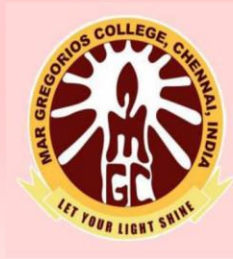


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Approved by the Government of Tamil Nadu
An ISO 9001:2015 Certified Institution



DEPARTMENT OF COMMERCE (ACCOUNTING & FINANCE)

SUBJECT NAME: PRACTICAL AUDITING

SUBJECT CODE: CPG5A

SEMESTER: V

PREPARED BY: PROF.M.PARTHIBAN

V SEMESTER
Core Paper XIII-PRACTICAL AUDITING

Objectives No of Credits: 4

- □ □ To make the students to understand the concept of present day Auditing Practices.
- □ □ To enable the students to gain knowledge of various techniques of Auditing.

UNIT I: Introduction

Meaning and Definition of Auditing - Distinction between Auditing and Accounting - Objectives - Advantages and Limitations of Audit - Scope of Audit - Classifications of Audit - Audit Planning - Meaning, Audit programme - Meaning - Objectives and Contents - Audit Note Book, - contents, Usefulness of Audit Note Book - Audit working papers - Meaning, Ownership and Custody - Test checking and Routine checking - Meaning. Internal control - Meaning - Definition - Objectives - Technique for evaluation of Internal Control System. Internal check - Meaning - Objectives difference between Internal control, Internal check and Internal Audit.

UNIT - II: Vouching and Verification

Vouching - Meaning and Definitions - Objectives. Trading Transactions - Audit of Ledger - Scrutinizing of ledgers - Vouching of cash Receipts and Payments - Vouching of outstanding Assets and Liabilities - Verification - Meaning - Objectives and Process - Valuation of Assets and liabilities - Distinction between Verification and Valuation.

Unit III: Audit and Accounting Standards

Types of Audit - Statutory Audit - Concurrent Audit - Stock Audit - Cost Audit - Secretarial Audit - CAG Audit - Management Audit. Accounting Standards - Standard on Auditing - Standard on Internal Audit - Penal Provisions - Role of National Financial Reporting Authority (NFRA)

Unit IV: Auditors and Audit Report

Appointment - Procedures - Eligibility and Qualifications - Powers and Duties - Rotation and Removal of Auditors - Resignation of Auditors - Remuneration of Auditors - Audit report - Preparation and presentation. Auditor's Responsibilities and liabilities towards Shareholders, Board and Audit Committee. Restriction on other Services.

Unit V: Recent Trends in Auditing

EDP Audit - Meaning - Division of auditing in EDP environment. Impact of Computerization on Audit Approach - Online Computer System Audit - Types of Online Computer System Audit - Auditor around with the Computers - Procedure of Audit under EDP system.

UNIT I

Introduction

INTRODUCTION TO AUDITING

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

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

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

Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirements || R.E. Schlosse

OBJECTIVES OF AUDITING

Main Objective:

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

Subsidiary objectives:

The subsidiary objectives of the auditing are:

Detection and prevention of fraud:

One of the important subsidiary objectives of auditing is the detection and prevention of fraud. Fraud refers to intentional misrepresentation of financial information. Fraud may involve:

1. Manipulation, falsification or alteration of records or documents
2. Misappropriation of assets
3. Suppression of effect of transactions from records or documents.
4. Recording of transactions without substance
5. Misapplication of accounting policies

Detection and prevention of errors:

Is another important objective of auditing. Auditing ensures that there is no misstatement in the financial statements. Errors can be detected through checking and vouching thoroughly books of accounts, ledger accounts, vouchers and other

relevant information.

IMPORTANCE OF AUDITING

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

The importance of auditing can be summed in following points:

1. Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.
2. Dispute over correctness of profits can be avoided.
3. Shareholders, who do not know about day-to-day administration of the company can judge the performance of management from audited accounts.
4. It helps management in detecting and preventing errors and frauds.
5. Management gets advice on financial affairs from the auditors.
6. Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.
7. Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.
8. Audited accounts are useful for the government while granting subsidies etc.
9. It can be used by insurance companies to settle the claims arising on account of loss by fire.
10. Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.
11. It safeguards the interest of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

DIFFERENCE BETWEEN ACCOUNTANCIES, AUDITING

Basis for Comparison	Accounting	Auditing
Meaning	Accounting means systematically keeping the records of the accounts of an organization and preparation of financial statements at the end of the financial year.	Auditing means inspection of the books of account and financial statements of an organization.
Governed By	Accounting Standards	Standard on Auditing
Work performed by	Accountant	Auditor
Purpose	To show the performance, profitability and financial position of an organization.	To reveal the fact, that to which extent financial statement of an organization gives true and fair view.

Start	Accounting starts where bookkeeping ends.	Auditing starts where accounting ends.
Period	Accounting is a continuous process, i.e. day today recording of transactions are done.	Auditing is a periodic process.

Types of Audit:

1. Cost Audit:

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

2. Secretarial Audit:

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

- Whether the books are maintained as per Companies Act, 2013.
- Whether necessary approvals as required from central Government, Company law board or other authorities were obtained.

3. Independent Audit:

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

4. Tax Audit:

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

STATUTORY AUDIT

Statutory Audit is a type of audit which is mandated by a Statute or Law to ensure true and fair view of the book of accounts of a Business is presented to the Regulators and the Public. Unlike internal audit, Statutory Audits are not optional and must be performed if a business satisfies certain criteria. Statutory audits must be completed by qualified Chartered Accountants who are independent of the Business. Further, the report prepared by the Auditor on his/her findings must be presented in the format prescribed by the Regulator.

Statutory Audits can be mainly classified into two types, company audits and tax audits. As per Companies Act, 2013, every company, irrespective of its sales turnover or nature of business or capital must have its book of accounts audited each financial year. Thus, the Board of Directors of a Company are required by law to appoint an Auditor within 30 days of incorporation and thereafter conduct an audit of its financial statements each financial year. The accounts of a Limited Liability Partnership (LLP) must be audited if it has an annual turnover of Rs. 40 lakhs or more or Rs. 25 lakhs or more capital contribution. Tax audit on the other hand is required for Proprietorships and Partnership Firms that have a certain hold

of sales.

AUDIT PROCEDURES

Audit procedures are an important area of the syllabus, though candidates often use inappropriate audit procedures to answer questions. The following tips will help you to understand the concepts and write appropriate audit procedures.

Every procedure must state:

1. the assertion tested
2. the audit procedure
3. the reason for the procedure

Each of these points is explained below. Identify the assertion tested

Audit procedures are performed in order to test financial statement assertions. Therefore, the first step in explaining an audit procedure is to identify the assertion that needs to be tested.

The assertions embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur, may take the following forms:

A brief explanation of the various assertions is as follows:

Completeness

This means that all transactions have been recorded in the financial statements – ie all assets, liabilities, equity interests (capital and reserves) and other disclosures have been included in the financial statements.

Occurrence

This assertion means that transactions and events and other matters that have been recorded actually took place – and relate to this organisation.

Valuation and allocation

This means that all items have been included in the financial statements at appropriate amounts according to company policy and the relevant financial reporting framework. Furthermore, any allocations or valuation adjustments required (like impairment) have been made and financial and other information is disclosed fairly and at appropriate amounts.

Classification and understandability

Financial information is appropriately presented and disclosed, and disclosures are clearly expressed so as to make them understandable to the users. For this, the disclosures should use simple language and state matters clearly and concisely.

Accuracy

Accuracy means that amounts and other data relating to transactions and events have been recorded at the correct amounts – ie at the amounts appearing in the source documents.

Rights and obligations

This means that the entity has a right to its assets – ie it is free to use or dispose of

the assets as it sees fit. Furthermore, the entity is obliged to pay off the liabilities that are shown in the statement of financial position.

Existence

This means that assets, liabilities and equity interests (capital and reserves) are physically present/belong to the entity on the reporting date.

Cutoff

This means that transactions and events have been recorded in the correct accounting period. For example, if goods are delivered prior to year end, they are included in the cost of goods sold, not in inventory.

Choose audit procedures from AEIOU

A: Analytical procedures

E: Enquiry and confirmation directly from a third party – ie inquiry
I: Inspection of records and assets

O: Observation

U: recalculation and re-performance while writing down the audit procedure

Write it clearly

Audit procedures should be written in such a way that even a junior auditor will be able to understand what is to be done. For example, avoid vague procedures like ‘check goods received notes’. This is vague as it does not explain what is to be examined in the goods received notes. Is it the description of items received, the quantity received or the name of the vendor?

Write down the reason for performing the audit procedure

The audit procedure ‘check goods received note’ does not mention why the goods received notes are to be checked. Instead, write the audit procedure as: ‘agree the description of items and the quantities ordered mentioned on the goods received note with the descriptions on the purchase orders raised on the vendor’. This confirms that the entity has procured goods based on an authorized purchase order.

Use audit terminology

Use terminology relating to audit like ‘cast’, ‘agree’, ‘trace’, etc. Use the word ‘cast’ to mean total in a list – for example, ‘cast the trial balance’. Use the words ‘agree’ or ‘trace’ to mean matching information from two documents/ records – for example, ‘agree the total sales of the sales day book to the general ledger account’; or ‘trace a sample of trade payable to the purchase invoices, to confirm the existence of the right to the goods purchased’.

A complete audit procedure would read as follows:

The auditor will agree a sample of items from the inventory sheets to the raw material inventory (1) to ensure that the inventory recorded on the sheets actually exists (2). This will confirm the assertion of existence of inventory as an asset in the financial statements

If the above mentioned procedure is written as ‘The auditor will check a sample of items from the inventory sheets to the raw material inventory’, it is incomplete as it does not mention why the audit procedure is being performed.

MEANING OF AUDIT PROGRAM

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- An auditor prepares a plan after the selection of senior and junior staffs allocating the jobs to them, mentioning when to start, how to do the work etc. This plan is known as audit program.
 - An auditor should include all the procedures in written form, objectives of each sector and all the directions which are to be given to the staffs which help to control their works and help to implement such programs into action.
 - **Following are the facts regarding meaning of audit program:**
 - Audit program is a detailed work plan which includes the time of doing work and how to do the works.
 - Audit program includes audit procedures. Audit program estimates the duration to complete the audit task.
 - Senior staffs prepare audit program to junior staffs on the basis of nature of business.
 - Generally accepted points are included in the audit program.
 - Junior staffs put tick marks in the completed tasks.
 - Audit program is a detailed program which helps to guide and control the junior staffs. Audit program classifies the work of junior staffs which help to complete the audit task without leaving any points. Audit program is prepared all the programs, nature and size of business, internal check and internal control. Following points should be included in an audit program:
 - Detail information of works of all the junior staffs like audit of bank/cashbook, purchase book, sales book etc.
 - Auditor should prepare audit program considering the nature of client.
 - Separate list of work assigned to assistants should be prepared by the auditor.
 - Audit program should fix the time period to complete job assigned to the assistants.
 - Assistant should sign after the completion of his/her job.

Audit working papers:

This article is about audit working papers. Auditors should prepare and organize their working papers in a manner that helps the auditor carry out an appropriate audit service. The auditor should avoid preparing or accumulating unnecessary working papers, and should therefore avoid making extensive copies of the client's accounting records. It is worth noting at this stage that it is neither necessary nor practicable for the auditor to document every matter considered during the audit.

IMPORTANCE OF WORKING PAPERS

Working papers are important because they:

- Are necessary for audit quality control purposes
- Provide assurance that the work delegated by the audit partner has been properly completed
- Provide evidence that an effective audit has been carried out
- Increase the economy, efficiency, and effectiveness of the audit
- Contain sufficiently detailed and
- Up-to-date facts which justify the reasonableness of the auditor's conclusions
- Retain a record of matters of continuing significance to future audits.

CONCEPT OF TEST CHECK,

Test Check

Big business houses have a lot of transactions. So, it is very difficult to check all the transactions in detail. An auditor needs to prepare and present report in short period of time. So, an auditor checks the sample transactions and prepares and presents report to the concerned authority which is known as 'Test Check'. An auditor checks the books of accounts of a particular time or area if there is no any doubt, s/he proves the account as true and fair, otherwise auditor checks in detail where s/he has doubts.

But if any errors or frauds are left out due to random sampling, auditor will be responsible for such losses. So, an auditor applies test check if internal check is effective in the organization.

Following points are to be taken into consideration while applying test check:

- Sample should be selected from the various books of account and of different times.
- Transactions related to beginning and ending period of particular year should be checked in detail.
- Transaction related to cash and stock should be checked in detail.
- Sample selection is to be made on random basis, not in planned way.
- Detail check of Bank Reconciliation Statement is necessary.

Routine Checking

Regular checking of all the daily transactions is known as Routine Checking. Routine checking incorporates the following tasks:

- Checking of record in primary books, costing, transfer etc.
- Checking transfer of transactions from original books of accounts to ledger account.
- Checking debit and credit side of various accounts.
- Checking transfer of balances of various accounts to other pages or accounts or statements.
- Various signs are used while conducting routine check. Such sign provides the proof of routine checking of transactions.
- Signs which are used in audit should be small and clear. Generally red or pink color is used while conducting routine check. But green color is used while conducting final audit.

Advantages of Routine Checking

Following benefits can be obtained from the routine checking:

1. All the original entries will be checked; so all the errors and frauds can be detected easily.
2. All the entries and posting will be tested.
3. Routine checking helps to conduct final audit because all the balancing and totals have already been checked.
4. Separate and specific staffs are not needed because it is a regular process.

