MAR GREGORIOS COLLEGE
OF ARTS & SCIENCE

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Affiliated to the University of Madras
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DEPARTMENT OF COMMERCE (ACCOUNTING & FINANCE)

SUBJECT NAME: PRACTICAL AUDITING

SUBJECT CODE: CPG5A

SEMESTER: V

PREPARED BY: PROF.M.PARTHIBAN

V SEMESTER

CorePaperXIII-PRACTICALAUDITING

ObjectivesNoofCredits:4

- Tomakethestudentstounderstandtheconceptofpresentday Auditing Practices.
- Toenablethestudentstogainknowledgeofvarioustechniquesof Auditing.

UNITI:Introduction

Meaning andDefinitionofAuditing-Distinctionbetween Auditing andAccounting- Objectives - Advantages andLimitations ofAudit-Scope ofAudit-Classifications of Audit-AuditPlanning-Meaning.Auditprogramme-Meaning-ObjectivesandContents -AuditNoteBook,-contents,UsefulnessofAuditNoteBook-Audit workingpapers-Meaning.OwnershipandCustody - TestcheckingandRoutinechecking-Meaning. Internalcontrol-Meaning-Definition-Objectives- TechniqueforevaluationofInternal ControlSystem. Internal check-Meaning- Objectives differencebetweenInternal control,InternalcheckandInternalAudit.

UNIT -II:VouchingandVerification

Vouching-MeaningandDefinitions-Objectives.TradingTransactions-AuditofLedger- Scrutinizingofledgers-VouchingofcashReceiptsandPayments-Vouching of outstanding AssetsandLiabilities - Verification-Meaning- Objectives andProcess - ValuationofAssetsandliabilities-DistinctionbetweenVerificationand Valuation.

UnitIII:AuditandAccounting Standards

TypesofAudit-StatutoryAudit-ConcurrentAudit-StockAudit-CostAudit-Secretarial Audit-CAGAudit-ManagementAudit.AccountingStandards-StandardsonAuditing- StandardsonInternalAudit-PenalProvisions-RoleofNationalFinancialReporting Authority(NFRA)

UnitIV:AuditorsandAuditReport

Appointment-Procedures-EligibilityandQualifications-PowersandDuties-Rotation andRemovalofAuditors-ResignationofAuditors-RemunerationofAuditors- Audit report-Preparationandpresentation.Auditor’sResponsibilitiesandliabilitiestowards Shareholders,BoardandAuditCommittee.RestrictiononotherServices.

UnitV:RecentTrendsinAuditing

EDPAudit-Meaning-Divisionof auditing in EDP environment.Impact of ComputerizationonAuditApproach- OnlineComputerSystemAudit-TypesofOnline ComputerSystemAudit-AuditaroundwiththeComputers- ProcedureofAuditunder EDPsystem.

UNIT I
Introduction

INTRODUCTIONTOAUDITING

The word Audit is derived from Latin word Audirewhich means _to hear‘. Auditing is theverification of financial position as disclosed by the financial statements. It is an examinationof accounts to ascertain whether the financial statements give a true and fair view financialpositionandprofitorlossof thebusiness. Auditingistheintelligent andcriticaltestofaccuracy,adequacyanddependabilityofaccountingdataandaccountingstatements. Differentauthorshavedefined auditingdifferently,some ofthedefinitionare:

Auditingisanexaminationofaccountingrecordsundertakenwithaviewtoestablishmentwhetherthe ycorrectlyandcompletelyreflectthetransactionstowhichtheypurporttorelate.‖L.R.Dicksee

Auditingisconcernedwiththeverificationofaccountingdatadeterminingtheaccuracyandreliability ofaccountingstatements andreports‖R.K.Mautz

Auditingisthesystematicexaminationoffinancialstatements,recordsandrelatedoperationstod etermineadherencetogenerallyacceptedaccountingprinciples,managementpoliciesand stated requirement‖R.E.Schlosse

OBJECTIVESOFAUDITING

MainObjective:

The main objective of the auditing is to find reliability of financial position and profit andloss statements. The objective is to ensure that the accounts reveal a true and fair view of thebusiness and its transactions. The objective is to verify and establish that at a given datebalance sheet presents true and fair view of financial position of thebusiness and the profitand loss account gives the true and fair view of profit or loss for the accounting period. It is tobe established that accounting statements satisfy certain degree of reliability. Thus the mainobjective of auditing is to form an independent judgment and opinion about the reliability ofaccountsandtruthandfairnessoffinancial stateofaffairsandworkingresults.

Subsidiaryobjectives:

Thesubsidiaryobjectivesoftheauditingare:

Detectionandpreventionoffraud:

Theoneoftheimportantsubsidiaryobjectiveofauditingisthedetectionandprevention of fraud. Fraud refers to intentional misrepresentation of financial information.Fraudmayinvolve:

1. Manipulation,falsificationoralterationofrecordsordocuments
2. Misappropriationofassets
3. Suppressionofeffectoftransactionsfromrecordsordocuments.
4. Recordingoftransactionswithoutsubstance
5. Misapplicationofaccountingpolicies

Detectionandpreventionoferrors:

Isanotherimportantobjectiveofauditing.Auditingensuresthatthereisnomisstatementinthefi nancialstatements.Errorscanbedetectedthroughcheckingandvouchingthoroughlybooksofaccount s,ledgeraccounts,vouchersandother relevantinformation.

IMPORTANCEOFAUDITING

Importance of auditing can be judged from the fact that even those organizations whichare not covered by companies Act get their financial statements audited. It has become anecessityforeverycommercialandevennon-commercial organization.

Theimportanceof auditingcanbesummedinfollowingpoints:

1. Auditedaccountshelpasoletraderinknowingthevalueofthebusinessforthepurposeofsale.
2. Disputeovercorrectnessofprofitscanbeavoided.
3. Shareholders,whodonotknowaboutdaytodayadministrationofthecompanycan judgetheperformance of managementfromauditedaccounts.
4. Ithelpsmanagementindetectingandpreventingerrorsandfrauds.
5. Managementgetsadviceonfinancialaffairsfromtheauditors.
6. Longandshorttermcreditorsdependonauditedfinancialstatementswhiletakingdecisiontogrant credittobusinesshouses.
7. Taxationauthoritiesdependonauditedstatementsinassessingtheincometax,salestaxandwealthtaxliabilityofthebusiness.
8. Auditedaccountsareusefulforthegovernmentwhilegrantingsubsidiesetc.
9. Itcanbeusedbyinsurancecompaniestosettletheclaimsarisingonaccountoflossbyfire.
10. Auditedaccountsserveasabasisforcalculatingpurchaseconsiderationincaseofamalgamationandabsorption.
11. Itsafeguardstheinterestsoftheworkersbecauseauditedaccountsareusefulfor settlingtradedisputes forhigherwagesorbonus.

DIFFERENCEBETWEENACCOUNTANCIES,AUDITING

Basisfor Comparison	**Accounting**	**Auditing**
Meaning	Accounting means systematically keepingthe records of the accounts of anorganization and preparation of financialstatementsattheendofthefinancialyear.	Auditing means inspection ofthe books of account andfinancial statements of anorganization.
GovernedBy	AccountingStandards	StandardsonAuditing
Workperformedby	Accountant	Auditor
Purpose	Toshowtheperformance,profitabilityandfinancialposition of an organization.	To reveal the fact, that to whichextent financial statement of anorganization gives true and fairview.

