors, promoters, etc.
- 14. Preparation of Audit Programme:** He should chalk out audit programme, which is nothing but a written scheme allocating the work amongst his assistants and the time schedule in completing each part of the work.
- 15. Plan of work:** He should plan his work carefully and allocate the work amongst his staff intelligently taking into account their individual skills, talents and experience.

## **Q.2. What is Audit Programme? What are the advantages and disadvantages of Audit Programme?**

An auditor while preparing audit programme must keep in mind size and composition of organization and nature and extent of internal control. It is auditor's plan of action.

### **Definition of Audit Programme:**

"An outline of all procedures to be followed in order to arrive at an opinion concerning client financial statements". - **STETTLER.**

### **Features of an audit programme:**

1. It should contain full details of the work to be conducted in writing.
2. It should be drawn by the auditor himself.
3. It should be very flexible.
4. It should refer to distribution of work among audit staff and state their responsibility.

**Types of audit programme:** There are two types of audit programmes.

1. Fixed Audit Programme
2. Flexible Audit Programme

Modifications in fixed audit programme are not easy. However, there is no such difficulty in case of flexible audit programme.

**Advantages of audit programme:**

1. Once an audit programme is made ready audit work can be started immediately.
2. Fixing of responsibility of audit assistants becomes easier.
3. It enables auditor to keep in touch with work done and general progress of work.
4. It serves as evidence, if any action is brought against auditor alleging negligence in performance of his duties.
5. Provides a check against possibility of certain important items requiring verification which are being omitted.
6. Continuity is not lost even if the person on duty is changed.
7. The chief auditor is saved from issuing instructions to the staff repeatedly.
8. It serves as a guide for the future audits.
9. It helps to complete the work within the scheduled time.

**Disadvantages of audit programme:**

1. An audit programme makes clerks mechanical and specialized in only one work.
2. It discourages initiative and interest of efficient staff as they have to act in accordance with programme. The juniors have to do what they are asked to do and they will not make any suggestions also in certain circumstances.
3. Even a well-prepared audit programme may not include all important points as it is drawn before commencement of audit.
4. Inefficient auditors try to conceal their defects on the basis of audit programme.
5. It is unnecessary for small business concerns.
6. The task may be finished necessarily to complete it within the schedule time.
7. Uniformity of audit programmes cannot be applied in all units because audit of different organizations cannot be exactly the same.
8. A rigid programme for all kinds of business is useless. Each business will have a separate problem of its own.

**Overcoming disadvantages of audit programme:**

1. The audit staff should be impressed upon to take audit programme only as a guide line. They should be asked to use their initiative and intelligence in course of audit.
2. The audit staff should be encouraged to make suggestions and review the same every year. They should be encouraged to keep in mind objectives of an audit based on which audit is to be conducted.
3. The audit programme should be revised and modified according to experience gained and changes made in the business. It should never be rigid. It should be flexible.

### Q.3. What is Internal Check? What are its advantages and disadvantages?

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

#### Internal check involves:

1. Division of all work among different employees.
2. Works are assigned to different employees according to their capabilities and qualifications.
3. No one is performing a single work from the beginning to the end.
4. Work done by one employee is automatically checked by another.

#### Definition of Internal Check:

“Internal Check is an arrangement of staff duties whereby no one person is allowed to carry through and record every aspect of transactions so that without collusion between two or more persons, fraud is prevented and at the same time the possibilities of error are reduced to minimum”. – **Spicer and Peglar**.