Disadvantages of Routine Checking

Following are the limitations of routine checking:

1. Routine checking is a mechanical test, so the staff who performs this work does not have inspiration. So, there are chances of leaving errors and frauds.
2. Routine checking can only detect small errors and frauds but not the planned frauds. Routine checking is not needed where self-balancing system is applied.
3. Routine checking cannot detect principle and compensating errors.

PRELIMINARY STEPS BEFORE COMMENCING A COMPANY AUDIT:

Verification of Appointment:

First of all auditor has to confirm whether his appointment is properly made or not. If appointment is not proper, he can claim remuneration, if he is appointed by shareholders, he has to see whether the procedure specified under Section 224, is properly followed or not. If he is appointed by directors he has to go through the resolution made by the court.

Verification of Memorandum:

Memorandum is started of the company. It deals with external affairs of the company. Out of its clauses, the information written under objects clause, liability clause and capital clause is useful to auditor. Therefore he should refer to memorandum and such informations should be taken to audit notebook.

Verification of Articles:

Articles read about internal affairs of the Company. It includes calls on share, transfer of shares, transmission of shares, reserves, payment of dividend etc. All these things are useful to Company auditor and hence abstracts from articles should be taken to audit notebook.

Verification of Prospectus: Before commencing the audit work, auditor should refer to prospectus also to obtain information relating to minimum subscription, preliminary expenses, underwriters commission, terms of issue etc.

Verification of Contract Deeds:

On account of legal entity company can enter into contracts. Auditor should refer to those contract deeds to know about names of parties to the Contract, Contract prices, other terms etc.

Verification of Certificate of incorporation and certificate of Commencement of business:

If it is first audit of the company, auditor should refer to Certificate of Incorporation and Certificate of Commencement of Business issued by registrar of Companies to confirm that the company has got formed properly in accordance with requirements of companies act.

Verification of Internal Check System:

Internal check means arrangement of staff in such a way where work done by one clerk automatically gets checked by the other. Well planned internal check system minimizes scope for frauds and errors. In presence of well-designed internal check system, auditor can follow shortcut methods like test checking etc. Good internal check system reduces the workload of auditor.

List of Books:

Auditor should obtain list of books maintained by the company. Company maintains several statutory books or compulsory books, Statistical or Optional books; Cost records, financial records etc. All those books are to be listed.

List of Offices:

Auditor should refer to organization chart of the company and key positions are to be found. Here auditor has to gather names, rights, duties, specimen signatures etc of staff members employed at such key positions.

Verification of Financial Statement:

Auditor should get copies of previous 3 or 4 years financial statements along with audit reports. By going through them an idea with regard to profitability, financial position and previous auditor's opinion can be obtained.

Central Government Permission:

On certain occasions company has to obtain permission to central government. For example; to issue share warrants, to grant to directors etc. Here auditor has to observe whether permission from Central Government is obtained or not.

Audit Program:

Planning of audit work is called Audit Programme. It shows division of audit work among audit staff. After preparation of audit program audit work can be commenced. Audit program has several advantages like completion of audit work within desired period, proper entrustment of work, etc. At the same time audit programme has certain disadvantages also like making work mechanical etc.

LIMITATION OF AUDIT:

The main risk in audit program is towards the assurance services that derives wrong conclusions. Assurances are to be provided within the related certification. Here are some of the limitations of an audit.

Extra cost:

Testing involves extra cost to the organization which is considered as a burden. It involves the disruptions of multiple cases. The auditor has to concentrate more even though there are disruptions. Before audit begins the auditor must get the attention of all the staff members of the organization.

Evidences:

Evidences that are identified are more pervasive than conclusive. The strength of submission of audited accounts makes major changes in the accounts of distribution of

profits.

Harassment of staffs:

Since the employees cannot express their own in terms of auditing, these changes are calibrated and the employees will feel harassed due to the changes that are caused. Even if they try to express their knowledge in new ideas, the organization may not entertain the employees in these types of situations.

Unsuitable changes:

The rules and regulations of business may vary from time to time. It remains unstable when the program begins. It is obvious that the company's policies may not change periodically where the rules and regulations may.

Chances of fraud:

Since the information delivered after an audit procedure is confidential, then there becomes more chances of getting the situations where an individual will be forced to commit crime. It harasses the auditor to commit crime after the audit gets over.

Small concerns:

Small scale industries may usually proceed with transactions that are usually completed within the shorter period of time. Thus, auditing is not too important.

Problems in remedial measures:

Here the problem is created in remedial measures that are enhanced within the detailed interface of the data of remedial measures. These remedial measures are not included in the audit program.

Insufficient consideration:

The education curve will be contented about the business and insufficient relaxed networks and also offers systematic internal recruitment. These may gravely obstruct the expense of all the employees.

Not guaranteed:

Auditing cannot provide any data that are analyzed and prepared. It has financial accounts on the data that are provided. It is disclosed based on the information and explanations that are agreed by the clients.

Accuracy in the audit process plays a vital role that is reflected on the statement of correct amount. Classification of the transaction is handled properly and timings are recorded on the exact dates. Posting and summation of the master files amounts are properly classified. Therefore, without an audit process, a progress of the company cannot be identified.

INTERNAL CHECK:

CK:

According to the special committee on Terminology, American Institute of Accountants, 1949 "Internal check-a system under which the accounting methods and details of an establishment are so laid out that the accounts procedures are not under the absolute and independent control of any person that, on the contrary, the work of one employee is complementary of that of another, and that a continuous audit of the business is made by the employees."

The essential elements of an internal check are:

1. Instituting of checks on day-to-day transactions.
2. These checks operate continuously as a part of routine system.
3. Work of each person is made complementary to the work of another.

Object of Internal Audit

1. To verify the correctness of the financial accounting and statistical records presented to the management.
2. To comment on the effectiveness of the internal control system and the internal check system in force and to suggest means to improve them.
3. To facilitate the early detection and prevention of frauds.
4. To ensure that the standard accounting practices to be followed by the organization are strictly followed.
5. To confirm that the liabilities have been incurred by the organization in respect of its legitimate activities.
6. To examine the protection provided to assets and the uses to which they are put.
7. To identify the authorities responsible for purchasing assets and other items as well as disposal of assets.

DIFFERENCES BETWEEN INTERNAL CONTROL AND INTERNAL AUDIT

The difference between internal control and internal audit can be drawn clearly on the following grounds:

1. The methods and procedures implemented by the management to control the operations, so as to help the organization in achieving the desired ends, is called as an internal control. The auditing program adopted by the firm, to review its financial and operating activities by the expert, is called internal audit.
2. While internal control is a system designed, implemented and maintained in an organization. Internal Audit is an audit function designed by those charged with governance, to keep a check on the activities of the firm.
3. In internal control, work of one person is verified by another, whereas in the case of an internal audit, every single component of work is verified.
4. In the internal control system, checking is performed simultaneously, while carrying out work. On the contrary, in internal audit system work is checked after it is performed.
5. The basic objective of the internal control system is to ensure compliance with management policies. In contrast, internal audit aims at detection of fraud.

INTERNAL CHECK WITH REGARD TO DIFFERENT ITEMS

Internal Check With Regard To Sales:

The system of internal check regarding sales should take care of following:

- On receipt of the order, it should be numbered and preserved in Orders Received Book with full Particulars. The Despatch Department should be given a copy of the order with necessary particulars.
- The Despatch Department should take steps to pack the goods as per order. The statement of goods as prepared by the Despatch Department should be checked with the customer's order and then the invoice will be prepared in triplicate by means of carbon papers.
- A responsible official should check the invoice particularly the rates charged and calculations made. With the help of the copy of invoices entries should be made in Sales Day Book. On dispatch of the goods records should be made in the Goods Outward Book.
- Two copies of the invoice may be sent to customer who will return one of them after signing it. It will serve the purpose of delivery note. Third copy will be retained for further reference.
- Entries should be made in Goods inward Book for all the goods returned by the customers.
- Credit notes should be prepared and should be duly checked and initialed by the responsible official. With the help of credit notes, records should be made in the Sales Return Book.

Internal Check With Regard To Purchases:

Requisition:

The procedure for issuing purchase requisitions should be specified. The head of the department, who is in need of goods, should fill a requisition slip duly signed and then should send it to the purchase department. The details about the quality, quantity and the time by which the goods must be supplied should be clearly mentioned in the requisition slip.

Enquiry:

Purchase department makes an enquiry about terms and conditions of the purchases from different suppliers for these purposes tenders are generally invited. But, who shall open and accept the tenders, should be clearly specified. As a rule lowest tenders should be accepted and decision be taken.

Internal check with regard to fixed assets:

- A proper authority should be designated for the sanction of capital expenditure. The authority may be given to managing director, a factory manager or a committee may be set up for this purpose.
- A proper authority should be designated even for sale of fixed assets, transfer or even for discarding of an asset.
- Proper accounting records in respect of fixed assets should be maintained and it should be ensured that the proper accounting distinction is observed between capital and revenue expenditure.
- There should be a periodic inspection of assets. A fixed asset register must be maintained giving details of all the fixed assets. In this register description of the assets, their cost and location should be mentioned.
- Management should also ensure that all the fixed assets are verified physically.

From time to time. Perfect arrangements should be made to ensure that fixed assets are properly maintained and applied in the service of the company.

- Where the fixed assets are transferred between branches or members of the sale group, proper arrangements in respect of their pricing, depreciation and accountings should be made.
- Depreciation rates are to be authorized and evidenced and which persons are to be responsible for carrying out and checking the necessary calculations. Lastly it should be seen that these fixed assets should be adequately insured.

Internal check with regard to cash transactions

- There should be a separate clerk known as cashier to deal with the receipts of cash. Immediately upon receipts of cash a rough record of the amount should be made. The cashier should not be authorized to keep cash with him. He should not be allowed to make expenditure out of it and to make entries in the ledger and other books of prime entry.
- All receipts should be banked daily. From time to time the bank reconciliation statements should be prepared to reconcile bank and cash balances.
- Bank pay-in-slips should not be prepared by the same person who is in charge of making actual deposits in the bank.
- All receipts should be acknowledged by means of printed receipts. Counter-foils of all the receipts issued should be properly maintained. Unused receipts must be kept with some responsible officer.
- Spoiled receipts should be cancelled and not torn off. If some alterations are made in the receipts already written, it should be properly initialed.
- Copies of receipts previously issued must be marked duplicate.
- Some responsible person of the firm should verify the balance of cash surprise physical check from time to time.

CASH PAYMENTS:

- The person in charge of making payments should have no connection with the receipts of cash. All payments should, as far as possible, be by cheque excluding petty cash payments. The cheques drawn for payment should be order cheques and as far as practicable they should be crossed.
- Arrangements should be made to ensure that the vouchers supporting payments cannot be presented for the payments twice, such vouchers should be stamped as paid before the cheques are signed.
- An official should check up the statements received from creditors and verify with the invoices and ledger accounts only after proper verifications cheques should be drawn in favour of the creditors.
- For sanctioning the payments of special nature, only directors and senior officers should be empowered.
- Bank reconciliation statements should be prepared to reconcile bank and cash balances from time to time by some authorities other than the cashier.
- Bank cheques must be held under lock and key with a responsible officer.
- Receipts duly signed and stamped should be obtained for each payment.
- Receipts so obtained should be properly arranged and maintained through proper filing system.

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- To ensure the availability of cash discounts, monthly or periodic payments should be made on the fixed dates

Internal control:

Meaning and Definition

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

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

The system of internal control can be defined as, - the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business. In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

Essential Characteristics of Internal Check System

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

Division of Work

Before applying test check it is necessary to divide the entire tasks among the staffs in such a way so that work can be checked automatically by the another staff. Like, when staff takes the responsibility of purchase, then another staff should make its payment.

Provision of Check

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

Use of Devices

In this modern world, various devices can be used to do various function like use of time record machine, wage determination machine etc. An organization should use such machines which help to make work of internal check easier.

Self-balancing System

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

Change in Work

An organization needs to transfer the staffs from one place to another place so that the work of previous staffs can be checked by the later staff which helps to make the internal check system effective.

Specialization

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

Control

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



UNIT – II VOUCHING

Definition:

Vouching, widely recognized as the backbone of auditing, is a component of an audit seeking to authenticate the transactions recorded in a firm's book of accounts. When an accounting transaction is vouched, it is tested and verified by presenting relevant documentary evidence.

OBJECTIVES OF VOUCHING

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

VOUCHING OF CASH TRANSACTIONS:

How to vouch various cash receipts

(Receipt side) 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 deposit 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.

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.

Loans:

While vouching the loans received, the terms and the conditions contained in the agreements should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.

Bills receivable:

Bills receivable book may be 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.

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 commissions 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.

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.

Bought Ledger or Purchase Ledger

This ledger contains accounts relating to creditors. The auditor

should take the following steps:

- He should check the opening balances of different accounts with the audited balance sheet of the previous year.
- He should examine all supporting books like purchases book, goods inwards book, cash book, discount register, goods outward book etc.
- If the self-balancing system is in use, he should ask his client for a schedule of creditors and total of the schedule should be tallied with the creditor's ledger adjustment account.
- The auditor should examine all the creditor's statements and with their help, the purchase ledger balances should be checked.
- He should see that the balances in the purchases ledger whether debit or credit are shown on the proper side of the balance sheet.
- He should ensure that provision for reserve for discount on creditors, if made, is not excessive.

Sales Ledger or Debtors Ledger

This contains accounts relating to debtors.

The following points should be noted while vouching sales ledger:

- The auditor should check the opening balances with the audited balance sheet of the previous year.
- He should examine supporting book like bills receivable book, cash book, goods outward book, sales returns book etc.