Start	Accountingstartswherebookkeepingends.	Auditing starts whereaccountingends .
Period	Accounting is a continuous process, i.e.day today recording of transactions aredone.	Auditingisaperiodicprocess.

TypesofAudit:

1.CostAudit:

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

2.SecretarialAudit:

SecretarialAuditisconcernedwithverificationcompliancebythecompanyofvariousprovisionso CompaniesAct and other relevant laws.Secretarialaudit reportincludes

- Whetherthe booksaremaintained asper companiesact,2013.
- Whethernecessaryapprovalsasrequiredfromcentral Government,Companylawboardorotherauthoritieswereobtained.

3.IndependentAudit:

Is conducted by the independent qualified auditor. The purpose of independent auditistoseewhetherfinancialstatementsgivetrueandfairviewoffinancialpositionandprofits.Mainly it is for safeguarding the interest of owners, shareholders and other partieswhodonot have knowledge ofday-to-dayoperationsoforganization.

4.TaxAudit:

Now-a-days tax audit has become very important to ascertain the accuracy of taxrelated documents. Tax audit mostly covers income returns, invoices, debit and credit notesand various current and fixed assets. Tax Audit an innovation of 21stcentury.It has added onemore chapter to the practice of auditing. Tax audit ensures the validity and credibility of taxrelateddocuments.

STATUTORYAUDIT

Statutory Audit is a type of audit which is mandated by a Statute or Law to ensure trueand fair view of the book of accounts of a Business is presented to the Regulators and thePublic. Unlike internal audit, Statutory Audits are not optional and must be performed if abusiness satisfies certain criterias. Statutory audits must be completed by qualified CharteredAccountants who are independent of the Business. Further, the report prepared by the Auditoronhis/herfindingsmustbepresented in theformat prescribedbytheRegulator.

StatutoryAuditscanbemainlyclassifiedintotwotypes,companyauditsandtaxaudits.AsperCompaniesAct,2013, everycompany,irrespectiveofitssales turnover ornature 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 daysofincorporationandthereafterconductanauditofitsfinancialstatementseachfinancialyear. The accounts of a Limited Liability Partnership (LLP) must be audited if it has an annualturnover of Rs.40 lakhs or more or Rs.25 lakhs or more capital contribution. Tax audit on theotherhandisrequiredforProprietorshipsandPartnershipFirmsthathavecrossacertainhold ofsales.

AUDITPROCEDURES

Audit procedures are an important area of the syllabus, though candidates often useinappropriate audit procedures to answer questions. The following tips will help you tounderstandtheconceptsandwriteappropriateauditprocedures.

Everyproceduremuststate:

1. theassertiontested
2. theauditprocedure
3. thereasonfortheprocedure

Each of these points is explained below.Identifytheassertiontested

Auditproceduresareperformedinordertotestfinancialstatementassertions. Therefore, the first step in explaining an audit procedure is to identify the assertion that needstobetested.

The assertions embodied in the financial statements, as used by the auditor toconsider the different types of potential misstatements that may occur, may take thefollowingforms:

Abriefexplanation ofthe variousassertionsisasfollows:

Completeness

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

Occurrence

This assertion means that transactions and events and other matters that have beenrecorded actuallytookplace– andrelatetothisorganisation.

Valuationandallocation

This means that all items have been included in the financial statements at appropriateamountsaccordingtocompanypolicyandtherelevantfinancial reportingframework. Furthermore,anyallocationsorvaluationadjustmentsrequired(likeimpairment)havebeenmadeandf inancialandotherinformationisdisclosedfairlyandatappropriateamounts.

Classificationandunderstandability

Financial information is appropriately presented and disclosed, and disclosures areclearlyexpressedsoastomakethemunderstandabletotheusers.Forthis,thedisclosuresshouldu sesimplelanguageandstatemattersclearlyandconcisely.

Accuracy

Accuracy means that amounts and other data relating to transactions and eventshave been recorded at the correct amounts – ie at the amounts appearing in the sourcedocuments.

Rightsandobligations

Thismeansthattheentityhasarighttoitsassets–ieitisfreetouseordisposeof theassetsasitseesfit.Furthermore,theentityisobligedtopayofftheliabilitiesthatareshown inthestatementoffinancialposition.

Existence

This means that assets, liabilities and equity interests (capital and reserves) arephysicallypresent/belong totheentityonthereportingdate.

Cutoff

Thismeansthattransactionsandeventshavebeenrecordedinthecorrectaccounting period.Forexample,ifgoodsaredeliveredpriortoyearend,theyareincluded inthecost ofgoodssold,notinventory.

ChooseauditproceduresfromAEIOU

A: **A**nalyticalprocedures
E: **E**nquiry and confirmation directly from a third party – ie inquiryI: **I**nspectionofrecords andassets
O: **O**bservation
U: recalc**u**lationandre-performancewhilewritingdowntheauditprocedure

Writeitclearly

Audit procedures should be written in such a way that even a junior auditor will be abletounderstandwhatistobedone.Forexample,avoidvagueprocedureslike_checkgoodsreceived notes‘. This is vague as it does not explain what is to be examined in the goodsreceived notes. Is it the description of items received, the quantity received or the name of thevendor?

Writedownthereasonforperformingtheauditprocedure

The audit procedure _check goods received note doesnotmention why the goodsreceived notes are to be checked. Instead, write the audit procedure as: _agree the descriptionofitemsandthequantitiesorderedmentionedonthegoodsreceivednotewiththedescriptions on the purchase orders raised on the vendor‘. This confirms that the entity hasprocured goodsbasedon anauthorizedpurchase order.

Useauditterminology

Useterminologyrelatingtoauditlike_cast‘,_agree‘,_trace‘,etc.Usetheword_cast‘tomeantotal ingupalist–forexample,_castthetrialbalance.‘Usethewords_agree‘or_trace‘tomean matching information from two documents/ records – forexample,_agreethetotalsalesofthesalesdaybooktothegeneralledgeraccount‘;or_traceasampleoftr ade payablestothepurchaseinvoices,toconfirmtheexistenceofthe rightstothe goodspurchased‘.

Acompleteauditprocedurewouldreadasfollows:

The auditor will agree a sample of items from the inventory sheets to the raw materialinventory (1) to ensure that the inventory recorded on the sheets actually exists (2). This willconfirmthe assertion ofexistenceofinventoryasan asset inthefinancialstatements

If the above mentioned procedure is written as _The auditor will check a sampleof items from the inventory sheets to the raw material inventory‘, it is incomplete as itdoesnotmentionwhythe auditprocedureisbeing performed.