#### Advantages of Internal Check:

1. **Proper division of work:** It enables proper division of work among the staff keeping in view their individual qualifications, experience and area of specialization.
2. **Detection of errors and frauds:** Since no individual worker is allowed to handle a job completely from the beginning to the end and work of each clerk is automatically checked by other, this helps in early detection and discovery of errors and frauds.
3. **Increased efficiency coupled with economy:** A good system of internal check increases efficiency of work it enables them to learn honesty, straight forwardness and hard work among the staff and leads to overall economy.
4. **Moral check:** Knowledge of subsequent checking of each employee's work by others acts as a great check to commission of errors and frauds.
5. **Quick preparation of final accounts:** It enables prompt preparation of final accounts.
6. **Accuracy of the accounts can be relied upon:** If there is a good system of internal check the owner of concern may rely upon the genuineness and accuracy of accounts
7. **Increase in profits:** Overall efficiency in operations results in more profits.

#### Disadvantages of Internal check:

1. **Uneconomical:** Division of labour is not possible in small concerns. It is uneconomical and expensive for small concerns. It is also time consuming.
2. **Carelessness among higher officials:** The owner of concern may become careless because as they believe though not always rightly, that under a sound system of internal check nothing can go wrong.
3. **Risky for an auditor:** If system of internal check is in any way defective, and if auditor does not apply tests and procedures of his own and if he relies on output of system his work cannot be free from irregularities.
4. **Disorder in the working of a business:** In the absence of a properly organized system of internal check there will be disorder in working of a business.
5. **Quality is sacrificed for promptness:** In an internal check system, quality of work declines because clerks of business attach greater importance to become quick or prompt and do not care about quality.

**Q.4. Distinguish between Internal Check and Internal Audit.**

<b>Points of distinction</b>	<b>Internal check</b>	<b>Internal audit</b>
<b>1. Meaning</b>	It is an arrangement of duties allocate in such a way that the work of one person is automatically checked by another.	It is an independent appraisal of operations and records company.
<b>2. Object</b>	The purpose is to prevent or minimize the possibilities of errors, frauds or irregularities.	The purpose is to detect the errors and frauds which have already been committed.
<b>3. Need for separate staff</b>	For internal check, no new appointment is made. In fact, represents only the arrangement of duties of staff in a particular way.	For carrying out internal audit, a separate staff of employees is engaged for the purpose.
<b>4. Nature of work</b>	Internal check represents a process under which the work goes on uninterruptedly and checking too is more or less automatic	Internal auditor has to report, from time to time, to the management about various inefficiencies and suggest improvements. It is also his duty to see that internal check system does not become static.
<b>5. Timing of work</b>	Internal check is in operation during the course of transactions.	Internal audit starts when accounting process of different transactions is finished.
<b>6. Device</b>	It is a device for doing the work	It is a device for checking the work.
<b>7. Errors and Frauds</b>	Errors and frauds are discovered during the course of work.	Errors and frauds are detected after the completion of work.
<b>8. Scope of work</b>	The scope of Internal check is very limited	The scope of internal audit is comparatively broad.
<b>9. Involvement</b>	A large number of employees are needed for implementation of internal check system	A much smaller number of persons are needed for implementation.

## **UNIT- IV: VOUCHING AND INVESTIGATION**

### **SHORT ANSWERS:**

#### **Q.1. Meaning and Definition of Vouching**

**Vouching means examination of documentary evidence to ascertain the accuracy and authenticity of transactions recorded in the books of accounts.**

Vouching is a careful examination of all the supporting documentary evidences i.e., invoices, receipts, minutes, contracts, correspondence etc. to ensure that all the transactions are properly authorized, recorded, and entered in the books of accounts.

#### **Definition of Vouching:**

“Vouching consists of comparing entries in the books of accounts with documentary evidence in support there of”. – **L.R. DICKSEE**

#### **Q.2. Importance of Vouching**

Vouching means examination of documentary evidence to ascertain the accuracy and authenticity of transactions recorded in the books of accounts.

Vouching is the essence of auditing. It is considered as "the backbone of auditing." The importance of vouching arises on account of the following points.

1. Primary step in auditing
2. Verification of accuracy and completeness of books of accounts
3. Detection of errors and frauds
4. Basis for the verification of assets and liabilities
5. Certification of the state of affairs of a business

#### **Q.3. Objectives of Vouching**

Vouching means examination of documentary evidence to ascertain the accuracy and authenticity of transactions recorded in the books of accounts.