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- Where self-balancing system is in use, the total of the balance as per the schedule of debtors should be verified with the total of the balance shown in the debtors ledger adjustment account.
 - He should test check postings to this ledger from various books of first entry. He should give special attention to credit postings, as any attempt to conceal defalcations will more usually take the form of fictitious credit entries.
 - He should also check the castings and balances with the list of debtors. If there is any credit balance in the sales ledger, he should see that it is shown on the liabilities side of the balance sheet along with sundry creditors.
 - While examining the accounts the auditor should ascertain the composition of each balance. In particular, he should note whether it represents specific items of goods or is an accumulated balance. In the latter case, he should ensure that it does not represent doubtful or bad debt.
 - He should call for a list of bad and doubtful debts and verify them thoroughly as there is quite a possibility of the figure being understated and misappropriated.

VOUCHING OF IMPERSONAL LEDGER:

- It is an important part of the auditor's duty to vouch the impersonal ledger which contains accounts from which trading and profit and loss accounts and the balance sheet are prepared. The impersonal ledger has two kinds of accounts - Nominal accounts & real accounts. Nominal accounts relate to the trading, profit account and real accounts record assets. Here, the transactions appearing in the impersonal ledger but relating to profit & loss account and the auditor's duty in connection with only those items is to be considered. While vouching these transactions, the auditor should consider the following points.
- He should check the totals of the various books of original entry with the accounts in the impersonal ledger.
- He should vouch the Journal carefully and should see that each entry is supported by sufficient evidence. He should also check their postings to impersonal ledger.
- He should test the postings from the cash book to the impersonal ledger in order to ensure that the entries have been posted to the correct accounts.
- In those cases where direct entries are passed from one account to another in the impersonal ledger, he must proceed in the same manner as if they had been passed through the journal. Such items are as follows:

Outstanding assets:

Under this head, there may be an expenditure already incurred for which the corresponding benefit could not be made available for the business during the period or some portion of this relates to the period subsequent to the date of balance sheet. Such items are usually named payments in advance or pre-payments and should be shown in the balance sheet.

Beside this, there may be some items accruing or due which may not have been recorded in the books, for example, prepaid expenses, accrued income items and deferred revenue expenditure. In case of prepaid expenses like advance payment of rates and commission etc.; the auditor should see that such amount has been excluded from the profit & loss account and be shown on the asset side of the balance sheet. He should vouch such expenses with the help of nominal accounts, demand notes, receipts and the actual

inspection of the original documents. He should also see that the correct amount has been proportioned between the two periods on the date of the balance sheet. In case of other items also, same procedure can be following by the auditor.

Outstanding liabilities:

It is the duty of an auditor to ascertain that all outstanding liabilities are brought into account before calculating the net profit or loss for the year under audit. But in practice, it may not be easy for an auditor, therefore it is better if he obtains a certificate from a responsible official that there are no expenses incurred in the current year which have not been recorded in the books of account. In spite of this, he should scrutinize the nominal accounts like interest, rent and salaries and discount etc, to verify that all expenses accrued up to the date of the balance sheet have been accounted for.

For example in case of unearned income, the auditor should examine the necessary vouchers to ascertain how much amount of such income is to be credited in the current year's profit and loss account and how much is to be carried forward to the following year. Another example of outstanding liabilities is unpaid expenses such as audit fee wages and salaries, freight & carriage, rent, rates, taxes & electricity etc. traveller's & agent's commission, interest on loan & debts etc. In order to vouch these expenses, the auditor should examine nominal accounts demand notes, receipts, invoices & other relevant vouchers & note the period covered by such payment. He should also ascertain with their help that the expenses unpaid have been debited to the profit & loss account of the current year and shown separately on the liability side of the balance sheet.

Contingent liabilities:

Contingent Liabilities are those liabilities which are not definite or certain as they may or may not arise after the preparation of the balance sheet. So it is the duty of an auditor to see that the necessary provision has been made for contingent liabilities. In order to ascertain the existence of such liabilities, he should examine the minutes of the meetings of the board of directors and other concerned correspondence. He should also enquire from the legal officer of the client about possible losses from pending law suits. He should write to the bank to supply a list of all the bills discounted, also the number of bills which have not matured as yet. He should also find out the amount of dividend payable to cumulative shareholders. The auditor should divide the contingent liabilities into two main groups according to Part - I of schedule IV of the companies Act. First come those liabilities in respect of which a provision has been made in the balance sheet. So in such a case, he should see that they appear under the heading "current liabilities and provisions". Then there are liabilities in respect of which no provision has been made in the balance sheet. In this respect, the auditor has to see that these are appearing by way of footnote in the balance sheet.

Contingent Assets

There is no practice of showing these in the balance sheet either as a foot note or in any other manner and in Companies Act also there is no provision to show them. It is but fair that if a contingent liability is shown, a contingent asset must also be shown at the same time.

VERIFICATION

Meaning and Definition

Verification means the procedures normally carried out at the year end, to confirm the ownership, valuation and existence of items at the balance sheet date. In simple words verification means, 'proving the truth or confirmation.' The verification of assets implies an enquiry into the value, ownership and title, existence and possession, and the presence of any charge on the assets - Spicer and Pegler

VALUATION

Meaning and Definition

Valuation means to set the exact value of an asset on the basis of its utility. Valuation forms an important part of the everyday audit. It is because the accuracy of balance sheet depends much upon how correctly the estimation of the value of various assets and liabilities has been made. Both over valuation and under-valuation of assets and liabilities would exhibit wrong picture of the financial affairs of a concern. The auditor has to see that the assets and liabilities appearing in balance sheet have been exhibiting their proper value i.e. neither they have been over-valued nor under-valued.

METHODS OF VALUATION:

Cost price:

The price which is paid for the acquisition of an asset is known as cost price, of course the expenses incurred in the purchase of an asset and its installation in its cost price.

Market value:

A value which an asset can fetch in the market when sold is known or termed as Market value.

Replacement Value:

It is a price at which a particular asset can be replaced. The assets such as commission, freight etc. is included in such a value.

Book Value:

A value at which an asset appears in the books of accounts is known as its book value. It is usually the cost less depreciation written off so far.

Going Concern value or Conventional value or token value or Historical value:

It is equivalent to the cost less reasonable amount of depreciation written off. No notice is taken of any fluctuation in the price of the assets. Reason for this is that these assets are acquired for use in the business and not for sale.

Residual Value:

A value which will be realized in the market and received from the sale of an asset is known as its realizable Value.

Scrap Value:

A value which is obtained from the asset if it is sold as scrap.

Verification and Valuation of Different assets

For the purpose of convenience we may divide the assets in the following categories

1. Intangible Assets. Viz., goodwill, patents, trademarks, copyright etc.
2. Fixed Assets viz., land and building, plant and machinery, furniture and fixtures etc.
3. Floating assets viz., cash in hand and at bank, B/R, stock in trade, sundry letters etc.

Intangible assets:

Goodwill:

Verification:

Where goodwill has been purchased along with a running business, the same should be verified from the agreement with the vendor showing the price paid for it. But when the amount is not specially fixed, the goodwill is the amount for the purchase of the business over the net assets taken over.

It should be verified that the goodwill has been recorded in the books of accounts only when some consideration in money or its equal has been paid for. In case of partnership the auditor should verify the changes made in the goodwill account from time to time on the basis of provisions made in the partnership deed.

Valuation:

Goodwill should be valued at cost less amounts written off.

Patents:

Verification:

The Auditor should examine the patents with the help of certificate which have granted such patent rights. The auditor should also ensure that the patents are registered in the name of client.

Valuation:

Patents must be valued at cost less depreciation. The patents should be written off in a period of sixteen years after which the right automatically lapses unless the term is extended.

Copyrights:

Verification:

In verifying the copyrights, auditor should inspect the agreement between the auditor and the publisher.

Valuation:

Generally the value of the copyright is not stable because copy rights lose their value by passage of time. In the balance sheet copyright must be shown at cost less amounts written off from time to time.

Trademarks:

Verification:

Trademarks can be verified by examining the assignment deed duly endorsed by the office of the registrar of trademarks. In case they have been purchased from others, the auditor should vouch the expenditures incurred in connection with their acquisition, e.g., registration.

fees, payments made to designers etc.

Valuation:

The valuation method is the most suitable method of valuation of trademarks. It should be seen that trademarks are properly valued and shown in balance sheet.

Fixed Asset:

Freehold land and building:

Verification:

The auditor should examine the title deed to ensure that they are in the name of the client. Any additions or sales during the year should be carefully examined.

Valuation:

Freehold land being a non-depreciable asset is generally shown at cost which includes the purchase price, broker's commission, registration fees, legal charges etc. Any payments made to Municipality Corporation or improvement trust as developmental charges should be included in the cost. If market realizable value is taken as basis for valuation of freehold land the same should be disclosed clearly in the balance sheet.

Valuation of buildings:

Buildings should always be valued at cost less depreciation at a reasonable rate. Actually, the market or realized value of the buildings keeps on fluctuating. Therefore, it should be taken into account while valuing the buildings.

Leasehold property:

Verification:

The auditor should inspect the lease agreement to find out the value and duration. The auditor should see that the lease agreement is registered with the registrar and certificate testing to the validity of the same.

Valuation:

Leasehold land and buildings are to be valued at cost less depreciation which should be sufficient to write it off completely during the period of lease.

Plant and machinery:

Verification:

Auditor should commence the process of verification by obtaining a schedule of plant and machinery certified by responsible officer of the concern.

Valuation:

For valuing the plant and machinery, the auditor should prepare a list of each machine from the plant register and should get the list certified by the works manager. The auditor should see the plant and machinery account is shown in the balance sheet at cost less depreciation after making proper adjustments regarding new purchases of machinery and sale of older machinery during the year.

Floating Assets:**Cash in hand:****Verification:**

The auditor should verify the cash in hand by actually counting it on the date of balance sheet.

Cash at Bank:**Verification:**

The auditor should verify cash at bank by comparing the balances shown in cash book and pass book. In verifying the bank balance the auditor should also prepare bank reconciliation statement to ascertain the correct position.

Stock in trade:**Verification:**

It is practically impossible for auditor to physically verify each item of the stock in hand because of various reasons i.e. limited time and the lack of technical knowledge. Therefore the auditor has to rely upon test checks to ascertain the accuracy of stock in trade.

Valuation:

The stock in trade being a floating asset should be valued at cost price or market price whichever is less. The cost price can be calculated from any of the following methods

- a. Unit cost method
- b. Average cost method
- c. First in first out method (FIFO)
- d. Last in first out method (LIFO)
- e. Highest in first out (HIFO)
- f. Base stock method
- g. Adjusted selling price method
- h. Standard cost method.

Investments:**VERIFICATION:**

The auditor should verify the details of the schedule of investment by applying tests e.g. financial journals and newspapers should be consulted for checking the market rates. These securities themselves may be consulted or the broker's notes may be examined for checking the cost etc.

The auditor should verify the amount of interest or dividends as have already been declared before the date of the balance sheet, should be taken into account as outstanding ones.

Valuation:

If investments are to be held as a fixed asset for the purpose of earning interest/dividend; these are to be valued at cost which includes brokerage and stamp duty paid in regard thereto. But if the investments are held as current assets, these assets should be valued at cost or market price whichever is less. The auditor may come across the situations where the market value is much below the cost of acquisition of investments. Ordinarily he should ignore a temporarily fall in the market value, but where the fall in value seems to be of a

permanent nature, he should see that adequate depreciation is provided by passing the required entries

Verification of Liabilities:

Capital:

In case of firm, the auditor should verify the liability on account of the capital with the help of partnership deed; pass book and the cash book. In case of a company auditor should examine the memorandum of association to verify the information as to the maximum capital the company is authorized to raise. He should also ascertain the amount of called up in respect of each class of shares and also ascertain how many shares of each class are allotted as fully paid. Auditor should also specify the sources from which the bonus shares are issued i.e. capitalization of profits, reserves for share premium accounts. He should also ensure that capital profit, if any on issue of forfeited shares, has been transferred to capital reserve.

Debenture:

The auditor should note the following points while verifying the depreciation:

1. Debenture trust deed should be inspected and with its help, the debenture account in the ledgers should be examined.
2. If necessary, the auditor can obtain a certificate from the debenture holders.
3. Since the debentures are supposed to be redeemed, the auditor should see the arrangements for their redemption.
4. The debenture may be issued at par or at premium.
5. The auditor should see the details as given in the Register of Mortgages and charges.

Trade creditors:

1. The first task the auditor is to ask for schedule of creditors.
2. The purchase ledger should be checked with the books of original entry, invoices and credit notes etc.
3. Discount on creditors should be checked with reference to creditor's account.
4. If any debt is found unpaid for a longer period of time any enquiry should be made since it is possible that instead of paying to the creditor the amount might have been misappropriated.

Loans:

The auditor should examine the loan agreement in order to ascertain the terms of loan, amount of loan and period and the nature of the loan. In case the loans are overdrafts have been taken from a bank an agreement with the bank and a certificate to that effect should be obtained and examined.

Outstanding liabilities for expenses:

The auditor should obtain a certificate from responsible officer of the company stating that all outstanding liabilities for expenses incurred have been brought into account. The auditor can verify those items of expenses which usually constitute outstanding liabilities. E.g. salaries payable, legal expenses, rent, wages, audit fees etc.

Reserves and Funds:

The auditor should examine and verify that whether the decision to create reserve or fund is

dictated by needs and circumstances of business and relevant legal provisions and check the relevant entries in books of accounts and check the entries passed for the purpose in the profit and loss appropriation account.