MEANINGOFAUDITPROGRAM

- Anauditorpreparesaplanaftertheselectionofseniorandjuniorstaffsallocating the jobs to them, mentioning when to start, how to do the work etc.Thisplanis knownas auditprogram.
- Anauditorshouldincludealltheproceduresinwrittenform,objectivesofeachsector and all the directions which are to be given to the staffs which helpstocontroltheirworksand helpstoimplement suchprogramsintoaction.
- **Followingarethefactsregardingmeaningof auditprogram:**
- Auditprogramisadetailedworkplanwhichincludesthetimeofdoingworkandhowto dotheworks.
- Auditprogram includes auditproceduresAudit program estimates the durationto completetheaudittask
- Seniorstaffspreparauditprogramtojuniorstaffsonthebasisofnatureofbusiness
- Generallyacceptedpointsareincludedintheauditprogram
- Juniorstaffsputtickmarksinthecompletedtasks
- Audit program is a detailed program which helps to guide and control the juniorstaffs.Auditprogramclassifiestheworkofjuniorstaffswhichhelpstocompletethe audit task without leaving any points. Audit program is prepared allthe programs, nature and size of business, internal check and internal control.Followingpoints shouldbe includedinauditprogram:
- Detail information of works of all the junior staffs like audit of bank/ cashbook,purchasebook, salesbooketc.
- Auditorshouldprepareauditprogramconsideringthenatureofclient.
- Separatelistofworkassignedtoassistantshouldbepreparedbytheauditor.
- Auditprogramshouldfixthetimeperiodtocompletejibassignedtotheassistants.
- Assistantshouldsignafterthecompletionofhis/herjob.

Auditworkingpapers:

This article is about audit working papers. Auditors should prepare and organize theirworking papers in a manner that helps the auditor carry out an appropriate audit service. Theauditorshouldavoidpreparing oraccumulatingunnecessaryworking papers, andshouldtherefore avoid making extensive copies of the client‘s accounting records. It is worthnotingatthis stage that it is neither necessary nor practicable for the auditor to document every matterconsideredduringtheaudit.

IMPORTANCEOFWORKINGPAPERS

Workingpapersareimportantbecausethey:

- Arenecessaryforauditqualitycontrolpurposes
- Provide assurance that the work delegated by the audit partner has beenproperlycompleted
- Provideevidencethataneffectiveaudithasbeencarriedout
- Increasetheeconomy,efficiency,andeffectivenessoftheaudit
- Containsufficientlydetailedand
- Up-to-datefactswhichjustifythereasonablenessoftheauditor'sconclusions
- Retainarecordofmattersofcontinuingsignificancetofutureaudits.

CONCEPTOFTESTCHECK,

TestCheck

Big business houses have a lot of transactions. So, it is very difficult to check all thetransactions in detail. An auditor needs to prepare and present report in short period of time.So,anauditorchecksthesampletransactionsandpreparesandpresentsreporttotheconcernauthoritywhichisknownas'TestCheck'.Anauditorchecksthebooksofaccountsofa particular time or area if there is no any doubt, s/he proves the account as true and fair,otherwiseauditorchecksindetailwhere s/hehasdoubts.

Butifanyerrorsorfraudsareleftoutduetorandomsampling,auditorwillberesponsible for such losses. So, an auditor applies test check if internal check is effective in theorganization.

Followingpointsaretobetakenintoconsiderationwhileapplyingtestcheck:

- Sample should be selected from the various books of account and of differenttimes.
- Transactions related to beginning and ending period of particular year shouldbe checked indetail.
- Transactionrelatedtocashandstockshouldbecheckedindetail.
- Sampleselection istobemadeinrandombasis,notinplannedway.
- DetailcheckofBankReconciliationStatementisnecessary.

RoutineChecking

RegularcheckingofallthedailytransactionsisknownasRoutineChecking.Routinecheckingincorporatesthefollowingtasks:

- Checkingofrecord inprimarybooks,costing,transferetc.
- Checking transfer of transactions from original books of accounts toledgeraccount.
- Checkingdebitandcreditsideofvariousaccounts.
- Checking transfer of balances of various accounts to other pages or accountsorstatements.
- Various signs are used while conducting routine check. Such sign provides theproof ofroutinecheckingof transactions.
- Signs which are used in audit should be small and clear. Generally red or pinkcolorisusedwhileconductingroutinecheck.Butgreencolorisusedwhileconductingfinal audit.

AdvantagesofRoutineChecking

Followingbenefits canbeobtainedfromtheroutinechecking:

1. Alltheoriginalentrieswill bechecked;soalltheerrorsandfraudscanbedetectedeasily.
2. Alltheentriesandpostingwillbetested.
3. Routinecheckinghelpstoconductfinalauditbecauseallthebalancingandtotalshaveal ready beenchecked.
4. Separateandspecificstaffsarenotneededbecauseitisaregularprocess.

DisadvantagesofRoutineChecking

Followingsarethelimitationsofroutinechecking:

1. Routine checking is a mechanical test, so the staffwho performs this work doesnothaveinspiration.So,there arechances of leavingerrorsandfrauds.
2. Routinecheckingcanonlydetectsmallerrorsandfraudsbutnottheplannedfrauds.Routi necheckingisnotneededwhereself-balancingsystemisapplied.
3. Routinecheckingcannotdetectprincipleandcompensatingerrors.

PRELIMINARIESSTEPSBEFORECOMMENCINGACOMPANYAUDIT:

VerificationofAppointment:

First of all auditor has to conform whether his appointment is properly made or not. Ifappointment is not proper, he can claim remuneration, if he is appointed by shareholders, hehas to see whether the procedure specified under Section 224, is properly followed or not. Ifhe isappointedbydirectorshehastogothroughtheresolution madebythecourt.

VerificationofMemorandum:

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 capitalclause is useful to auditor. Therefore he should refer to memorandum and such informationshould betaken toauditnotebook.

VerificationofArticles:

ArticlesreadaboutinternalaffairoftheCompany.Itincludescallsonshare,transferofshares, transmission ofshares, reserves, payment of dividend etc. All these things areusefultoCompanyauditorandhenceabstractsfromarticlesshouldbetakentoauditnotebook.

Verification of Prospectus: Before commencing the audit work, auditor should refer toprospectusalsotoobtaininformationrelatingtominimumsubscription,preliminaryexpenses,under writers commission,termsofissue etc.

VerificationofContractDeeds:

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

VerificationofCertificateofincorporationandcertificateofCommencementofbusiness:

If it is first audit of the company, auditor should refer to Certificate of Incorporationand Certificate of Commencement of Business issued by registrar of Companies to conformthatthecompanyhasgotformedproperlyinaccordancewithrequirementsofcompaniesact.

VerificationofInternalCheckSystem:

Internalcheckmeansarrangementofstaffinsuchawaywhereworkdonebyoneclerk automatically gets checked by the other. Well planned internal check system minimizesscope for frauds and errors. In presence of well-designed internal check system, auditor canfollow shortcut methods like test checking etc. Good internal check system reduces the workloadofauditor.

ListofBooks:

Auditor should obtain list of books maintained by the company. Company maintainsseveral statutory books or compulsory books, Statistical or Optional books; Cost records,financial records etc.Allthosebooksaretobelisted.

ListofOffices:

Auditor should refer to organization chart of the company and key positions are to befound. Here auditor has to gather names, rights, duties, specimen signatures etc of staffmembersemployedatsuchkey positions.

VerificationofFinancialStatement:

Auditorshouldgetcopiesofprevious3or4yearsfinancialstatementsalongwithauditreports. Bygoing through them an idea withregard to profitability,financial positionandprevious auditor‘sopinioncanbeobtained.

CentralGovernmentPermission:

On certain occasions company has to obtain permission to central government. Forexample; to issue share warrants, to grant to directors etc. Here auditor has to observewhether permission from CentralGovernmentisobtainedornot.