#### **Objectives of Vouching**

1. To confirm that all transactions relating to the business have been recorded in the books of accounts.
2. To ensure that no transaction which is not connected with business has been recorded.
3. To see that all entries are genuine and supported by documentary evidences.
4. To detect errors, frauds and serious discrepancies.

#### **Q.4. Investigation**

Investigation means a searching enquiry into the accounts and records of a business for a special purpose. It is to ascertain a particular fact and to assess the situation.

Investigation is a sort of special detailed audit with a particular object in view.

#### **Definitions of Investigation:**

1. “The term investigation implies an examination of accounts and records for some special purpose”. - **SPICER and PEGLER**
2. “Investigation involves enquiry into facts behind the books of accounts, into the technical, financial and economic position of the business or organization”. - **TAYLOR and PERRY**

**ESSAYS:****Q.1. Define Vouching. Explain its Objectives and importance.**

**Vouching means examination of documentary evidence to ascertain the accuracy and authenticity of transactions recorded in the books of accounts.**

Vouching is a careful examination of all the supporting documentary evidences i.e., invoices, receipts, minutes, contracts, correspondence etc. to ensure that all the transactions are properly authorized, recorded, and entered in the books of accounts.

**Definition of Vouching:**

“Vouching consists of comparing entries in the books of accounts with documentary evidence in support there of”. – **L.R. Dicksee**

**Objectives of Vouching:**

1. To confirm that all transactions relating to the business have been recorded in the books of accounts.
2. To ensure that no transaction which is not connected with business has been recorded.
3. To see that all entries are genuine and supported by documentary evidences.
4. To detect errors, frauds and serious discrepancies.

**Importance of Vouching:**

Vouching is the essence of auditing. It is considered as "the backbone of auditing." The importance of vouching arises on account of the following points.

1. **Primary step in auditing:** Vouching is an indispensable preliminary work in the process of auditing of accounts. When it is done properly, it enables the auditor to carry on further verification very easily.
2. **Verification of accuracy and completeness of books of accounts:** The work of an auditor aims at verification of books of accounts to ascertain their accuracy and completeness. The auditor verifies all the transactions with the help of supporting documentary evidences through vouching. It enables him to achieve this object.
3. **Detection of errors and frauds:** Vouching is very useful in detecting various kinds of errors committed by accounting staff. If vouching is done with care and intelligence, the auditor can detect all kinds of frauds. This possibility of detection automatically prevents the commission of errors and frauds.
4. **Basis for the verification of assets and liabilities:** Vouching is very useful for the verification of assets and liabilities. In the verification work, the auditor proves the correctness of assets and liabilities appearing in the Balance Sheet. This can be easily done if proper vouching is performed in advance.
5. **Certification of the state of affairs of a business:** The most important duty of an auditor is to certify whether or not the Profit and Loss Account and Balance Sheet exhibit a true and fair view of the state of affairs of the business. This can be done only if the auditor is satisfied himself with regard to authority and authenticity of transactions. Vouching enables him to do so.

## Q.2. Write about Vouching of receipts side of Cash Book.

### Vouching of various cash receipts (Receipt side)

1. **Cash sales:** In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same. Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.
2. **Cash received from the debtors:** The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.
3. **Loans:** While vouching the loans received, the terms and the conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.
4. **Bills receivable:** Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonour of such bill has been made.