Income Received in Advance

The auditor should examine the schedules of income received in advance and ensure that these are fully disclosed in the balance sheet. The auditor's duty is to examine whether interest, rent, installments etc., received in advance should be classified as liability and shown as such in the balance sheet.

DIFFERENCE BETWEEN VOUCHING AND VERIFICATION

It has been stated earlier that both vouching and verification are very important aspects to auditing. However, verification is a much wider term than vouching.

The points of difference between the two may be stated as follows:

1. Vouching means substantiating an entry in the books of account with the supporting vouchers like receipts, invoices, correspondence, contracts etc. Verification means examining with regard to the assets shown in the balance sheet that they exist, are in the name of the company, are properly valued and are free from any charge.
2. The object of vouching is to check that the entries made in the books of accounts are correct. Whereas the object of verification is to check the existence, valuation, ownership and possession of the assets.
3. Vouching is carried out with the help of vouchers. Verification includes in addition to vouching, the checking of physical existence, valuation and ownership of the assets.
4. Vouching is done at any time during the year. Verification is done only after accounts are completed and balances are drawn.
5. Vouching of assets is undertaken once during the life time of the asset. Verification of assets shown in the balance sheet is done every year.
6. Vouching does not include valuation of assets and liabilities. Verification includes valuation of assets and liabilities.
7. Vouching is the first step taken before verification. It involves examining the transactions when they take place. Verification is the next step after vouching is completed. It includes checking many aspects of assets and liabilities.

DIFFERENCE BETWEEN VALUATION AND VERIFICATION

Meaning

Verification means checking whether the assets shown in the balance sheet are in the name of business, whether they exist or not, whether there is any charge on it etc. Valuation means determining the proper values of assets and liabilities shown in the balance sheet.

Purpose

The purpose of verification is to check existence, ownership and possession of assets. The purpose of valuation is to determine the proper values of assets as per generally accepted principles.

Basis

The basis of verification is the type of assets, and liabilities. There is not fixed method of verification. The basis of valuation of assets is the types of assets are valued on different basis.

Certificate

The auditor is not able to get certificate of verification of assets and liabilities. The auditor is entitled to get certificate of valuation of assets from responsible officer of the business unit.

Vouching

Verification includes vouching. Valuation does not include vouching.

Scope

The scope of verification is wide. It includes checking of many things like existence, ownership, possession etc. The scope of valuation is limited. Here only values of assets and liabilities are determined and checked.

Qualities of an Auditor:

The Auditor must possess the following qualifications and qualities:

1. Only the qualified chartered accountant can be appointed as auditor of a limited company.
2. The auditor must have thorough knowledge of principles and practice of all aspects of accountancy. He must be familiar with all systems of accountancy in use.
3. He should have adequate knowledge of financial management, industrial administration and business organization.
4. He must have thorough knowledge of audit case laws as per the various cases decided by the courts in and outside India.
5. He should be able to understand the technical details of business whose accounts he is going to audit.
6. An auditor must be honest i.e. He must certify that he does not believe to be true and he must take reasonable care and skill before he believes what he certifies is true.
7. He must act impartially and not influenced by others, directly or indirectly while discharging his duties.
8. He should be hard working, systematic and methodical.
9. He must have capacity to hear arguments of others.
10. He should have adequate skills and courage to write audit report correctly, clearly and concisely.
11. He should not disclose the secrets of his client.

Appointment of an Auditor

APPOINTMENT OF COMPANIES AUDITORS:

The provisions regarding appointment of the auditor are contained in section 139 of Companies Act 2013

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

1. A company shall appoint an individual or a firm as an Auditor at the first annual general meeting and each subsequent sixth annual general meeting.
2. Such auditor shall hold office till conclusion of sixth annual general meeting.
3. Such appointments shall be placed before the members at each annual general meeting for ratification.

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

1. An individual can be appointed for a term not more than five years.
2. An audit firm can be appointed for a consecutive term not more than two terms of five years.
3. An individual or a firm which has completed its term shall not be eligible for reappointment as auditor in the same company for five years from the completion of term.

Appointment of auditor of Government companies (sec 139(5)):

The Comptroller and Auditor General shall in respect of financial year appoint an auditor duly qualified within 180 days from the commencement of financial year who shall hold office till conclusion of annual general meeting.

Appointment of First Auditor by Board of Directors [sec 139(6)]:

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

Appointment of First Auditor of Government Company [sec 139(7)]:

The first Auditor of a Government Company shall be appointed by Comptroller and Auditor General within 60 days of registration of company. In case of its failure to appoint first auditor, then board of directors shall appoint auditor within next 30 days. The company shall inform the members if the board fails to appoint first auditor who shall appoint the auditor within 60 days at extra ordinary general meeting who shall hold the office till conclusion of the first general meeting.

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

- a. The casual vacancy of auditor, except in case of Government Company, shall be filled by the board of directors within 30 days but if it arises as a result of resignation of the auditor it shall be approved by company at general meeting convened within 3 months or recommendation of board. Such auditor shall hold office till conclusion of next annual general meeting.
- b. Casual vacancy in case of Government Company shall be filled by Comptroller and Auditor General within 30 days if he fails to fill the vacancy, the board shall fill the vacancy within next 30 days.

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

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

- a. He is not disqualified for reappointment.
- b. He has not given notice to the company of his unwillingness.
- c. A special resolution has not been passed at an annual general meeting appointing some other person or providing expressly that he shall not be reappointed.

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

QUALIFICATIONS OF AN AUDITOR:

- a. A person shall be eligible for the appointment of an auditor of a company only if he is a chartered accountant.
- b. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

Disqualification of an Auditor:

The following persons shall not be eligible for the appointment as an auditor of a company:

- a. An officer or employee of the company.
- b. A person who is a partner, or who is in employment or an officer or employee of the company.
- c. A person or a firm who, whether directly or indirectly has business relationship with the company, or subsidiary of such holding company or associate company of such nature as may be prescribed.
- d. A person whose relative is director or is in the employment of the company as director or key managerial personnel.
- e. A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies.
- f. A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

REMUNERATION OF AN AUDITOR (SEC 142)

- a. The remuneration of the Auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.
- b. The remuneration under subsection (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company extended to him but does not include any remuneration paid to him by any other services rendered by him at the request of the company.

REMOVAL, RESIGNATION OF AN AUDITOR

- c. The Auditor appointed under section 139 may be removed from his office before expiry of his term only by a special resolution of the company after obtaining the previous approval of the central Government.
- d. The Auditor who resigns from the company shall file within a period of thirty days from the date of resignation, a statement in a prescribed form with the company registrar, the auditor shall also file such statement with the comptroller and auditor-general.

indicating the reasons and other facts as may be relevant with regard to his resignation.

Rights of an Auditor

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

DUTIES OF AN AUDITOR:

Duties under section 143(1):

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

Duties under section 143(2):

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

Duties under section 143(3):

1. He has the duty to seek and obtain all information and explanation which are necessary for his audit.
2. He has a duty to ensure that the books of accounts as required by law have been kept by the company.

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3. He has a duty to see whether the company has adequate internal financial control systems in place and their operative effectiveness.
 4. He has a duty to ensure whether the company's balance sheet and profit and loss account dealt within the report or in agreement with the books of account and returns.

LIABILITIES OF AN AUDITOR:

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

1. Civil liabilities
2. Criminal Liabilities

1. Civil Liabilities:

(i) Liability for Negligence:

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

(ii) Liability for misfeasance:

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

2. Criminal Liabilities:

(i) Misstatement in prospectus section 34:

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

(ii) Non compliance by auditor with section 143 and 145:

If the auditor does not comply with section 143 and 145 regarding making his report or signing or authentication of any document and makes willful neglect on his part he shall be punishable with imprisonment up to 1 year and with fine not less than twenty thousand extendable to five lakhs. In case an auditor knowingly or willfully with the intention to deceive the company or Shareholders or creditors or tax authorities, he shall be punishable with imprisonment up to 1 year and fine not less than 1 lakh extendable up to twenty five lakhs.

(iii) Failure to assist in the investigation section 217(6):

Where the central Government appoints an inspector to investigate the affairs of the company, it is the duty of the auditor to preserve and produce to the inspector all books and papers relating to the company. If an auditor fails to assist the inspector in investigation he shall

be punishable with imprisonment up to 1 year and with fine not less than twenty five thousand extendable to 1 lakh

(iv) Penalty for falsification of books section 336:

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

(v) Penalty for deliberate act of commission or omission section 448:

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



U
nit II
I:
Audit and Accounting Standards

Types of Audit

Statutory Audit

A statutory [audit](#) is a legally required check of the accuracy of the [financial statements](#) and records of a [company](#) or government. A [statutory audit](#) is intended to determine if an organization delivers an honest and accurate representation of its financial [position](#) by evaluating information, such as bank balances, financial transactions, and [accounting](#) records.

Concurrent Audit

It's an audit which goes on a daily basis.

It happens where transactions are huge and requires daily checking as the chance of risk of misstatement is high. Concurrent audit is mostly in banks, mutual fund, other financial service providers and organisation with high volume of material transaction.

For eg: In mutual funds, daily NAV p.u (Net Asset Value) of every plan of the scheme is released on all working days which requires a verification by auditor or any other eligible person so that the NAV p.u released by mutual fund doesn't have discrepancies.

Stock Audit

Stock audit or inventory **audit** is a term that refers to physical verification of a company or institution's inventory assets. Every business organization needs to perform an **audit** once a year to update and ensure that the physical **stock** and the computed **stock** match.

Cost Audit

A **cost audit** represents the verification of **cost** accounts and checking on the adherence to **cost** accounting plan. **Cost audit** ascertains the accuracy of **cost** accounting records to ensure that they are in conformity with **cost** accounting principles, plans, procedures and objectives.

Secretarial Audit

The **Secretarial Audit** is an effective tool for corporate compliance management. It helps ensure timely corrective measures when non-compliance is detected. Process of verification of records and documents to check compliance with the provisions of various laws and rules/procedures, maintenance of books, records etc.

CAG Audit

The Comptroller and Auditor General (CAG) of India is an authority instituted vide Article 148 of the Constitution of India. The prime responsibility of this authority is to audit the receipts and expenditures of the state governments and the union government in India including those of the entities and corporations financed by the government. The reports generated by the CAG are crucially important for the Public Accounts Committees (PACs) and Committees on Public Undertakings (COPUs), which are part of the state and central governments

1. **What is full name of CAG?**

The expansion of CAG reads as 'The Comptroller and Auditor General of India'.

2. **Who is the present CAG president?**

The incumbent CAG is Rajiv Mehrishi, IAS who assumed his office on 25 September 2017. Born on August 8, 1955 RahivMehrishi is a former Indian Administrative Service (IAS) officer belonging to the 1978 batch of the Rajasthan cadre. Rajiv is the 13th Comptroller and Auditor General of India (C&AG) and also the Vice - Chairman of United Nations Panel of External Auditors.

3. **Who was the first CAG in India?**

V. NarahariRao, a former civil servant was the first CAG who remained in his office from 1948 to 1954. In recognition of his significant contributions to the civil service in India, the government of India awarded him the highest civilian award namely Padma Bhushan in the year 1954.

4. **Who can appoint CAG?**

The President of India appoints the CAG (The Comptroller and Auditor-General of India) based on the recommendations made by the Prime Minister. On his appointment to the office, the CAG needs to take the oath or affirmation in front of the President of India.

5. **How can the CAG be removed from his office?**

The CAG can be removed from his office only if both the houses of parliament pass a resolution to do so on grounds of misbehavior or incapacity. The tenure of the CAG is 6 years or till the age of 65, whichever happens earlier while he serves from his position.

6. **What is the power of CAG?**

Ranked 9th in the country in terms of his powers, the CAG enjoys the status that is similar to that of a judge of the Supreme Court of India. Vide article 148 of the Constitution of India, the CAG enjoys an independent office in the country. The CAG is also the head of the Indian Audit and Accounts Department. He too has the most important duty to protect the interests of the public exchequer. The Indian Audit and Accounts Service provides the support necessary for the CAG to carry out his functions.

7. **What are the important functions of CAG?**

Auditing the state and central government accounts and finding the performance of the consolidated fund of the state and the union government's irrespective of whether they happened inside or outside India Auditing all the revenues into the consolidated funds of the state and central governments and all the transactions connected to the public accounts and the contingency funds of the union and state governments.

Management Audit.

A management audit is an analysis and assessment of the competencies and capabilities of a company's management in carrying out corporate objectives. The purpose of a management [audit](#) is not to appraise individual executive performance but to evaluate the management team in its effectiveness to work in the interests of [shareholders](#), maintain good relations with employees, and uphold reputational standards. It is important to stress that the management audit assesses the overall management of the company, not the performance of individual managers

ACCOUNTING STANDARDS

What is an Accounting Standard?

An accounting standard is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices.

Concept of Accounting Standards:

We know that Generally Accepted Accounting Principles (GAAP) aims at bringing uniformity and comparability in the financial statements. It can be seen that at many places, GAAP permits a variety of alternative accounting treatments for the same item. For example, different methods for valuation of stock give different results in financial statements.

Such practices sometimes can misguide intended users in taking decision relating to their field. Keeping in view the problems faced by many users of accounting, a need for the development of common accounting standards was aroused.

For this purpose, the Institute of Chartered Accountants of India (ICAI), which is also a member of International Accounting Standards Committee (IASC), had constituted Accounting Standard Board (ASB) in the year 1977. ASB identified the areas in which uniformity in accounting was required. After detailed research and discussions, it prepared and submitted a draft to the ICAI. After proper examination, ICAI finalized them and notified for its use in financial statements.