AuditProgram:

Planning of audit work is called Audit Programme. It shows division of audit workamong audit staff. After preparation of audit program audit work can be commenced. Auditprogram has several advantages like completion of audit work within desired period, properentrustment of work, etc. At the same time audit programme has certain disadvantages alsolike making workmechanical etc.

LIMITATIONOFAUDIT:

The main risk in audit program is towards the assurance services that derives wrongconclusions. Assurances are to be provided within the related certification. Here are some ofthelimitations ofanaudit.

Extracost:

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

Evidences:

Evidencesthatareidentifiedaremorepervasivethanconclusive.Thestrengthofsubmissionofa uditedaccountsmakesmajorchangesintheaccountsofdistributionof profits.

Harassmentofstaves:

Since the employees cannot express their own in terms of auditing, these changes arecalibrated and the employees will fell harassed due to the changes that are caused. Even ifthey try to express their knowledge in new ideas, the organization may not entertain theemployeesinthesetypes ofsituations.

Unsuitablechanges:

The rules and regulations of business may vary from time to time. It remains unstablewhentheprogrambegins.Itisobviousthatthecompany‘spoliciesmaynotchangeperiodically whereastherulesandregulationsmay.

Chancesoffraud:

Sincetheinformationdeliveredafterauditprocedureiscredentialthentherebecomes more chances of getting the situations where an individual will be forced to commitcrime.Itharassestheauditorstocommit crimeaftertheaudit gets over.

Smallconcerns:

Smallscaleindustriesmayusuallyproceedwithtransactionsthatareusuallycompletedwithinthe shorterperiodoftime.Thus,auditingisnottooimportant.

Problemsinremedialmeasures:

Heretheproblemiscreatedinremedialmeasuresthatareenhancedwithinthedetailedinterface ofthedataofremedialmeasures.Theseremedialmeasuresarenotincluded intheauditprogram.

Insufficientconsiderate:

The education curve will be contented about the business and insufficient relaxednetworks and also offers systematic internal recruitment. These may gravely obstruct theexpenseofalltheemployees.

Notguaranteed:

Auditing cannot provide any data that are analyzed and prepared. It has financialaccountsonthedatathatareprovided.Itisdisclosedbasedontheinformationandexplanations thatareagreedby theclients.

Accuracy in the audit process plays a vital role that is reflected on the statement ofcorrect amount. Classification of the transaction is handled properly and timings are recordedontheexactdates.Postingandsummationofthemasterfilesamountsareproperlyclassified.Thereforewithoutauditprocess,aprogressofthecompanycannotbeidentified.

INTERNALCHE
CK:

AccordingtothespecialcommitteeonTerminology,AmericanInstituteofAccountants, 1949 "Internal check-a system under which the accounting methods and detailsof an establishment are so laid out that the accounts procedures are not under the absoluteand independent control of any person that, on the contrary, the work of one employee iscomplementary of that of another, and that a continuous audit of the business is made by theemployees."

Theessentialelementsof aninternalcheckare:

1. Institutingofchecksonday-to-daytransactions.
2. Thesechecksoperatecontinuouslyasapartofroutinesystem.
3. Workofeachpersonismadecomplementarytotheworkofanother.

ObjectsofInternalAudit

1. To verify the correctness of the financial accounting and statistical recordspresentedtothemanagement.
2. To comment on the effectiveness of the internal control system and the internalchecksysteminforce and tosuggest meanstoimprovethem.
3. Tofacilitatetheearlydetectionandpreventionoffrauds.
4. To ensure that the standard accounting practices to be followed by theorganization arestrictlyfollowed.
5. Toconfirmthattheliabilitieshavebeenincurredbytheorganizationinrespectofits legitimateactivities.
6. To examine the protection provided to assets and the uses to which they areput.toundertakespecialinvestigationforthemanagement.
7. Toidentifytheauthoritiesresponsibleforpurchasingassetsandotheritemaswell asdisposal ofassets.

DIFFERENCESBETWEENINTERNALCONTROLANDINTERNALAUDIT
The difference between internal control and internal audit can be drawn clearly on thefollowinggrounds:

1. The methods and procedures implemented by the management to control theoperations, so as to help the organization in achieving the desired ends, is calledas an internal control. The auditing program adopted by the firm, to review itsfinancial and operatingactivitiesbytheexpert,iscalled internalaudit.
2. While internal control is a system designed, implemented and maintained in anorganization. Internal Audit is an audit function designed by those charged withgovernance,tokeepacheckontheactivities ofthefirm.
3. In internal control, work ofone person is verifiedby another, whereas in thecase ofaninternalaudit,everysingle componentofworkisverified.
4. Intheinternalcontrolsystem,checkingisperformedsimultaneously,whilecarrying out work. On the contrary, in internal audit system work is checked afterit isperformed.
5. The basic objective of the internal control system is to ensure compliance withmanagementpolicies.Incontrast,internalauditaimsatdetection offraud.

INTERNALCHECKWITHREGARDTODIFFERENTITEMS

InternalCheckWithRegardToSales:

Thesystemofinternalcheckregardingsalesshouldtakecareoffollowing:

- On receipt of the order, it should number and preserved in Orders ReceivedBook with full Particulars. TheDespatch Department should be given a copy oftheorderwithnecessaryparticulars.
- The Despatch Department should take steps to pack the goods as per order.The statement of goods as prepared by the Despatch Department should becheckedwiththecustomer‘sorderandtheninvoicewillbepreparedintriplicateby means ofcarbonpapers.
- Aresponsibleofficialshouldchecktheinvoiceparticularlytherateschargedand calculations made. With the help of the copy of invoices entries should bemade in Sales Day Book. On dispatch of the goods records should be made intheGoodsOutwardBook.
- Two copies of the invoice may be sent to customer who will return one of themafter signing it. It will serve the purpose of delivery note. Third copy will beretainedforfurtherreference.
- Entries should be made in Goods inward Book for all the goods returned by thecustomers.
- Credit notes should be prepared and should be duly checked and initialed bythe responsibleofficial.With the help of credit notes, records shouldbemadein theSales ReturnBook.

InternalCheckWithRegardToPurchases:

Requisition:

The procedure for issuing purchase requisitions should be specified. The head of thedepartment, who is need of goods, should fill a requisition slip duly signedand then shouldsend to the purchase department. The details about the quality, quantity and the time bywhichthe goods mustbesuppliedbe clearly mentionedintherequisitionslip.

Enquiry:

Purchasesdepartmentmakesanenquiryabouttermsandconditionsofthe purchases from different suppliers for these purposes tenders are generally invited. But,whoshall open and accept the tenders, should be clearly specified. As rule lowest tendershould beacceptedanddecisionbetaken.

Internalcheckwithregardtofixedassets:

- A proper authority should be designated for the sanction of capital expenditure.Theauthoritymaybegiventomanagingdirector,afactorymanageroracom mittee maybesetup forthispurpose.
- A proper authority should be designated even for sale of fixed assets, transferorevenfordiscardingofanasset.
- Proper accounting records in respect of fixed assets should be maintained and itshould be ensured that the proper accounting distinction is observed betweencapitalandreviewexpenditure.
- There should be a periodic inspection of assets. A fixed asset register must bemaintained giving details of all the fixed assets. In this register description of theassets,theircostandlocation shouldbementioned.
- Managementshouldalsoensurethatallthefixedassetsareverifiedphysically

Fromtimetotime.Perfectarrangementsshouldbemadetoensurethatfixedassetsareproperlymaintained andappliedin theserviceofthecompany.