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

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

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

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

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

### Q.3. Write about Vouching of payments side of Cash Book.

#### Vouching of cash payments (payment side):

1. **Cash Purchases:** goods purchased are actually received by store keeper. Cash memos can be compared with goods inward book to verify the goods received. Only the net amount (after trade discount) should be entered in the books.
2. **Payment to creditors:** Should be examined with the receipts issued by the creditors. The receipts should indicate the purpose for which the payment has been made. If the payment is made in full and final settlement of account, the balance should be accounted for as discount received. Where the payment is made in excess of the bill, either the excess payment is in advance or the payment is made by mistake, which should be recovered back from the creditor.
3. **Bills payable:** Bills payable honoured on the date of maturity and is returned by the payee after receiving the payment. These bills should be cancelled after being paid. Bills payable paid can be vouched with bills book. If the payment is made by the bank, bank statement or pass book can be examined to verify the payment of bill
4. **Wages:** wages paid and calculated for various months should be compared. If the wages of particular month differ from the preceding month, the auditor should look into the reasons for difference. Random checking of wages calculations should be made. The auditor should see the proper record is maintained for unpaid wages, deductions for any advance taken by the worker should also be verified, and deductions made from the wages should also be entered in the proper account. Special attention should be given to the payments made to casual workers.
5. **Payment of Salaries:** In vouching the payment of salaries following points are important
  - a. Auditor should check salary register with the entries made in the cash book
  - b. He should examine carefully alterations in the amount of deductions on account of fines, funds, loans, insurance etc.
6. **Purchase of Investment:** the auditor should compare the investment purchased with Broker's Bought Note. If the possible, physical verification of investments should be made. Investments must be in the name of the company. Where the investments are purchased at cum-interested price, interest included in the purchase price should be debited in the interest account and the balance in investment account. Later on, when the interest is received on the investment, it should be credited in the interest account.
7. **Rent paid:** the auditor should verify the payment of rent from the agreement. The rent voucher should be supported by rent receipt from the landlord. It should be seen that payment of rent is sanctioned responsible officer.
8. **Loans:** Auditor should be that the loan voucher should be supported by the receipt given by the party. Further details regarding terms and condition of the loan can be verified from the loan agreement. It should be seen that instalment of loan along with interest are received in time. Mortgage Deeds and other documents should also be examined.
9. **Interest on Loan:** Auditor should verify that rate of interest on loan does not differ from the terms and conditions of loan agreement. Debenture interest can be verified from debenture interest book. All the payments of interest must be supported by vouchers and receipts.

**Q.4. Distinguish between Auditing and Investigation.**

<b>Basis of Difference</b>	<b>Auditing</b>	<b>Investigation</b>
<b>1.Scope</b>	The main purpose is to see whether the balance sheet shows true and fair view of statement of affairs of the business and profit and loss account shows true and fair view of operating results during the year.	Investigation have certain specified objects, like future earning capacity, extent of suspected fraud and mis- appropriations, matters concerning purchase of business.
<b>2.Period Covered</b>	Audit of accounts is usually for a financial year.	Investigation covers several years say 2,3, or 5 years to find out average earning capacity, financial position etc.
<b>3.Statutory Requirement</b>	Audit of accounts is statutory requirement as per Companies Act, 2013.	Investigation of accounts may or may not be statutory requirement under Companies Act, 2013.
<b>4.Initiated by Outsiders or Proprietors</b>	Audit is always initiated by Proprietors only.	Investigation may be normally carried out on behalf of outsiders who either want to purchase the business or to become partners, to advance loans etc.
<b>5.Investigation of audited accounts</b>	In the ordinary sense investigated accounts are not audited.	The audited accounts are further investigated for some special purpose in view.
<b>6.Evidence</b>	In case of auditing, the auditor is concerned only with prima facie evidence.	The investigator looks for substantive evidence and even conclusive evidence are also seen.
<b>7.Qualification</b>	Audit of companies can only be conducted by a qualified Chartered Accountant.	The investigator may not be necessarily a qualified Chartered Accountant.

## UNIT- V: COMPANY AUDIT AND AUDITORS REPORTS

### **SHORT ANSWERS:**

#### **Q.1. Qualifications of an Auditor**

**Qualifications of an Auditor:** The Companies Act prescribes the qualifications and disqualifications of company auditors.