Meaning of Accounting Standards:

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Nature of Accounting Standards:

On the basis of forgoing discussion we can say that accounting standards are guide, dictator, service provider and harmonizer in the field of accounting process.

The following points highlight the nature of Accounting Standards.

1. Accounting Standards are guidelines providing the framework so that credible financial standards can be produced.
2. The objective of setting the Accounting Standard is to bring uniformity in accounting practices and to ensure transparency, consistency, and comparability.
3. Accounting Standards are prepared to keep in view the business environment and laws of the country. It, therefore, naturally means that the guidelines change with the change in business environment and laws. It is because of this that Accounting Standards are being revised from time to time. It may be noted that whenever a conflict arises between law and Accounting Standards, the law will prevail.
4. Accounting Standards are mandatory in nature.
5. Accounting Standards have also been made flexible in the sense that where alternative accounting practices are acceptable, an enterprise is at free to adopt any of the practices with a suitable disclosure. In case the enterprise chooses to change the practice followed, the effect of such change must be quantified and disclosed. An example of this would be the method of

depreciation charged. An enterprise may charge depreciation on the written down value Method or Straight Line Method.

StandardsonAuditing

To ensure that information provided in the financial statements are of high quality and are acceptable worldwide the Auditing and Assurance Standards board under the council of Institute of Chartered Accountants (ICAI) have formulated few Standards. These are in line with the International Standards issued by the International Auditing and Assurance Board (IAASB). Standards issued by the AASB include :

- **Standards of Quality Control (SQC)** For all the services under Engagement Standards. These standards are applicable to all auditing firms which perform audits and reviews of historical financial information including assurances and related service engagements.
- **Standards on Auditing (SAs)** For auditing historical financial information. These apply whenever any independent Audit is carried out.

In simpler words, whenever an independent examination of financial information is carried on for ANY entity whether the business motive is to make the profit or not, whether the size of the entity is big or small or even if the entity has any legal form (unless any law specifies something else) the SAs will be applicable. All SAs are interlinked and have to apply in unity. The number given to SA is similar to the numbering system followed for International Standards on Auditing formulated by IAASB.

- **Standards on Review Engagements (SREs)** for reviewing historical financial information
- **Standards on Assurance Engagements (SAEs)** for assurance engagements other than the audits and reviews of financial information
- **Standards on Related Services (SRSs)** for all engagements about the application of agreed procedures to information, compilation engagements, and other related services engagements

The major standards are listed here below:

Standards on Quality Control (SQCs)

- SQC 1, “Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements”
- Announcement on Amendment to SQC 1 - Retention Period for Engagement Documentation (Working Papers)

Audits and Reviews of Historical Financial Information

New/Revised Standards (Auditing, Review and Others) issued under the Clarity Project

- 100-199 Introductory Matters
- 200-299 General Principles and Responsibilities
 - SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
 - SA 210, Agreeing the Terms of Audit Engagements
 - SA 220, Quality Control for an Audit of Financial Statements
 - SA 230, Audit Documentation

- SA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- SA 250, Consideration of Laws and Regulations in an Audit of Financial Statements
- Revised SA 260, Communication with Those Charged with Governance
- SA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
- Revised SA 299, Joint Audit of Financial Statements
- 300-499 Risk Assessment and Response to Assessed Risks
 - SA 300, Planning an Audit of Financial Statements
 - SA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
 - SA 320, Materiality in Planning and Performing an Audit
 - SA 330, The Auditor's Responses to Assessed Risks
 - SA 402, Audit Considerations Relating to an Entity Using a Service Organisation
 - SA 450, Evaluation of Misstatements Identified During the Audit
- 500-599 Audit Evidence
 - SA 500, Audit Evidence
 - SA 501, Audit Evidence-Specific Considerations for Selected Items
 - SA 505, External Confirmations
 - SA 510, Initial Audit Engagements – Opening Balances
 - SA 520, Analytical Procedures
 - SA 530, Audit Sampling
 - SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
 - SA 550, Related Parties
 - SA 560, Subsequent Events
 - Revised SA 570, Going Concern
 - SA 580, Written Representations
- 600-699 Using Work of Others
 - SA 600, Using the Work of Another Auditor
 - Revised SA 610, Using the Work of Internal Auditors
 - SA 620, Using the Work of an Auditor's Expert
- 700-799 Audit Conclusions and Reporting
 - Revised SA 700, Forming an Opinion and Reporting on Financial Statements
 - SA 701, Communicating Key Audit Matters in the Independent Auditor's Report
 - Revised SA 705, Modifications to the Opinion in the Independent Auditor's Report
 - Revised SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
 - SA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements
 - Revised SA 720, The Auditor's Responsibilities Relating to Other Information
- 800-899 Specialized Areas
 - SA 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
 - SA 805, Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
 - SA 810, Engagements to Report on Summary Financial Statements
- 2000-2699 Standards on Review Engagements (SREs)
 - SRE 2400 (Revised), Engagements to Review Historical Financial Statements
 - SRE 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"

Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

- 3000-3699 Standards on Assurance Engagements (SAEs)
- 3000-3399 Applicable to All Assurance Engagements

- 3400-3699 Subject Specific Standards
 - SAE 3400 “The Examination of Prospective Financial Information”
 - SAE 3402, “Assurance Reports on Controls At a Service Organisation”
 - SAE 3420, Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

Related Services

- 4000-4699 Standards on Related Services (SRSs)
 - SRS 4400 “Engagements to Perform Agreed-upon Procedures Regarding Financial Information”
 - SRS 4410 (Revised), Compilation Engagements

General Clarifications issued

- General Clarification (GC)-AASB/2/2004 on SA 210
- General Clarification (GC)-AASB/1/2002 on SA 620

Standard on Internal Audit

PREFACE TO THE FRAMEWORK AND STANDARDS ON INTERNAL AUDIT

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Preface to the Standards on Internal Audit was, originally, issued in November, 2004, revised in July, 2007, and was recommendatory in nature. The revised Preface to the Framework and Standards on Internal Audit shall become mandatory from such date as notified by the Council.

* Issued in November, 2018.





1. Introduction

This Preface to the Framework, Basic Principles and Standards on Internal Audit facilitates understanding of the scope and authority of the pronouncements of the Internal Audit Standards Board, issued under the authority of the Council of the Institute of Chartered Accountants of India.

2. Internal Audit Standards Board

2.1. The Institute of Chartered Accountants of India (hereinafter referred as “ICAI” or “the Institute”) constituted the “Committee for Internal Audit (CIA)” in February 2004, which in November 2005 was renamed as the “Committee on Internal Audit”. In November 2008, the Council renamed this Committee as the “Internal Audit Standards Board (hereinafter referred as the Board)”.

2.2. The objectives and functions of the Board are as follow:

- (i) To review existing and emerging internal auditing practices worldwide and identify areas in which Standards on Internal Audit (SIAs) need to be developed.
- (ii) To formulate Standards on Internal Audit, which may be issued under the authority of the Council of the Institute.
- (iii) To formulate Guidance Notes on issues relating to internal audit, including those arising from the SIAs, or pertaining to any specific industry, which may be issued under the authority of the Council of the Institute.
- (iv) To continuously review the existing Standards and Guidance on Internal Audit and to undertake their revision, if necessary.
- (v) To formulate and review Implementation Guides, Technical Guides, Practice Manuals, Studies and other papers which may be issued under its own authority for guidance of the members, as felt appropriate by the Board.
- (vi) To undertake research and promote knowledge dissemination in the field of internal audit.

3. Framework Governing Internal Audits

3.1. Every standard setting process operates within a pre-defined framework which outlines certain fundamental components inherent to

Preface

the function or activity of internal audit. This is essential to ensure a consistent application of Basic Principles, Best Practices and Standards to achieve a high level of quality consistent with the objective of internal audit.

- 3.2. The Framework Governing Internal Audits is an overarching document to be read along with this Preface. It consists of Definition of Internal Audit, Code of Ethics and the following four components of internal audit:
- (a) Basic Principles of Internal Audit
 - (b) Key Concepts
 - (c) Standards on Internal Audit, and
 - (d) Guidance

4. Standards on Internal Audit (SIAs)

- 4.1. The Standards on Internal Audit (SIAs) are a set of minimum requirements that apply to all members¹ of the ICAI while performing internal audit of any entity or body corporate.
- 4.2. As per Section 138 of Companies Act, 2013, the Board of a Company may, besides a Chartered Accountant, appoint a cost accountant or any other professional to conduct Internal Audits. The ICAI recommends the adoption of the SIAs by non-members of the ICAI who are performing internal audits so as to ensure a consistent approach and quality in the discharge of their professional duties.

5. Mandatory Nature of Framework and Standards

- 5.1. The Council of the ICAI has decided that the Standards will be made mandatory in a phased manner.
- 5.2. The SIAs shall initially be mandatory for members performing internal audits in all listed companies, as per Section 138 of the Companies

¹ The current law in India permits internal audit to be performed either by an entity's own employee (i.e., personnel on the payroll of the organization or its group company) or by a professional who is part of an external agency (e.g., a firm of practicing Chartered Accountants undertaking internal audit engagements). These SIAs apply to ICAI members in both situations, irrespective of whether the internal audit is conducted by them in the capacity of an employee or as a representative of an external agency.

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Act, 2013, read with Rule 13 of Companies (Accounts) Rules 2014 from the effective date of the SIA, and all other companies from one year thereafter.

- 5.3. The mandatory status of a SIA implies that while carrying out an internal audit, it shall be the duty of the members of the Institute to ensure that they comply with the SIA read with the Preface, Framework Governing Internal Audits and Basic Principles of Internal Audit.
- 5.4. If, for any reason, a member is unable to comply with any of the SIA requirements, or if there is a conflict between the SIA and other mandates, such as a regulatory requirement, the internal audit report (or such similar communication) should draw attention to the material departure therefrom along with appropriate explanation.

6. Standard Setting Process

- 6.1. The Board develops and revises SIA in consultation with Study Groups (if required). Exposure drafts are thereafter released to various interest groups and public at large for their feedback and comments. The Board reviews the comments and thereafter places the SIA before the Council for its deliberation. The SIA approved by the Council is issued with the final changes.
- 6.2. The detailed process is explained under Annexure 1.

7. Contents of the Standards

- 7.1. SIA shall be principle based and will clearly outline the objective of issuing the particular Standard along with the essential requirements for its compliance.
- 7.2. Internal Auditors shall apply their best professional judgement in the implementation of SIA on a “substance over form” basis. Implementation and Technical guides issued by the Board would help to provide the necessary guidance and clarification in this regard.
- 7.3. The essence of each Standard is captured under the following key sections:
 - (i) Introduction: To provide a brief background and scope of the Standard and its applicability.

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- (ii) Objective: Reasons for issuing the Standard and why it is required.
- (iii) Requirements: The desired outcome and what is essential to ensure compliance with the Standard.
- (iv) Explanatory Comments on Implementation and Application: Certain parts of the Standard which need to be elaborated, including defining keywords and terms.
- (v) Effective Date: Date from which the Standard is to be applied and made mandatory.

7.4. The Standards on Internal Audit, as and when issued, will be classified and numbered in a series format, as follows:

- (i) 100 Series : Standards on Key Concepts
- (ii) 200 Series : Standards on Internal Audit Management
- (iii) 300–400 Series : Standards on the Conduct of Audit Assignments
- (iv) 500 Series : Standards on Specialised Areas
- (v) 600 Series : Standards on Quality Control
- (vi) 700 Series : Other/Miscellaneous Matters

8. Guidance

8.1. Guidance Notes on Internal Audit are primarily designed to provide guidance on matters of implementation or clarification on their applicability in certain circumstances.

8.2. The Board may issue the following guides (as appropriate):

- (i) Implementation Guide: Best practices, methodologies or approach on how best to apply internal audit procedures in order to achieve the objectives of the SIA.
- (ii) Technical Guide: Clarifications as to what extent the SIA applies in a certain industry or a particular situation, considering the technical or operational uniqueness of the same, and how best to achieve the objectives of the SIA.

8.3. The Implementation and Technical Guides are recommendatory in nature. The Internal Auditors should ordinarily follow these

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recommendations except where, under particular circumstances, it may not be necessary or appropriate to do so.

9. Effective Date

- 9.1. The Preface to the Framework and Standards on Internal Audits is applicable for all internal audits beginning on or after a date to be notified by the Council of the Institute.
- 9.2. In case of SIAs issued by the ICAI for which a Guidance Note is already in existence, the Guidance Note shall stand withdrawn from the date on which the Standard comes into effect.



DETAILS OF THE STANDARD SETTING PROCESS

1. **Selection of Topics and Time-lines:** The Internal Audit Standards Board, on a continuous basis, and in consultation with its key stakeholders, keeps identifying the broad areas in which the SIAs need to be formulated (including the review and revision of prevailing SIAs) and prepares a priority list with time lines for the issuance of the SIAs.
2. **Formation of Study Group to Draft Standards:** In the preparation and drafting of the SIAs, the Board is assisted by a Study Group (SG) of professionals constituted by the Board. In the formation of the SG, provision is made for the participation of a cross-section of members of the Institute. In certain situations the Board may also consider having expert professionals on the SG, who need not necessarily be members of the ICAI. The SG is generally chaired by a member of the Board and convened by the Board. The SG is responsible for preparing and finalising the Exposure Draft of the Standard and make it ready for review and approval of the Board.
3. **Review of Exposure Draft of SIA by the Board:** The Exposure Draft (ED) of the Standard is put up to the Board for their review, deliberation and approval. On the basis of the deliberations of the Board, changes are made to the draft, and the final ED is made ready for exposure with a wide set of stakeholders.