- Where the fixedassets aretransferredbetweenbranches or members ofthesalegroup,properarrangementsinrespectoftheirpricing,depreciationandaccountingshouldbemade.
- Depreciation rates are to be authorized and evidenced and which persons are tobe responsible for carrying out and checking the necessary calculations.Lastly itshould be seenthatthese fixed assetsshouldbeadequatelyinsured.

Internal check with regard to cash transactionsCASHRECEIPTS:

- There should be a separate clerk known as cashier to deal with the receipts ofcash. Immediately upon receipts of cash a rough record of the amount should bemade.Thecashiershouldnotbeauthorizedtokeepcashwithhim.Heshouldnotbeallowedtomakeexpenditureoutofitandtomakeentriesintheledger\ andotherbooksofprimeentry.
- All receipts should be banked daily. From time to time the bankreconciliationstatementsshouldbepreparedto reconcilebankandcashbalances.
- Bank pay- in-slips should not be prepared by the same person who is incharge ofmakingactualdeposits inthebank
- All receipts should be acknowledged by means of printed receipts. Counter-foilsof all the receipts issued should be properly maintained. Unused receipt must bekeptwithsomeresponsibleofficer.
- Spoiled receipts should be cancelled and not torn off. If some alterations is madein thereceiptsalready written,itshouldbeproperly initialed.
- Copiesofreceiptspreviouslyissuedmustbemarkedduplicate.
- Someresponsiblepersonsofthefirmshouldverifythebalanceofcashsurprisephysicalcheckfromtimetotime.

CASHPAYMENTS:

- The person in charge of making payments should have no connection with thereceiptsof cash. All payments should, as far as possible be by chance chequesexcluding petty cash payments. The cheques drawn for payment should be ordercheques andasfaraspracticablethey shouldbecrossed.
- Arrangements should be made to ensure that the vouchers supporting paymentscannot be presented for the payments twice, such vouchers should be stampedaspaidbeforethechequesaresigned.
- An official should check up the statements received from creditors and verifywith the invoices and ledger accounts only after proper verifications chequesshould bedrawnin favourofthecreditors.
- For sanctioning the payments of special nature, only directors and senior officersshould beempowered.
- Bank reconciliation statements should be prepared to reconcile bank and cashbalancesfromtimetotime bysome authoritiesother thanthecashier.
- Bankchequesmustbeheldunderlockandkeywitharesponsibleofficer.
- Receiptsdulysignedandstampedshouldbeobtainedforeachpayment.
- Receiptssoobtainedshouldbeproperlyarrangedandmaintainedthroughproperfilingsystem.

- Toensuretheavailabilityofcashdiscounts,monthlyorperiodicpaymentsshouldbemad eonthefixeddates

Internalcontrol:
MeaningandDefinition

Internal control is a broad term with a wide coverage. It covers the control of wholemanagement system. Internal control involves a number of checks and controls exercised in abusinesstoensureitsefficientandeconomicworking.

AccordingtoTheAmericanInstituteofCertifiedPublicAccountants,–Internalcontrol comprisesoftheplanoforganizationandallthecoordinatemethodsandmeasuresadoptedwithinabusine sstosafeguarditsassets,checktheaccuracyandreliabilityofitsaccountingdatatopromoteoperationaleff iciencyandtoencourageadherencetoprescribedmanagerialpolicies.‖

The system of internal control can be defined as, - the plan of organization and all themethods and procedures adopted by the management of an entity to assist in achieving themanagement‘s objectives of ensuring, as far as practicable, the orderly and efficient conduct ofits business.‖ In brief it can be stated that internal control includes not only internal check andinternal audit but the whole system of controls, financial and otherwise, established by themanagementinordertocarryonthebusinessofthecompanyinanorderlymanner,tosafeguarditsasset sandto secureasfaraspossiblethe accuracyandreliabilityofrecords.

EssentialCharacteristicsofInternalCheckSystem

Certainqualitiesareneededtomakeaninternalchecksystemmoreeffectiveandefficient.Such qualitiesare knownasfeaturesof internalchecksystemwhichareasfollows

DivisionofWork

Before applying test check it is necessary to divide the entire tasks among the staffs insuch a way so that work can be checked automatically by the another staff. Like, when stafftakes the responsibilityof purchase,then anotherstaff should makeitspayment.

ProvisionofCheck

Anorganizationshouldsetupsuchprovision, sothatworkcanbecheckedbytheanotherstaff.Anofficercancheckttheworkofonestaffbytransferringt othestaffsandagain.

UseofDevices

In this modern world, various devices can be used to do various function like use of timerecord machine, wage determination machine etc. An organization should use such machineswhichhelptomake workofinternal checkeasier.

Self-balancingSystem

Anorganizationcanuse self-balancingledgeraccountswhichhelptomaketheworkofinternalcheckeasier. Itseffectivenessdepends on itsmanagement.

ChangeInWork

An organization needs to transfer the staffs from one place to another place so that thework of previous staffs can be checked by the later staff which helps to make the internal checksystem 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 bemade moreeffective.

Control

Thereismorechanceoffraudswherethereisdirectcontactofconsumerorpublic.So,a manager can keep eyes in those works so that internal check system can be made moreeffectively.

UNIT – II VOUCHING

Definition:

Vouching,widelyrecognizedas–thebackboneofauditing,isacomponentofan audit seeking to authenticate the transactions recorded in a firm's book of accounts. When anaccountingtransactionisvouched,itistestedandverifiedbypresentingrelevantdocumentaryevidence.

OBJECTIVESOFVOUCHING

- Allthetransactionswhichareconnectedwiththebusinesshavebeenrecordedinthebooksofaccountsproperly.
- Toverifythatalltransactionsrecordedinthebooksofaccountsaresupportedbydocumentaryevidence.
- Thevoucherswhichsupporttheentriesarelegallyvalidfromtheviewpointthattheyare authentic, addressedtothebusiness andproperlydated.
- Toverifythatnofraudorerrorhasbeencommittedwhilerecordingthetransactioninbooksofaccounts.
- Thevouchershavebeenprocessedcarefullythroughvariousstagesofinternalchecksystem.
- Whilerecordingthetransactionwhetherdistinctionhasbeenmadebetweencapitalandrevenue items.
- Whetheraccuracyhasbeenobservedwhiletotaling,carryingforwardandrecordingan amountintheaccount

VOUCHINGOFCASHTRANSACTIONS:

How to vouch various cash receipts (Receiptside)Cash sales:

In vouching cash sales, cash register should be fully checked with carbon copies of cashmemos.Then,theauditorshouldverifythedailydepositsofcashreceivedinthebankdatesof 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 cancelledshould be kept in the book. Where a company has a discount policy, if more discount isallowed in atransaction itmustbeapprovedbyaresponsibleofficer.

Cashreceivedfromthedebtors:

The auditor should verify amount received from debtors from the counterfoils orcarbon copies of the receipt issued to the customers. All these receipts should be seriallynumbered. Amount should be entered in the cash book on the day when received. Discountallowedtocustomersshouldbeauthorizedbyaresponsibleofficer.Sometimescorrespondence madewithcustomercanalsobeverified.