- ❖ According to sec 226(1), "a person shall not be qualified as auditor of a company unless he is a Chartered Accountant within the meaning of the Chartered Accountant Act, 1949".
- ❖ In addition to practicing Chartered accountants, sec 226(2) allows a holder of a certificate of practice under the Restricted Auditor Certificate (Part B states) Rules, 1956, is also qualified to act as an auditor of a company.
- ❖ A firm of chartered accountants is also capable of being appointed as auditors of a joint stock company provided all the partners of the firm are Practising Chartered Accountants.

#### **Q.2. Disqualifications of an Auditor**

**Disqualifications of an auditor:** According to the Sec 226(3) of the Companies Act, the following are the disqualifications of an auditor.

1. A body corporate.
  2. An officer or employee of the company.
  3. A person who is a partner or who is in the employment, of an officer or employee of the company.
  4. A person who is indebted to the company for an amount exceeding Rs. 10,000 or who has given any guarantee in connection with indebtedness to any third person.
  5. A director or member of a private company.
  6. An un-discharged insolvent or an insane person.
  7. If auditor holds appointment as auditor in specified number of companies as per Sec 224(1-B) he will be disqualified for further appointment as auditor.
- ❖ If after his appointment an auditor becomes subject to any of the disqualifications listed above, he shall be deemed to have vacated his office forthwith.

#### **Q.3. Appointment of an Auditor**

The provisions regarding appointment of a company auditor are given below (Sec.224)

1. **First Auditors [Sec.224 (5)]:** The first auditor/auditors of a newly started company are appointed by the Board of Directors within one month of the date of registration of the company.
2. **Subsequent Auditors [Sec.224(1)]:** The subsequent auditor/auditors are appointed by the shareholders of the company at the Annual General Meeting.
3. **Re- Appointment of Retiring Auditor [Sec.224(2)]:** A retiring auditor can be re-appointed in the Annual General Meeting.
4. **Appointment by the Central Government [Sec.224(3)]:** If no auditor is appointed or re-appointed at an Annual General Meeting, the company must notify the matter to the Central Government. Then the Central Government may appoint an auditor.
5. **Casual Vacancy of an Auditor [Sec.224(6)]:** Any casual vacancy in the office of the auditor can be filled by the Board of Directors. The auditor appointed in a casual vacancy can hold office until the conclusion of the next Annual General Meeting.
6. **Appointment of Auditors for Government Companies [Sec.619]:** The auditor of a Government company shall be appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor General of India.
7. **Appointment by Special Resolution [Sec.224-A]:** In case of a company in which not less than 25% of the subscribed share capital is held whether singly or in combination by public financial institutions, Government Companies, Nationalized Banks, Insurance Companies etc., the appointment and re-appointment of auditors shall be made at each Annual General Meeting by a special resolution.

#### Q.4. Types of Audit Report

1. **Clean Report/ Unqualified Report:** When an auditor is satisfied that the Profit and Loss Account and Balance Sheet exhibits a true and fair view of the state of affairs of the company, he will give a clean report. Clean report is one in which the auditor does not insert any qualification, modification or reservation.
2. **Qualified Report:** A qualified report is one which contains the opinion of the auditor subject to certain conditions or reservations. In this report the auditor answers to any statutory affirmation in negative or expresses his opinion with a qualification.
3. **Disclaimer of Opinion:** When an auditor does not have sufficient information to serve as the basis of his opinion, he may disclaim an opinion on the financial statements.
4. **Adverse or Negative Report:** When the auditor is of the opinion that the accounts and financial statements do not present a true and fair view of the financial condition and result of operation, he will be forced to give adverse report.
5. **Piece meal Opinion or Report:** Such a report may be given in case the auditor concludes that he is unable to give an opinion on the statements taken as a whole but he believes that he can express an opinion limited to certain items in the statements, with which he is satisfied.