While formulating the SIAs, the Board takes into consideration the applicable laws, customs, business environment in India. The Board also, where appropriate, takes into consideration the international practices in the area of internal audit, to the extent they are relevant and applicable to the condition existing in India.
4. **Exposure Draft Open for Comments for 30 days:** The Exposure Draft of the proposed Standard is issued for comments by the members of the Institute. The ED is also open for comments by non-members, including the regulators and other such bodies as well as general public. The ED is also published in the monthly Journal of the Institute and hosted on the website of the Institute wherefrom it is downloadable free of charge for comments by the professional accountants and the public. The ED is also circulated to all the members of Council of the ICAI, the Institute's past Presidents,

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Regional Councils and the branches of the Institute for their comments. The Exposure Draft is also circulated to other external stakeholders as listed in **Annexure 2**.

The Exposure Draft is normally open for comments for a period of at least 30 (thirty) days from the date of issuance, but this time may be extended if considered necessary.

5. **Finalisation and Submission to ICAI Council:** After taking into consideration the comments received on the Exposure Draft, the Board will update the draft of the proposed Standard, take input of the SG (if appropriate), finalise the Standard for consideration by the Council of the Institute.
6. **ICAI Council Deliberates and Approves SIA:** The Council of the Institute will consider the final draft of the proposed Standard on Internal Audit and if necessary, modify the same in consultation with the Internal Audit Standards Board.
7. **SIA Issued with Final Changes:** The SIA will then be issued under the authority of the Council of the Institute.

LIST OF STAKEHOLDERS FOR INPUTS ON EXPOSURE DRAFTS

1. The Ministry of Corporate Affairs
2. The Reserve Bank of India
3. The Securities and Exchange Board of India
4. The Insurance Regulatory and Development Authority
5. The Comptroller and Auditor General of India
6. The Controller General of Accounts
7. The Central Board of Direct Taxes
8. The Central Board of Excise and Customs
9. The Institute of Cost Accountants of India
10. The Institute of Company Secretaries of India
11. Recognised Stock Exchanges in India
12. The Indian Banks' Association
13. The Standing Conference of Public Enterprises
14. The National Bank for Agricultural and Rural Development
15. The Indian Institute(s) of Management
16. The Telecom Regulatory Authority of India
17. The Central Registrar of Co-operative Societies
18. Various Industry bodies/associations, such as, The Confederation of Indian Industry, The Associated Chambers of Commerce and Industry, The Federation of Indian Chambers of Commerce and Industry, etc.
19. Any other body considered relevant by the Board, keeping in view the nature and requirements of SIAs.

Preface

Penal Provisions

Penalty on Officer of Company:

Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year OR with fine which shall not be less than Rs. 10,000/- (Rupees ten thousand) but which may extend to Rs. 1 Lac (Rupees one lakh), OR with BOTH.

B. Contravention of Provision of Section 145: (Signing of Auditor Report): If any provisions of this Section contravene then:

Penalty on Auditor (without intention or will):

The auditor shall be punishable with fine which shall not be less than Rs. 25,000/- (Rupees twenty-five thousand) but which may extend to Rs. 5 Lac (Rupees five lakh)

Penalty on Auditor (Contravene the provisions knowingly or willfully):

if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year **AND** with fine which shall not be less than Rs. 1 Lac (Rupees one lac) but which may extend to Rs. 25 Lac (Rupees twenty-five lac).

Other Liability on Company if Contravene provisions knowingly and willfully:

i. Refund the remuneration received by him to the company; and

ii. Pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

Penalty on all Partners of Firm:

Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

Class action against auditors and audit firm:

Class action against auditor/firm of auditors for such damages, compensation or other action is possible under Section 245 of Companies Act, 2013 for improper and misleading statements in his audit report.

Professional misconduct of auditor:

Certain Acts of auditors will be considered as misconduct and Institute of ICAI can take suitable action. In some cases, action can be taken only with permission of High Court. The provisions are similar in case of all three professional Institutes.

Control over professions- All CA's are required to maintain professional ethics while undertaking audit. The ICAI through its disciplinary committee exercise control over professional misconducts of its members.

Peer Review: ICAI has established an 11 member peer review Board in year 2002 to take care of all functions relating to Peer Review. Peer Review means work done by one person in reviewed by another person of similar standing. The aim is to ensure quality of attestation services and is de-linked from other activities, including disciplinary action.

National Financial Reporting Authority (NFRA)

Updated on Jan 04, 2021 - 11:41:32 PM

The National Financial Reporting Authority (NFRA) is a body constituted under the provisions of Section 132 of the Companies Act, 2013. The constitution of this authority is effective from 1st October 2018. The aim of the Central Government in this regard appears to be:

- Setting up of a separate and independent regulatory body to assist in the framing and enforcement of legislation relating to accounting & auditing and
- Improving investor and public confidence in the financial reporting of an entity.

Supposedly, the need for this authority arose as a response to various corporate scams in recent times.

Composition of the NFRA

The Companies Act requires the NFRA to have a chairperson who will be appointed by the Central Government and a maximum of 15 members. The appointment of such chairperson and members are subject to the following qualifications:

- They should be having an expertise in accountancy, auditing, finance or law.
- They are required to make a declaration to the Central Government that there is no conflict of interest or lack of independence in their appointment.
- All the members including the chairperson who are in full-time employment should not be associated with any audit firm (including related consultancy firms) during their term of office and 2 years after their term.

The terms and conditions relating to the appointment of the chairperson and members have not yet been

prescribed. However, the draft NFRA rules outline the following composition of the authority:

1. Chairperson is a Chartered Accountant and a person of eminence having expertise in accountancy, auditing, finance or law;
2. Member – Accounting;
3. Member – Auditing;
4. Member – Enforcement;
5. One representative of the MCA not below the rank of Joint Secretary or equivalent (ex-officio)
6. One representative of RBI, being a member of the RBI Board is to be nominated by the RBI;
7. One representative of SEBI, being the Chairman of SEBI or whole-time member of SEBI is to be nominated by SEBI;
8. A retired chief justice of high court or a person who has been the judge of a high court for more than 5 years is to be nominated by the Central Government,
9. President of the Institute of Chartered Accountants of India (ex-officio)

The Chairman may also invite any other person to the meeting to give their expert opinion.

Role of the NFRA

The NFRA has the following responsibilities:

- Make recommendations on the foundation and laying down of accounting and auditing policies and standards;
- Monitor and enforce the compliance of the accounting standards and auditing standards;
- Oversee the quality of service of the professionals (such as auditors, CFOs, etc) and suggest measures required for improvement in the quality of service;
- Perform such other functions related to the above.

Prior to the constitution of this authority, the Central Government would prescribe accounting standards on the recommendation of ICAI. The ICAI would prescribe the same only after consulting with the National Advisory Committee on Accounting Standards who will provide their recommendations. The ICAI will now have to consult with the NFRA and examine its recommendations in this regard. Thus the National Advisory Committee on Accounting Standards is effectively replaced by the NFRA.

Powers of the NFRA

The NFRA shall have the following powers:

- To investigate the matters of professional or other misconduct committed by a prescribed class of CA firms or CAs. No other authority can initiate or continue proceedings where the NFRA has initiated an investigation. Such an investigation can be initiated either suo-moto (by itself) or on a reference made by the Central Government.
- The same powers as a Civil Court under the Code of Criminal Procedure, 1908, in respect of a suit involving the following matters.
 - Discovery and production of books of account and other documents, at such place and time as may be specified by the NFRA
 - Summoning and enforcing the attendance of persons and examining them under oath
 - Inspection of any books, registers, and other documents of any person at any place
 - Issuing commissions for the examination of witnesses or documents
- Where professional or other misconduct is proved, it shall have the power to impose the following punishment:
 - Penalty:
 - For individuals a fine between Rs. 1,00,000 to 5 times the fees received;
 - For firms a fine Between Rs. 5,00,000 to 10 times the fees received;

- Debarring the member/firm from practice as a member of ICAI between 6 months to 10 years as may be decided

Any person who is not satisfied with the order of the NFRA can then make an appeal to the Appellate Authority.

Scope of the NFRA

As discussed earlier, the NFRA has the power to investigate and also conduct quality reviews for a certain prescribed class of companies. While the draft NFRA Rules have not been prescribed yet, they would include the following class of companies if implemented as it is:

- Companies listed in India
- Unlisted Companies whose:
 - Net worth $\geq$ Rs. 500 crore; or
 - Paid up Capital $\geq$ Rs. 500 crore; or
 - Annual turnover $\geq$ Rs. 1000 crore (As on 31st March of the preceding financial year); OR
 - Companies whose securities are listed outside India

The NFRA also holds the power of investigation of a certain class of bodies corporate or persons (auditors) in relation to matters of professional or other misconduct by a member or firm of Chartered Accountants or auditors. In this regard, as per the draft NFRA rules, the auditors or audit firms which conduct the audit of the following category of companies or their branches (including through the network/brand to which it belongs) whether directly or indirectly, are covered:

- Audit of ≥ 200 companies in a year;
- Audit of ≥ 20 listed companies;
- Company or companies (whether listed or not), having:
 - Net Worth $\geq$ Rs. 500 crores; or
 - Paid up Capital $\geq$ Rs. 500 crores; or
 - Annual turnover $\geq$ Rs. 1000 crores;(As on 31st March of the immediately preceding financial year); OR
 - Company or Companies listed outside India

Note: The above restriction of companies will not apply where :

- A reference is made by the Central Government or any regulator to the NFRA to conduct such an investigation; or
- The NFRA by itself decides to conduct an investigation in public interest.

Conclusion

Thus it can be concluded that the ICAI will continue to retain its regulatory powers in respect of private companies and unlisted public companies below the above-prescribed threshold. The Quality Review Board will also continue conducting quality audits in respect of private limited companies, unlisted public companies and such other audit of companies that are delegated by the NFRA. As per news reports, the president of the Institute of Chartered Accountants of India (ICAI), CA Naveen Gupta, in a statement to the media mentioned that the new regulatory for auditors, i.e, the National Financial Reporting Authority (NFRA) is not legally valid.

UNIT-IV

AUDITOR'S REPORT

Preface

Management auditor's report

In the end, the management auditor prepares a report. On the basis of findings and definite information, the auditor prepares a report making suggestions for improvement in the working of the management. His report should give a correct assessment of the working of organization. He should not hesitate in criticizing the management. His recommendations should be constructive and not merely condemning in nature. His report may include the following matters:

1. Whether the management; and the staff relations are healthy.
2. Whether the return to shareholders is adequate.
3. Whether the methods of production are out-dated.
4. Comparison of operating efficiency of the organization with other concerns.
5. Rate of the return on investment.

Content of Audit Report

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

In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and in the case of profit and loss account, of the profit or loss account for its financial year. Sub-section (iii) of the section 227 required that the auditor's report shall also state.

- a. Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;
- b. Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of these books, and proper returns adequate for the purposes of his audits have been received from the branches not visited by him.
- c. Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
- d. Whether the company's balance sheet and profit and loss A/C dealt with by the report are in agreement with the books of accounts and returns. If any of the matters as referred to in section 227 (2) and (3) is answered in the negative or with the qualification the auditor has to state in his report the reasons for such answer.

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

empowers the Central Government to order the inclusion of certain matters in the auditor's report. The Institute of Chartered Accountants of India requires the auditor's to ensure that the accounting standards are implemented in the presentation of financial statements covered by their audit reports. The deviation should be reported in the report

Preface

Difference between Investigation and Audit

- An Audit is carried out to ensure that the balance sheet and the profit and loss A/C show a true and fair picture. But, on the other hand, an investigation is carried out for some predefined purpose e.g. to know the financial position of the company or its earning capacity.
- An Audit is limited only for an examination of the accounts of the concern but the investigation covers not only examination of accounts, it involves probing deep into the matter and looking for required information far behind the books whenever necessary.
- The Investigation is not legally compulsory but audit is statutorily compulsory in case of joint stock companies.
- Auditing can only be conducted by a chartered accountant but it is not necessary that an investigator must be a Chartered accountant.
- An audit is always carried out on behalf of the owner of the business, but the investigation may be conducted on behalf of the proprietor of the business, in case he suspects any fraud, or on behalf of the outside parties.
- An audit always relates to a period of 1 year or 6 months but the investigation may cover several years.
- Investigation is done when the books of accounts are already subject to a regular audit i.e.
- The investigation starts where the audit ends.
- Unlike an auditor, an investigator is not bound by accounting conventions, policies and Disclosure requirements.
- Qualified opinion/report

Qualified report is given by the auditor in either of these two cases:

- When the financial statements are materially misstated due to misstatement in one particular account balance, class of transaction or disclosure that does not have a pervasive effect on the financial statements.
- When the auditor is unable to obtain audit evidence regarding particular account balance, class of transaction or disclosure that does not have a pervasive effect on the financial statements.

The report is mostly like a Clear Opinion Report and only includes a paragraph viz. Basis for Qualification after Scope paragraph and before Opinion paragraph. Opinion paragraph in addition to its standard wording includes – except for the after described in Basis for Qualification paragraph the financial statements give true and fair view.