Loans:

Whilevouchingtheloansreceived,thetermsandtheconditionscontainedinthe agreementshouldbeverified.Iftheloanissecuredwhatsecurityhasbeenoffered,whetherthefacthasbeen disclosedin thebalancesheet.

Billsreceivable:

Bills receivable book maybe verified because the various details regarding the billsmaturedanddiscountedareavailableinit.Auditorshouldchecktheamountreceivedwiththebanks tatement.

SaleofInvestment:

If the sales have been affected through a bank, the auditor should examine the bankadvice to know the various details. Sometimes the investment is sold through the broker.Broker'ssoldnoteorcommissionshouldbeexaminedtoverifythesaleproceedsandcommission charged by the broker. If the investments are sold at cum-dividend price, auditorshould see that proper apportionment has been made between capital receipts and revenuereceipts.Sometimestheinvestmentsaremadeagainstspecifiedfunds.Profitorlossonsaleofsuch investmentsmust betransferredtosuchfundsaccount.

SaleofFixedAssets:

Saleoffixedassetsmaybevouchedwithminutebookofboardofdirectors,correspondence, agents' sale account and sale contract. It should be seen that proper accounthas been credited. Any profit arising on the sale of asset shall be credited to revenue accountwhich 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 becredited to asset account. It must be seen that sale of fixed assets has been sanctioned by theauthorizedperson orcommittee.

BoughtLedgerorPurchaseLedger

This ledger contains accounts relating to creditors.Theauditor shouldtakethefollowingsteps:

- Heshouldchecktheopeningbalancesofdifferentaccountswiththeauditedbalancesheetofthe previous year.
- Heshouldexamineallsupportingbookslikepurchasesbook,goodsinwardsbook,cash book,discountregister,goodsoutwardbooketc.
- Iftheself-balancingsystemisinuse,heshouldaskhisclientforascheduleofcreditorsandtotaloftheschedulesshouldbetalliedwiththecreditor'sledgeradjustmentaccount.
- Theauditorshouldexamineallthecreditorsstatementsandwiththeirhelp,thepurchaseledger balances shouldbechecked.
- He should see that the balances in the purchases ledger whether debit or credit areshown ontheproperside ofthebalancesheet.
- He should ensure that provision for reserve for discount on creditors, if made, isnotexcessive.

SalesLedgerorDebtorsLedger

Thiscontainsaccountsrelatingtodebtors.

Thefollowingpointsshouldbenotedwhilevouchingsalesledger:

- Theauditorshouldchecktheopeningbalanceswiththeauditedbalance-sheetofthepreviousyear.
- Heshouldexaminesupportingbooklikebillsreceivablebook,cash-book,goodsoutwardbook,sales returnsbooketc.

- Where self-balancing system is in use, the total of the balance as per the scheduleofdebtors should be verified with the total of the balance shown in the debtors ledgeradjustmentaccount.
- He should test check postings to this ledger from various books of first entry. Heshould give special attention to credit postings, as any attempt to concealdefalcationswillmoreusuallytakethe formoffictious creditentries
- He should also check the castings and balances with the list of debtors. If there is anycredit balance in the sales ledger, he should see that it is shown on the liabilities sideofthebalance sheetalongwithsundrycreditors.
- While examining the accounts the auditor should ascertain the composition of eachbalance.Inparticularheshouldnotewhetheritrepresentsspecificitemsofgoodsorisanac cumulatedbalance.Inthelattercase, heshouldensurethatitdoes notrepresentdoubtfulforbaddebt.
- He should call for a list of bad and doubtful debts and verify them thoroughly asthereisquitepossibilityofthefigurebeingunderstatedandmisappropriated.

VOUCHINGOFIMPERSONALLEDGER:

- It is an important part of the auditor's, duty to vouch the impersonal ledger whichcontains accounts from which trading and profit and loss accounts and the balancesheetareprepared.Theimpersonalledgerhastwokindsofaccounts-Nominalaccounts & real accounts. Nominal accounts relate to the trading, profit account andreal accounts record assets. Here, the transactions appearing in the impersonal ledgerbut relating to profit & loss account and the auditor's duty in connection with onlythoseitemsistobeconsidered.Wholevouchingthesetransactions,theauditorshould considerthefollowingpoints .
- He should check the totals of the various books of original entry with the accounts intheimpersonalledger.
- He should vouch the Journal carefully and should see that each entry is supported bysufficientevidence.He should alsocheckttheirpostingsto impersonalledger.
- He should test the postings from the cash book to the impersonal ledger in order toensurethattheentrieshave beenposted tothecorrectaccounts.
- In those cases where direct entries are passed from one account to another in theimpersonal ledger, he must proceed in the same manner as if they had been passedthoughthejournal. Suchitemsare asfollows:

Outstandingassets:

Underthishead,theremaybeenanexpenditurealreadyincurredforwhichthecorresponding benefit could not be made available for the business during the period or someportion of this relates to the period subsequent to the date of balance sheet. Such items areusually named payments in advance or pre-payments and should be shown in the balancesheet.

Beside this, there may be some items accruing or due which may not have beenrecorded in the books, for example, prepaid expenses, accrued income items and deferredrevenueexpenditure.Incaseofprepaidexpenseslikeadvancepaymentofratesandcommissio netc;theauditorshouldseethatsuchamounthasbeenexcludedfromtheprofit& loss account and be shown on the asset side of the balance sheet. He should vouchsuchexpenseswiththehelpofnominalaccounts,demandnotes,receiptsandtheactual inspection of the original documents. He should also see that the correct amount has beenproportioned between the two periods on the date of the balance sheet. In case of otheritems also, sameprocedure canbefollowingby theauditor.

Outstandingliabilities:

It is the duty of an auditor to ascertain that all outstanding liabilities are brought intoaccount before calculating the net profit or loss for the year under audit. But in practice, it maynot beeasy for an auditor, therefore it is better if he obtains a certificate from a responsibleofficial that there are no expenses incurred in the current year which have not been recorded inthe 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 thebalance sheethavebeenaccounted for.

For example in case of unearned income, the auditor should examine the necessaryvouchers to ascertain how much amount of such income is to the credited in the current year'sprofit and loss account and how mcuh is to be carried forward to the following year. Anotherexample 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, intereston loan & debts etc. In order to vouch these expenses, the auditor should examine nominalaccountsdemandnotes,receipts,invoices&otherrelevantvouchers&notetheperiodcovered by such payment. He should also ascertain with their help that the expenses unpaidhave been debited to the profit & loss account of the current year and shown separately on theliabilitysideofthebalancesheet.

Contingentliabilities:

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

ContingentAssets

There is no practice of showing these in the balance sheet either as a foot note or anyother manner and in Companies Act also there is no provision to show them. It is but fair thatifacontigentliabilityisshown,acontingentaseet mustalsobe shownatthe sametime.