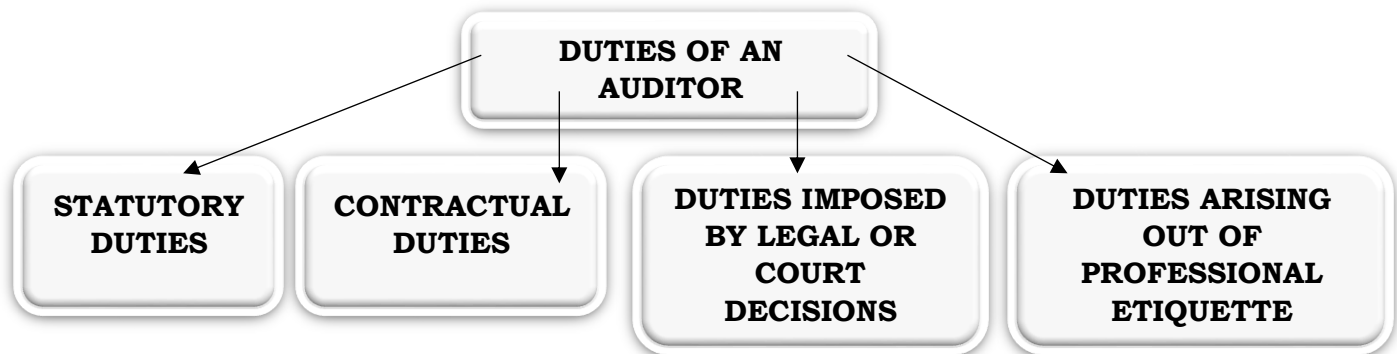
#### ESSAYS:

#### Q.1. What are the Rights of the Company Auditor?

1. **Right to access books of accounts:** According to Sec 227(1) auditor of a company has a right to free and complete access at all times to the books, accounts and vouchers of company.
2. **Rights to obtain information and explanation:** According to Sec 227(1) an auditor is authorized "to receive from the officers of the company such information and explanation for the performance of his duties as auditor".
3. **Right to visit branches and to inspect books of accounts:** According to sec 228(2), where accounts of any branch office are audited by a person other than company's auditor, he shall be entitled to visit branch office. He shall also have access at all times to the books, accounts and vouchers at a branch office.
4. **Right to receive notices:** According to Sec 231 all notices and other communications relating to a general meeting of a company, which any member of the company is entitled to have sent to him, shall also be forwarded to auditor of company.
5. **Right to seek legal and technical advice:** The auditor has a right to take legal, expert or technical advice on any matter relating to business, in order to perform his work satisfactorily.
6. **Right to claim remuneration:** The auditor has a right to claim remuneration for the work done by him as per the contract.
7. **Right to be indemnified:** For many purposes, an auditor is considered to be an officer of company. He has a right to be indemnified out of assets of company against any liability incurred by him in defending himself against any civil or criminal proceedings by the company.
8. **Right to sign the audit report:** According to Sec 209, only 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 audit report.

9. **Right to report to the members of the company:** The auditor has a right to report to members, if the accounts audited by him show an unsatisfactory state of affairs.
10. **Right to refuse to start the audit work:** The auditor has a right to refuse to start the audit work, until the management balances the accounts.
11. **Right to correct any wrong statements:** The auditor has a right to correct wrong statements made by the directors relating to accounts.
12. **Right of Lien:** The auditor has no right of lien on the books of accounts. However, he can exercise lien on working papers. The rights of an auditor cannot be limited by the Articles or by resolution of the members.

## Q.2. What are the Duties of the Company Auditor?



### A. Statutory Duties:

Statutory Duties refer to the duties of auditor imposed by the Companies Act.