Detailed below:

A **Qualified Opinion** report is issued when the auditor encountered one of the two types of situations which do not comply with generally accepted accounting principles, however the rest of the financial statements are fairly presented. This type of opinion is very similar to an unqualified or "clean opinion", but the report states that the financial statements are fairly

presented with a certain exception which is otherwise misstated. The two types of situations which would cause an auditor to issue this opinion over the unqualified opinion are:

Single deviation from GAAP– this type of qualification occurs when one or more areas of the financial statements do not conform with GAAP (e.g. are misstated), but do not affect the rest of the financial statements from being fairly presented when taken as a whole. Examples of this include a company dedicated to a retail business that did not correctly calculate the depreciation expense of its building. Even if this expense is considered material, since the rest of the financial statements do conform with GAAP, then the auditor qualifies the opinion by describing the depreciation misstatement in the report and continues to issue a clean opinion on the rest of the financial statements.

Limitation of scope – this type of qualification occurs when the auditor could not audit one or more areas of the financial statements, and although they could not be verified, the rest of the financial statements were audited and they conform to GAAP. Examples of this include an auditor not being able to observe and test a company's inventory of goods. If the auditor audited the rest of the financial statements and is reasonably sure that they conform with GAAP, then the auditor simply states that the financial statements are fairly presented, with the exception of the inventory which could not be audited.

The wording of the qualified report is very similar to the unqualified opinion, but an explanatory paragraph is added to explain the reasons for the qualification after the scope paragraph but before the opinion paragraph. The introductory paragraph is left exactly the same as in the unqualified opinion, while the scope and the opinion paragraphs receive a slight modification in line with the qualification in the explanatory paragraph.

The scope paragraph is edited to include the following phrase in the first sentence, so that the user may be immediately aware of the qualification. This placement also informs the user that, except for the qualification, the rest of the audit was performed without qualifications:

"Except as discussed in the following paragraph, we conducted our audit..."

The opinion paragraph is also edited to include an additional phrase in the first sentence, so that the user is reminded that the auditor's opinion explicitly excludes the qualification expressed. Depending on the type of qualification, the phrase is edited to either state the qualification and the adjustments needed to correct it, or state the scope limitation and that adjustments could have but not necessarily been required in order to correct it. For a qualification arising from a deviation from GAAP, the following phrase is added to the opinion paragraph, using the depreciation example mentioned above:

"In our opinion, except for the effects of the Company's incorrect determination of depreciation expense, the financial statement referred to in the first paragraph presents fairly, in all material respects, the financial position of..."

For a qualification arising from a scope of limitation, the following phrase is added to the opinion paragraph, using the inventory example mentioned above:

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"In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to perform proper tests and procedures on the Company's inventory, the financial statement referred to in the first paragraph presents fairly, in all material respects, the financial position of Unqualified Opinion

An opinion is said to be **unqualified**, or unmodified, 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. An Auditor gives a Clean opinion or Unqualified Opinion when he or she does not have any significant reservation in respect of matters contained in the Financial Statements. The most frequent type of report is referred to as the "Unqualified Opinion", and is regarded by many as the equivalent of a "clean bill of health" to a patient, which has led many to call it the "Clean Opinion", but in reality it is not a clean bill of health, because the Auditor can only provide reasonable assurance regarding the Financial Statements, not the health of the company itself, or the integrity of company records not part of the foundation of the Financial Statements. This type of report is issued by an auditor when the financial statements are free of material misstatements and are presented fairly in accordance with the Generally Accepted Accounting Principles (GAAP), which in other words means that the company's financial condition, position, and operations are fairly presented in the financial statements. It is the best type of report an auditor may receive from an external auditor.

An Unqualified Opinion indicates the following:

- The Financial Statements have been prepared using the Generally Accepted Accounting Principles which have been consistently applied;
- The Financial Statements comply with relevant statutory requirements and regulations;
- There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements, where applicable;
- Any changes in the accounting principles or in the method of their application and the effects thereof have been properly determined and disclosed in the Financial Statements.

Objectives of Investigation

The real objective of conducting an investigation by an auditor on behalf of his client is to provide him the desired information in the form of a report about the matter specified. Normally the objective of investigation is to collect, analyze and evaluate facts in respect of desired field of activity with a view on some special purpose as determined by the person on whose behalf the investigation is undertaken. In short investigation is to ascertain the financial position and earning capacity of a business on behalf of a certain person.

The common objectives of investigation are listed below:

- 1) Proposed purchase of business.
- 2) Proposed sale of business.
- 3) Reasons for low profitability.
- 4) Cause of high employee turnover.

- 5) Reliability of business data.
- 6) Proposed investment in particular securities.
- 7) Suspected fraud.
- 8) Joining in existing partnership business.
- 9) Borrowing funds.
- 10) Lending funds.
- 11) Proposed purchase of controlling shares in a company.
- 12) Suspected misfeasance against directors.
- 13) Detection of undisclosed income for tax purposes.
- 14) Suspected misappropriation by trustees.

Preface

DUTIES OF AN AUDITOR

Duties of an auditor can be stated under two heads:

- A. Duties under the Companies Act
- B. Duties as per the Legal Decisions

A. Duties under the Companies Act

The auditor has the following duties under the Companies Act:

To make special enquiries and investigations in connection with the following matters (Sec.227 (IA))

- (i) 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 interest of the company or its members;
- (ii) whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;
- (iii) 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;
- (iv) Whether loans and advances made by the company have been shown as deposits.
- (v) Whether personal expenses have been charged to revenue accounts;
- (vi) Whether 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.

To make report to the shareholders: (Section 227(2,3 &4))

The auditor of the company is duty bound to make report to the members of the company on the accounts examined by him and on every balance sheet, every profit and loss account laid before the company in the general meeting during his tenure of office. The auditor has to make a report to the members and not to the directors, though his appointment may have been made by the directors. The duty of the auditor is over as soon as he submits the report to the Secretary of the company. It is none of his concern to know whether the same has reached to the hands of the members of the company.

The Audit Report must expressly state the following besides other necessary things;

- (a) Whether in his opinion and to the best of his information and according to the explanations given to him the accounts give the information required by the Act and in the manners so required.
- (b) Whether the balance sheet gives true and fair view of the company's affairs as at the end of the financial year and the profit and loss account gives a true and fair view of the profit and loss of its financial year;
- (c) whether he has obtained all the information and explanations required by him for the purposes of his audit;
- (d) whether, in his opinion, proper books of account as required by law have been kept by the company, and proper returns for the purposes of his audit have been received from the branches not visited by him;
- (e) 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.

Duty to state the reasons for the answers in negative

In case of the answers to any of the points stated above are in negative, the auditor is required to explain the reason for the answer in his report.

1. Duty to include in the report the matters as directed by the Central government:

Section 227(4A) empowers the Central Government to require by order, that the auditor's report will include a statement on such matters as may be specified therein. Before making any such order the Central Government may consult the Institute of Chartered Accountants of India in regard to the classes of description or companies and other ancillary matters proposed to be specified therein.

2. Duty to sign the audit report (Section 229)

It is the duty of the auditor to sign the audit report before sending it to the secretary of the company.

3. Duty to give a report upon the Prospectus (Section 56(1))

The auditor is required to give his report upon the Prospectus issued by an existing company. He should also give his report on the assets, liabilities and Profit and Loss of such company.

4. Duty to certify the Statutory Report (Section 165(4))

The auditor has to certify the correctness of the Statutory Report with regard to the following:

- (a) The number of shares which have been allotted by the company whether for cash or for consideration other than cash;
- (b) The total amount of cash received by the company in respect of all the shares allotted, distinguished as aforesaid;
- (c) An abstract of the receipt of the company and the payments made.

5. Duty to declare the solvency of the Directors, (Section 488(2)(b))

The auditor has to declare that solvency of the directors in case of the Voluntary Liquidation of the company,

6. Duty to give a report upon the Profit and Loss Account and the Balance Sheet enclosed with the Declaration of Solvency. (Section 488(2)(b))

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The auditor has to give his report upon the profit and loss account and the balance sheet which is enclosed with the Declaration of solvency made by the Directors of the company, in the case of Voluntary Liquidation of the Company,

7. Duty to assist the Investigators (Section 240(v)(b)).

In case the affairs of the company are to be investigated, the auditor should assist the Investigators in every possible manner. He should produce his working papers relating to audit when asked for by the Investigators.

8. Duty to assist the Advocate General

If the Advocate General is making any enquiry against the directors, the auditor is duty bound to help him in his work.

B. Duties According to the Legal Decisions

Certain matters have been taken to the court of law from time to time and the courts have in their decisions fixed certain duties upon the auditors. These duties in short are enumerated here.

1. **Duty to inform the members and shareholders about the contravention of the provisions of the company Law.**
2. Duty to enroll himself with the Institute of Chartered Accountants of India and to obtain a certificate to practice from it.
3. Duty to acquaint himself with the provisions of the company law and also enquire from his predecessor about it in writing,
4. Duty not to canvass for and also approach and press any member of the company for his appointment as an auditor of the company.
5. Duty to enquire about the true and fair state of affairs of the company and submit his proper report.
6. Duty to verify himself cash in hand and not to be negligent in his work.
7. Duty to see the Debenture Trust Deed and verify whether the debentures issued by the company are according to the terms laid down in the trust Deed.
8. Duty to verify the investments himself.
9. Duty to perform his task with ability, care and skill.
10. Duty to verify the inventories and the ledger accounts.
11. Duty to personally inspect all securities and see that they are in the safe custody of the Secretary of the Company.

Various courts have penalized the auditors for non-performance of the above stated duties and therefore, the auditor should take note of these duties also.

Classes of Investigation:

There are many types of Investigation, but certain main classes can be identified. Following are some of the areas where the investigation is mostly called for:

1. Investigation on behalf of a person or company who wants to purchase a running business.
2. Investigation on behalf of a person who is interested to join as a partner in a partnership firm

3. Investigation on behalf of a person who wants to lend money to a business or interested to know its financial position.
4. Investigation on behalf of the owner/shareholder of the business who suspects a fraud.
5. Investigation on behalf of the tax authority for assessing actual tax liability.

Preface

Comprehensive audit:

The primary purpose of a comprehensive audit is to ascertain the economy, efficiency and effectiveness of an organization's operations and use of resources. Comprehensive audits are also called "value for money" audits and are designed to be wide ranging and thorough, integrating financial auditing, corporate compliance, operational audit procedures and management reviews. Comprehensive audits have also been performed on regional governments to combat fraud and corruption.

Levels

Comprehensive audits can be performed on the entire company or at the level of a specific department, such as finance management, human resources or information systems. Any audit of a public company is required to be conducted by an accounting firm registered with the Public Company Accounting Oversight Board (PCAOB) and should include the full range of the company's activities.

Risk

Risk assessment is a part of a comprehensive audit. It is based on the nature, quantity and quality of evidence, and the professional independent auditor's judgment in interpreting the evidence. It also includes the company's internal controls over financial reporting to reduce the risk of error or fraud.

Responsibility

A comprehensive audit examines the Management Control Framework (MCF) of the company, which would identify the division of responsibility within the company or the areas covered by the audit. This includes an analysis of the company's internal audit procedures, quality controls and quality reviews. The auditor should also assess the effectiveness of the company's internal control over financial reporting. It is the auditor's professional responsibility to exercise professional skepticism that includes an inquiring mind and independent critical assessment.

Recommendations

A comprehensive audit report will include recommendations on how to improve procedures and activities and enhance economy, efficiency and effectiveness in all areas covered by the audit. It will also include the auditor's opinion on the company's financial statements.

Meaning and Definition of cost audit:

Cost Audit is a critical review undertaken to verify the correctness of Cost Accounts and to check that cost accounting principles and planning have been efficiently followed. It is noteworthy that India is the only country which has introduced statutory cost audit to regulate about 45 vital industries of the country. Cost Audit has been defined by the Chartered Institute of

management accountants (CIMA) of and loan the verification of cost accounts and check on the adherence to the cost accounting plan.

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This definition implies the following:

- (i) The objects of cost accounting with reference to which the cost accounting plan must have been drawn up have to be kept in mind to see whether or not the plan itself and the figures collected will lead to the achievement of the goal or objective set. For instance, if the objective is to achieve maximum efficiency, the plan and the analysis of data will be different from the case where the only objective is to fix prices.
- (ii) It has to be examined whether the methods laid down for ascertaining costs and other relevant decisions are being implemented. Treatment and determination of abnormal losses or gains or treatment of certain expenses as direct or indirect are cases in point.
- (iii) The correctness of the figures has to be vouched.

Statutory Cost Audit is a system of audit introduced by the Government of India for the review, examination and appraisal of the cost accounting record and added information required to be maintained by specified industries (ICWA of India).

The concept of cost audit has been elaborated by ICWA as an audit of efficiency of minute details of expenditure, while the work is in progress and not a post-mortem examination. Financial audit is a fait accompli, cost audit is mainly a preventive measure, a guide for management policy and decision in addition, to being a barometer of performance.

Cost Audit can be called efficiency audit. It is evidenced by amendment in section 209 which reads, "The object of the amendment of the section is to ensure specified company proper records relating to utilization of material and labor are available which would make efficiency audit (cost-audit) possible".

Management Auditing is the process of auditing the quality of managers through appraising them as individual managers and appraising the quality of the total system of managing in an enterprise. Thus management audit aims at assessing how managers perform different functions of management, e.g., planning, coordinating, motivating, etc.

Advantages of Cost Audit:

The chief advantage of a cost audit will be that management will be sure to get reliable data for its objectives—price fixing, decision-making, control, etc. Existence of such a system of audit will also be of great use for maintaining internal check and control and will be of great help to even financial audit. But it must be understood that the aims of financial and cost audit are different.

The former aims at prevention of frauds and errors and with presentation of Profit and Loss Account and Balance Sheet which exhibit a true and fair view of the state of affairs (of profit earned during the year and of financial position at the end of the year).