VERIFICATION

MeaningandDefinition

Verification means the procedures normally carried out at the year end, to confirm theownership,valuationandexistenceofitemsatthebalancesheetdate.Insimplewordsverification means, _proving the truth orconformation.'The verificationof assets implies anenquiry into the value, ownership and title, existence and possession, and the presence of anycharge ontheassets - **SpicerandPegler**

VALUATION

MeaningandDefinition

Valuation means to set the exact value of an asset on the basis of its utility. Valuationforms an important part of the everyday audit. It is because the accuracy of balance sheetdepends much upon how correctly the estimation of the value of various assets and liabilitieshas been made. Both over valuation and under- valuation of assets and liabilities would exhibitwrong picture of the financial affairs of a concern. The auditor has to see that the assets andliabilities appearing in balance sheet have been exhibiting their proper value i.e. neither theyhavebeenover-valuednorunder-valued.

METHODSOFVALUATION:

Costprice:

Thepricewhichispaidfortheacquisitionofanassetisknownascostprice,ofcoursetheexpensesin curred inthepurchaseofanassetand itsinstallation in itscostprice.

Marketvalue:

Avalue whichanassetcanfetchinthe marketwhensoldis known or termedasMarketvalue.

ReplacementValue:

It is a price at which a particular asset can be replaced. The assets such as commission, freightetc.isincludedinsuchavalue.

BookValue:

A value at which an asset appears in the books of accounts is known as its book value. It isusuallythecostless depreciation writtenoffsofar.

GoingConcernvalueorConventionalvalueortokenvalueorHistoricalvalue:

Itis equivalent to thecostless reasonable amount ofdepreciation writtenoff. No notice istaken of any fluctuation in the price of the assets. Reason for this is that these assets areacquired foruse inthebusiness andnotforsale.

ResidualValue:

Avaluewhichwillberealizedinthemarketandreceivedfromthesaleofanassetitisknownasits realizableValue.

ScrapValue:

Avaluewhich isobtained fromtheassetifitissoldasscrap.

VerificationandValuationofDifferentassets

Forthepurposeof conveniencewemaydividetheassetsinthefollowingcategories

1. IntangibleAssets.Viz.,goodwill,patents,trademarks,copyrightsetc.
2. FixedAssets viz., landand building, plantand machinery, furniture andfixturesetc.
3. Floatingassetsviz.,cashinhandandatbank,BR,stockintrade,sundrylettersetc.

Intangibleassets:

Goodwill:

Verification:

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

It should be verified that the goodwill has been recorded in the books of accounts onlywhen some consideration in money or its equal has been paid for. In case of partnership theauditor should verify the changes made in the goodwill account from time to time on the basisofprovisions madeIthepartnershipdeed.

Valuation:

Goodwillshould bevaluedatacostlessamountswrittenoff.

Patents:

Verification:

The Auditor should examine the patents with the help of certificate which have grantedsuchpatentrights.Theauditorshouldalsoensurethatthepatentsareregisteredinthenameofclient

Valuation:

Patentsmustbevaluedatcostlessdepreciation.Thepatentsshouldbewrittenoffinaperiodofsixteenyearsafterwhichtherightautomaticallylapses unlessthetermisextended.

Copyrights:

Verification:

Inverifyingthecopyrights, auditorshouldinspecttheagreementbetweentheauditorandthepublisher.

Valuation:

Generally the value of the copyright is not stable because copy rights lose their value bypassage of time. In the balance sheet copyright must be shown a cost less amounts written offfromtimetotime.

Trademarks:

Verification:

Trademarks can be verified by examining the assignment deed duly endorsed by theoffice of the registrar of trademarks. In case they have been purchasedfrom others, the auditorshouldvouchtheexpendituresincurredinconnectionwiththeiracquisitione.g.registration fees,payments madetodesignersetc.

Valuation:

Thevaluationmethodisthemostsuitablemethodvaluationoftrademarks.itshouldbeseenthattrademarks are properly valued andshowninbalance sheet.

FixedAsset:

Freeholdlandandbuilding:

Verification:

Theauditorshouldexaminethetitledeedstoensurethattheyareinthenameoftheclient.Any additionorsaleduringtheyearshouldbecarefully examined.

Valuation:

Freehold land being a no depreciable asset is generally shown at cost which includes thepurchase price, broker‘s commission, registration fees, legal chargesetc. Any payments made toMunicipality Corporation or improvement trust as developmental charges should be included inthe cost. If market realizable value is takenas basis for valuation of freehold land the sameshould bedisclosedclearly inthebalancesheet

Valuationofbuildings:

Buildingsshouldalwaysbevaluedatcostlessdepreciationatareasonablerate. Actually,themarketorrealized valueofthebuildings keepsonfluctuating.Therefore,itshouldbetakenintoaccountwhilevaluingthebuildings.

Leaseholdsproperty:

Verification:

The auditor should inspect the lease agreement to find out thevalue and duration. Theauditorshouldseethatleaseagreementisregisteredwiththeregistrarandcertificatetestingtothevalidity ofthesame.

Valuation:

Leaseholdlandandbuildingsaretobevaluedatcostlessdepreciationwhichshouldbesufficientwritesitoffcompletelyduringtheperiodoflease

Plantandmachinery:

Verification:

Auditorshouldcommencetheprocessofverificationbyobtainingascheduleofplantandmachinery certifiedbyresponsibleofficerofthe concern.

Valuation:

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

FloatingAssets:
Cashinhand:
Verification:

Theauditorshouldverifythecashinhandbyactuallycountingitonthedateofbalance sheet.

CashatBank:
Verification:

Theauditorshouldverifycashatbankbycomparingthebalanceshownincashbookandpassbook. Inverifying thebankbalancetheauditorshouldalso preparebankreconciliationstatementtoascertainthecorrectposition**.**

Stockintrade:
Verification:

It is practically impossible for auditor to physically verify eachitem of the stock in handbecause of various reasons i.e. limited time and the lack of technical knowledge. Therefore theauditorhastorelyupontestcheckstoascertainthe accuracyofstockintrade.

Valuation:

Thestockintradebeingafloatingassetshouldbevaluedatcostpriceormarketpricewhichever lessis. Thecostpricecanbecalculatedfrom any ofthefollowingmethods

a. Unitcostmethod
b. Averagecostmethod
c. Firstinfirstoutmethod(FIFO)
d. Lastinfirstoutmethod(LIFO)
e. HighestInfirstout(HIFO)
f. Basestockmethod
g. Adjustedsellingpricemethod
h. Standardcost method.

Investments:
VERIFICATION:

The auditor should verify the details of the schedule of investment by applying tests e.g.financialjournalsandnewspapersshouldbeconsultedforcheckingthemarketrates.Thesecuritiesth emselvesmaybeconsultedorthebroker‘snotesmaybeexaminedforcheckingthecostetc.

The auditor should verify the amount of interest or dividends ass have alreadyhave beendeclared before the date of the balance sheet, should be taken into account as outstandingones.