1. Duty to make report
2. Duty to assist investigators
3. Duty to enquire and call for information on various points
4. Duty to certify Statutory Report
5. Duty to certify Profit and Loss Account in a prospectus
6. Duty to make a report on Public Deposits
7. Duty to sign his audit report
8. Duty to certify the declaration of the solvency of the company
9. Duty to assist the Central Government in connection with prosecution

❖ Statutory duties of an auditor cannot be restricted either by the Articles of Association of the company or by any resolution of the members of the company or by the directors of the company.

### B. Contractual Duties:

An auditor is appointed by an agreement with his client, i.e., the company. So, the auditor has some duties arising out of the common law or the law of the contract. Under the law of contract, he has to perform all those duties which he has expressly or impliedly undertaken to perform under the contract with the company.

### C. Duties imposed by Legal or Court Decisions:

There are certain duties imposed on a company auditor by court and legal decisions like:

1. He is not bound to be a detective or to approach his work with suspicion or with forgone conclusion that there is something wrong. He is a watchdog, but not a blood hound. He is justified in believing the responsible officials of the company and rely upon their representations, provided he takes reasonable care.
2. An auditor should correspond in writing with the previous auditor in whose place he has been appointed as an auditor of the company.

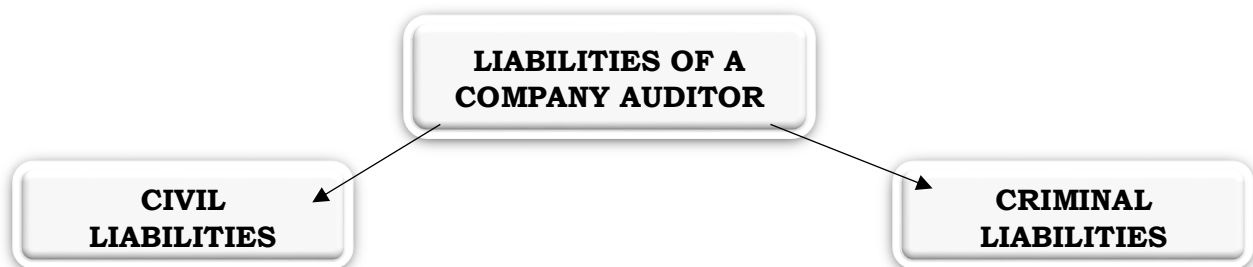
#### D. Duties arising out of Professional Etiquette:

1. Every auditor should carry on his duties with due regard to public interest and not his personal interest.
2. An auditor should comply with the rules and regulations formulated by the Institute of Chartered Accountant of India.
3. He must be honest, sincere, technically competent and independent.
4. He should disclose full and fair information about the working and financial position of the company to the shareholders.

#### Q.3. Explain about Liabilities of an Auditor.

##### LIABILITIES OF COMPANY AUDITOR:

A company auditor is appointed under the companies act, so his liabilities are determined by the Companies Act. It may be noted that the liabilities of a company auditor laid down in the companies act cannot be curtailed or restricted. Further, under the companies act, the liabilities of a company auditor can be grouped under two heads:



**A. Civil Liabilities:** Liability of an auditor to pay damages is known as civil liabilities. The civil liabilities of company auditor may be grouped under two heads.

1. **Civil liability of an Auditor for negligence:** To safeguard the interest of the company, he must exercise reasonable care & skill in the performance of his duties. If he fails to do so & as a consequence thereof, if the company suffers any loss, the auditor will be held liable to compensate the loss suffered by the company.
2. **Civil Liability of an auditor for misfeasance:** -Misfeasance means breach of trust or duty imposed by law. In other words, if an auditor of a company does something wrongfully in the performance of his duties, resulting in financial loss to the company, he is held guilty of misfeasance.

**B. Criminal Liabilities:** Criminal liability of an auditor arises out of an act constituting a crime. The penalty for any criminal liability of an auditor may be fine, imprisonment or both.