It is concerned with totality of expenditure and revenue rather than its functional

analysis. Cost Audit will establish the accuracy of cost of each product, job, activity, etc., and is concerned with proper analysis of information and its estimation so that management gets the necessary information promptly. Apart from reliability of data, cost audit should afford certain incidental advantages. Rather, it should be said that cost audit will help consolidate and realize advantages expected from a system of costing. Following statement of the HR Gokhale Ex-minister of Law, Justice and Company Affairs emphasizes the social advantage of cost audit.

The objective of this measure (cost audit) is to protect consumers from unwarranted increase in prices. Reasonableness of the prices charged can only be ensured by correct determination of costs and the margin charged by producers and their retailers. Another object underlying this step is to make the industries covered by such rules alert and efficient and also to make them know their rational cost with a view to reducing it to the extent possible. Thus by resorting to this method, the interest of consumer is safeguarded and it is a definite step towards removal of social injustice.

Types of Cost Audit:

The main types of Cost audit are the following:

(i) Cost Audit as an Aid to Management:

The aim is to see that all information placed before management is relevant, reliable and prompt so that management can discharge its duties well. It must also be seen that no relevant or pertinent information is suppressed.

(ii) Cost Audit on Behalf of a Customer:

Often contracts are placed on —Cost Plus— basis. In other words, the customer will determine the final price to be paid on the basis of exact cost plus an agreed margin of profit. The customer, in such a case, usually gets cost accounts of the product concerned audited to establish correct cost and, therefore, price.

(iii) Cost Audit on Behalf of Government:

Sometimes the Government is approached with request for financial help or protection. Before taking a decision on the request, the Government may choose to get cost accounts of the applicant audited to establish whether the need for help is genuine or is a result of mere inefficiency.

(iv) Cost Audit under Statute:

The Amendment Act of 1965 has inserted a new section, 233B, in the Companies Act, 1956 whereby the Central Government may order that certain classes of companies will get their cost accounts audited by a member of the Institute of Cost and Works Accounts of India. Only such companies as are required to maintain proper records regarding materials consumed, labour and other expenses under Section 209 (as amended to date) and may be required to get their cost accounts audited.

The powers and duties and manner of appointment of the cost auditor are the same as that of external financial auditor and the same disqualifications will apply. The cost auditor will submit this report to the Company Law Board with a copy to the company. The right to investigate all aspects of cost accounts is presumably granted to the cost auditor.

(v) Cost Audit on Behalf of the Trade Association:

Sometimes trade associations seek to maintain prices at a certain level. For this purpose, the accuracy of costing information submitted by various concerns has to be checked. The trade associations may seek to have full information about production capacity and the relative efficiency of productive processes.

Advantages to Management:

- (i) Errors in following costing principles and techniques are detected. Inconsistencies and frauds can also be detected. This keeps everyone alert and promotes efficiency.
- (ii) Cost audit can serve to measure performance of managers and better performance can be rewarded.
- (iii) It helps to prepare accurate cost reports and this business planning can be more accurate.
- (iv) Inter-firm comparisons can be made with ease and this might be a very useful proposition if industrial intelligence is good.
- (v) Cost audit can give an idea about the comparative operational efficiency of each department of division; and may thus pin-point deficiencies and also encourage to operate in a competitive spirit.

Advantages to Management/Cost Accountant:

Important advantages are:

- (i) It is facilitated since errors, deficiencies, etc., are pointed out. Costing plans can be repaired to take care of these things.
- (ii) Cost audit may help in easier reconciliation of cost and financial accounts.
- (iii) If the cost auditor is an outsider and an expert, he can certainly give some practical and sound advice to streamline costing systems and organization.
- (iv) Cost audit helps to focus attention of management on the problems faced by the cost accountant. This helps him to realize his goals and objectives with ease.

Advantages to Statutory Auditor:

- (i) Audited cost data helps him to determine the value of stocks, remuneration of managerial personnel, etc., with ease and accuracy.
- (ii) Data and statements of cost audit help him to prepare his audit programme and plans so that he concentrates more on those aspects which have not been adequately covered by cost audit.

Advantages to Consumers:

- (i) The direct benefit accrues where a statutory cost audit has been done to fix a reasonable price for the consumers.
- (ii) Since cost audit aims at ensuring efficiency in the organization, this may also get reflected in reduced prices to the consumers.

Advantages to Labour:

- (i) If cost audit is done thoroughly, labour also stands to gain through increased profitability in the shape of bonus and other benefits.

- (ii) Also it brings into focus the role of labour in improving efficiency in terms of increased productivity.

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Advantages to Shareholders:

- (i) There is correct valuation of all kinds of inventories. This may project a true picture of the organization before shareholders and other investors and help them to assess its performance.
- (ii) External cost audit highlights efficiency or inefficiency, utilization of manpower and other resources, adequacy of return, etc.

Advantages to Government and Economy:

- (iii) It helps the government to settle accounts where cost-plus contracts have been made.
- (iv) The government can intervene to protect the interests of the consumers, labour, shareholders and investors from exploitation or inefficient managements.
- (v) At the national level, cost audit promotes cost consciousness and overall efficiency. This means that every rupee invested produces the maximum quantity of goods and services.

Definition of performance audit:

Performance auditing has been variously defined. A working definition is as follows: "Performance auditing is an assessment of the activities of an organization to see if the resources are being managed with due regard for economy, efficiency and effectiveness and accountability requirements are being met reasonably."

In this definition the keywords are:

- a. assessment
- b. activities
- c. organization
- d. resources
- e. management
- f. economy
- g. efficiency
- h. effectiveness
- i. accountability requirements
- j. reasonability

a. Assessment:

It means that the auditor formulates a judgment on the basis of relevant and reliable evidence. The judgment may contain a certain amount of subjectivity and hence may be contested by the auditor management. But to the extent it is based on agreed facts and is arrived at after carrying out generally accepted auditing procedures it is treated as valid.

b. Activities:

Performance auditing extends to financial as well as non-financial activities of an

organization. It reviews the main operations of the organization. Obviously, it implies that auditors would require some understanding of technical operations of the auditee. This may necessitate association of social or physical scientists or other specialists with the auditors.

c. Organization:

Performance auditing takes an overview of the activities and functions of an organization as a whole. In exceptional cases, it may review an isolated project or a programme as well. But for generalized conclusions it is necessary that the organisation is reviewed as a whole in its operational environment.

d. Resources:

The resources of an organization consist of money, men, materials, and machines. Performance auditing reviews all these resources.

e. Management:

Management covers such functions as planning, organisation, resourcing, directing and controlling. Performance auditing reviews all these phases of management cycle. It is not concerned merely with the 'use' of resources.

f. Economy:

Review of economy is a primary element in performance auditing. Economy means acquiring resources at the lowest cost keeping in view the objectives of the organization.

g. Efficiency:

Efficiency refers to the relationship of inputs and outputs. It relates to utilization of resource.

h. Effectiveness:

It means the extent to which an organization achieves its objectives.

i. Accountability requirements:

Public managers are responsible to carry out the policies of the legislature by translating them into appropriate programmes. Certain resources are provided to them to implement these programmes. They are expected to report back to the legislature about the results of their programmes. Traditionally, the report to the legislature is presented in the form of appropriation accounts, which is, as a matter of fact, a report of the financial results. With increased emphasis on receiving value for money and reducing waste in public spending, more and more legislatures are demanding reports on operations of government departments and agencies.

j. Reasonability:

The performance auditing adopts the approach of a reasonable manager. It does not turn an oblique eye to the constraints of the management. Instead it takes into account the total environment in which executive departments operate. It does not base its judgement on hindsight wisdom.

Performance Measures for effectiveness

Appropriate performance measures to assess the effectiveness of projects are very difficult to devise. There are three main problems:

a. Problem of jointers:

Where a number of different policies may contribute to satisfying unmet needs. For example, educational standards may be affected by the size of classes, the quality of teachers and the supply of equipment. It may be very difficult in practice to analyse the effect of individual policies.

b. External factors:

Sometimes factors outside the control of the management affect the outcome of a project or programme. For example, income and social status of the consumers.

c. Cost:

Sometimes programmes cannot be carried out in the most effective manner due to prohibitive cost. For example, it may be more effective to have more teachers than to provide more books. But the cost of the former may be prohibitively high.

Because of these difficulties in the measurement of effectiveness the auditor should move cautiously. The best method should be to devise performance indicators in consultation with the management. But the auditor should keep in view any national or international standards already available. Similarly, the objectives laid down in the plan may be taken as a benchmark for some of the outcomes. In no case should the auditor restrict his audit criteria to the original plan only.

Sources of Performance Measures:

There are a number of sources of effectiveness measures, such as following:

Citizen surveys:

Especially in areas of social services, police, garbage collection etc. For reliable results, extreme care needs to be exercised in determining sample size and preparing questionnaires. Trained observer ratings: Trained observers are used to rate conditions in a particular area, using pre-designated rating criteria such as street cleaning.

Industry standards:

Comparison of the results of a programme with prevalent standards in that area or with others similar programmes.

Internal records:

Review of internal records such as occupancy rate for residential homes, user complaints, etc. sometimes provides vital information for measuring effectiveness.

Normally, the auditor is not expected to carry out the above exercise himself. His primary duty is to see if the auditor has a reliable system to evaluate its own effectiveness. In that case, he would focus his attention on the adequacy of these procedures. In case the auditor does not have a reliable mechanism to measure its own effectiveness the auditor may have to do it himself.

The main focus of effectiveness auditing is on the assessment of the extent to which an agency failed to attain the intended goals. But a simple explanation of possible reasons for shortfall in achievement of goals is not enough. For example, it is not enough to say that the agency could not achieve its goals because of cost overrun or time over-run.

Instead it is necessary that the auditor should analyze the reasons into following two categories.

- a. Factors that could have been influenced by the agency. They would emerge from an answer to the question: did the agency perform its task in the most appropriate way, seen in relation to the assignment that it intended to carry out?
- b. Factors that could not be influenced by the agency such as Government policy, applicable rules, socio-political environment, appropriation of funds and availability of trained manpower, etc.

Technical Guide on Audit in Hotel Industry

India is fortunate to have a domestic market that supports the growth of the travel industry even when the world economy is experiencing a downturn. However, domestic travel has probably never been given its due. Even today, it is the statistics on the foreign travellers that garner attention; though, it is the less represented domestic segment that forms the major component of revenue generated by the Indian travel industry.

The domestic demand for hotels in India has historically been higher than the demand from foreigners. Though a large portion of domestic demand originates from commercial activity, an increasing number of Indians are taking annual holidays, both within the country and overseas. Many States within India such as Kerala, Rajasthan, Goa have started focusing their efforts on the Indian traveller.

The current count of hotel rooms in India is 130,000, and the country is expected to require an additional 50,000 rooms over the next two to three years, according to World Travel and Tourism Committee (WTCC) estimates.

The World Travel and Tourism Council (WTTC) has predicted that India has the potential to become the number one tourist destination in the world with the demand growing at 10.1 per cent per annum and will receive 25 million tourists by the year 2015.

Other than hotels, there are lots of standalone restaurants which are also contributing to economic activity and there are branded chains of restaurants which are claiming prominence across India. Similarly, standalone SPA, medical tourism, etc., are driving the demand and need for expansion of hotel room requirements.

Factors affecting Hotel Industry

There are various factors which affect the growth of the Hotel industry, viz., economic, political, competition, substitutes, strength of suppliers and of course employees.

Economic Factors

Various key economic factors like interest rates, taxation changes, economic growth, inflation and exchange rates affect the Hotel industry as much as any other business. However,

even global recession which has even though not affected India much had major impact in hotels as foreign tourist arrival dropped considerably. Hence, economic circumstances of not only India but global economic factors also affect the industry performance. This phenomenon has been witnessed even in the past like during the 1997 Asian economic crisis.

Political factors

Political stability in the country is considered important for the growth of any industry in the country. The political stability is even more necessary for the growth of Hotel industry. In the past Afghanistan war, Mumbai terror attacks, etc., have forced foreign countries to bring in travel adversaries which poorly affected the Hotel industry.

Competition

Competition drives both the supply of the rooms and also creates demand for rooms through advertisements by competitors. Whereas competition leads to reduction in prices in the short run, it also leads to improvement in quality of service / product and also bring in healthier impact in the Industry by forcing players to reposition the brand / quality of service in the long run.

Substitutes

Of late due to ever raising room rates especially in five star Hotels category, lots of substitutes have emerged to cater to travellers who spend considerable amounts on Hotel stays. For instance, video conferencing has obviated the need for businessmen to travel long distances, stay in hotels and have face-to-face meetings. Similarly, most corporates have started using own guesthouses / shared service apartments resulting in reduction in the Hotel capacity.

Strength of Suppliers

The existence of reliable sources that could provide timely high quality goods and services at competitive rates, is a very important factor for growth of the Hotel industry. The existence of such sources is of even greater necessity for purchase of perishable goods that need to be procured on a daily basis. In the scenario where outsourcing of certain services (like back of the house cleaning services, Kitchen Stewarding) is gaining wider acceptance for the purpose of converting fixed overheads into variable overheads, the strength of suppliers in terms of their ability to provide consistently timely services, assumes great significance.

Employees

Employees are always considered as the key asset in a service-oriented industry. The quality and competence of employees, not only of those who interact directly with the guests but also of those who provide support services, are critical to the success of a hotel. Ever increasing employee cost also results in reduction in manpower. Hotels in India in the past had operated with an average of 2, and in some cases, 3 employees per room as compared to the international benchmark of 1.5 or less employees per room.