##### I. Criminal Liabilities of an Auditor under the Companies Act of 1956:

1. Where the **prospectus issued by a company includes any untrue statement or mis-statement by the auditor**, the auditor becomes criminally liable. In this case, he may be punishable with imprisonment for a term which may extend to two years or with fine which may extend to Rs. 5,000 or both.
2. If an **auditor intentionally gives false evidence** upon any examination about the winding up of the company, he becomes punishable with imprisonment for a term which may extend to 7 years also to fine.
3. An auditor of the company becomes liable for criminal prosecution, if he, in any return report, certificate, **makes a false statement**, particularly knowing it to be false or omits any material fact, knowing it to be material. The punishment on conviction will be imprisonment for a term which may extend to 2 years & also fine.

4. If an **auditor destroys, mutilates or make alterations** in any books, papers or securities belonging to the company with intent to defraud or deceive any person at the time of the winding up of the company he become punishable with imprisonment for terms which may extend to 7 years & also to fine.
5. If the **central government takes action & prosecutes any officer** connected with the affairs of the company, the auditor is required to assist the prosecution. If he fails to do so, he becomes punishable with imprisonment for 6 months or with the fine up to 5,000 or with both.

## II. Criminal Liability of an auditor under the Indian Penal Code:

If an auditor issues or signs any certificate, knowing or believing that such certificate is false in any material point, he becomes punishable in the same manner as if he gives false evidence.

## III. Criminal liabilities of an auditor under the Income Tax Act of 1961:

If an auditor induces in any person to make deliver to the income tax authorities a false statement or declarations relating to any income chargeable to tax, he becomes punishable with simple imprisonment which may extend to 6 months with fine which may extend to Rs. 1,000 or with both.

## IV. Criminal Liabilities of an auditor under the Chartered Accountants Act 1949:

If a person, not being a chartered accountant, acts as auditor of a company & signs any document, he becomes liable for criminal prosecution.

## Q.4. State the contents and format of Auditors Report.

Audit report is the medium through which an auditor expresses his opinion on the state of affairs of the client's business.

### Definition:

“A report is a statement of collected and considered facts, so drawn up to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report.”- **LANCASTER**

### Importance of Auditor's Report:

The true ownership of the company rests in the shareholders and not in the management. One of the reports on which the shareholders depend for forming their opinion about the management is the auditor's report.

### Contents of the Audit Report:

According to Sec. 227 (2) of the Companies Act, 1956, the auditor's report should state the following matters.

1. Whether he has obtained all the information and explanations necessary for the performance of his duties.
2. Whether in his opinion, proper books of accounts as required by law have been kept by the company.
3. Whether, in his opinion, the Profit and Loss Account gives a true and fair view of the profit or loss of the financial year.
4. Whether, in his opinion, the Balance Sheet exhibits a true and fair view of the state of affairs of the company.
5. Whether he has received a report from the branch auditor in respect of branch accounts audited under Section 228 and how he has dealt with the same.
6. Whether the Company's Profit and Loss Account and Balance Sheet dealt with by the report are in agreement with the books of accounts and returns.

**Form of Audit Report:**

The basic elements of the Report are briefly stated as follows:

1. **Title:** A suitable title helps the reader to identify the report and to distinguish it from report issued by others.
2. **Addressee:** The report should be appropriately addressed. i.e., to the shareholders or government.
3. **Identification of financial statements:** The financial statements can be identified by including the name of the entity and the date and period covered by the financial statements.
4. **Reference to auditing standards and practices:** Such a reference assures the readers that the accounting and auditing standards have been complied with.
5. **Opinion on financial statements:** The report should also mention the auditor's opinion on the concern's operational results and financial position.
6. **Signature:** The report should be signed in the name of the audit firm or personal name of the auditor or both.
7. **Address of the auditor:** The report should also state the address of the auditor.
8. **Dating of the report:** The report should be properly dated.

**Features of a Good Report:**

A good report should be well written and brief. It should be based upon reliable and factual information. It should contain constructive suggestions. A good report should be convincing and forceful. It should contain healthy criticism and not be in reprimanding tone.