Valuation:

Ifinvestmentsaretobeheldasafixedassetforthepurposeofearninginterest/dividend; these are to be valued at cost which includes brokerage and stamp duty paidin regard there to.But if the investments are held as current assets, these assets should bevalued at cost or market price whichever less is. The auditor may come across the situationswhere the market Value is much below the cost of acquisition of investments. Ordinarily heshouldignore atemporarilyfallinthe marketvalue, butwhere the fallinvalueseems to be ofa permanentnature,heshouldseethatadequatedepreciationisprovidedbypassingtherequiredentries

VerificationofLiabilities:

Capital:

In case of firm, the auditor should verify the liability on account of the capital with thehelp of partnership deed; pass book and the cash book. In case of a company auditor shouldexamine the memorandum of association to verify the information as to the maximum capitalthe company is authorized to raise. He should also ascertain the amount of called up in respectofeachclassofsharesandalsoascertainhowmanysharesofeachclassareallottedasfullypaid. Auditorshouldalsospecify thesources from which thebonus shares areissued i.e.capitalization of profits are reserves for share premium accounts. He should also ensure thatcapitalprofit,ifanyonissue offorfeited shares,hasbeentransportedtocapitalreserve.

Debenture:

Theauditorshouldnotethefollowingpointswhileverifyingthedepreciation:

1. Debenturetrustdeedshouldbeinspectedandwithitshelp,thedebentureaccountintheledgershouldbeexamined.
2. Ifnecessary,theauditorcanobtainacertificatefromthedebentureholders.
3. Sincethedebenturesaresupposedtoberedeemed,theauditorshouldseethearrangementsfortheirredemption.
4. Thedebenturemaybeissuedatparoratpremium.
5. TheauditorshouldseethedetailsasgivenintheRegisterofMortgagesandcharges.

Tradecreditors:

1. TheFirsttasktheauditoristoaskforscheduleofcreditors.
2. Thepurchaseledgershouldbecheckedwiththebooksoforiginalentry,invoicesandcreditnotesetc.
3. Discountoncreditorsshouldbecheckedwithreferencetocreditor‘saccount.
4. If any debt Is found unpaid for a longer period of time any enquiry should be made sinceitispossiblethatinsteadofpayingtothecreditortheamountmighthavebeenmisappropriated

Loans:

Theauditorshouldexaminetheloanagreementinordertoascertainthe termsofloan, amount of loan and period and the nature of the loan. In case the loans are overdrafts havebeen taken from a bank an agreement with the bank and a certificate to that effect should beobtained andexamined**.**

Outstandingliabilitiesforexpenses:

The auditor should obtain a certificate from responsible officer of the company statingthatalloutstandingliabilitiesforexpensesincurredhavebeenbroughtintoaccount.Theauditorcanverifythoseitemsofexpenseswhichusuallyconstituteoutstandingliabilities. E.g.salariespayable,legalexpenses,rent,wages,auditfeesetc.

ReservesandFunds:

Theauditorshouldexamineandverifythatwhetherthedecisiontocreatereserveorfundis dictated by needs and circumstances of business and relevant legal provisions and check therelevant entries in books of accounts and check the entries passed for the purpose in the profitand loss appropriationaccount.

IncomeReceivedinAdvance

The auditor should examine the schedules of income received in advance and ensurethat these are fully disclosed in the balance sheet The auditor duty is to examine whetherinterest, rent, installments etc, received in advance should be classified as liability and shown assuch inthebalancesheet.

DIFFERENCEBETWEENVOUCHINGANDVERIFICATION

It has been stated earlier that both vouching and verification are very important aspectsto auditing. However,verificationisamuchwidertermthanvouching.

Thepointsofdifferencebetweenthetwomaybestatedasfollows:

1. Vouching means substantiating an entry in the books of account with the supportingvoucherslikereceipts,invoices,correspondence,contractsetc.Verificationmeansexamining with regardto the assets shown in the balance sheet that they exist,are inthenameofthecompany,areproperlyvalued and arefreefromanycharge.
2. The object of vouching is to check that the entries made in the books of accounts arecorrect.Whereastheobjectofverificationistochecktheexistence,valuation,ownershipandpossessionoftheassets
3. Vouching is carried out with the help of vouchers. Verification includes in addition tovouching,thecheckingof physicalexistence,valuation and ownershipofthe assets.
4. Vouching is done at any time during the year.Verification is done only after accounts arecompletedandbalancesaredrawn.
5. Vouching of assets is undertaken once during the life time of the asset. Verification ofassetsshowninthebalancesheetis doneevery year.
6. Vouchingdoesnotincludevaluationofassetsandliabilities.Verificationincludesvaluation ofassetsandliabilities.
7. Vouchingisthefirststeptakenbeforeverification.Itinvolvesexaminingthetransactionswhentheytakeplace.Verificationisthenextstepaftervouchingiscompleted.Itincludeschecking manyaspectsofassets andliabilities.

DIFFERENCEBETWEENVALUATIONANDVERIFICATION

Meaning

Verification means checking whether theassets shown in thebalancesheet areinthenameofbusiness,whether they existornot,whetherthereisany chargeonitetc. Valuationmeansdeterminingthepropervaluesofassetsandliabilitiesshowninthebalancesheet

Purpose

Thepurposeofverificationistocheckexistence,ownershipandpossessionofassets.
Thepurposeofvaluationistodeterminethepropervaluesofassetsaspergenerallyacceptedprinciples.

Basis

Thebasisofverificationisthetypeofassets, andliabilities.Thereisnotfixedmethodof verification.Thebasisof valuationofassetsisthetypesofassetsarevaluedondifferentbasis.

Certificate

Theauditoris notabletogetcertificateofverificationofassets andliabilities.Theauditorisentitledtogetcertificateofvaluationofassetsfromresponsibleofficeroftheb usinessunit.

Vouching

Verificationincludesvouching.Valuationdoesnotincludevouching.

Scope

Thescopeofverificationiswide.Itincludescheckingofmanythingslikeexistence, ownership, possession etc.he scope of valuation is limited. Here only values of assets andliabilities aredeterminedandchecked.

QualitiesofanAuditor:

TheAuditormustpossessthefollowingqualificationsandqualities:

1. Onlythequalifiedcharteredaccountantcanbeappointedasauditorofalimitedcompany.
2. Theauditormusthavethoroughknowledgeofprinciplesandpracticeofallaspects of accountancy. He must be familiar with all systems of accountancyinuse.
3. Heshouldhaveadequateknowledgeoffinancialmanagement,industrialadministration andbusiness organization.
4. He must have thorough knowledge of audit case laws as per the various casesdecidebythecourtsinandoutsideIndia.
5. Heshouldbeabletounderstandthetechnicaldetailsofbusinesswhoseaccountsheisgoin gtoaudit.
6. Anauditor must be honest i.e. He must certify thathe does not believe to betrueandhemusttakereasonablecareandskillbeforehebelieveswhathecertifiesistrue.
7. He must act impartially and not influenced by others, directly or indirectly whiledischarginghisduties.
8. Heshouldbehardworking,systematicandmethodical.
9. Hemusthavecapacitytohear argumentsofothers.
10. Heshouldhaveadequateskillsandcouragetowriteauditreportcorrectlyclearlyand concisely.
11. Heshouldnotdisclosethesecretsofhisclient

AppointmentofanAuditor

APPOINTMENTOFCOMPANIESAUDITORS:

Theprovisionsregardingappointmentoftheauditorarecontainedinsection139ofCompaniesAct201 3

Appointmentofauditorbymembers[sec139(1)]:

1. AcompanyshallappointanindividualorafirmasanAuditoratthefirstannualgeneralmeetingandeachsubsequent sixth annualgeneralmeeting.
2. Suchauditorsshallholdofficetillconclusionofsixthannualgeneralmeeting.
3. Suchappointmentshallbeplacedbeforethemembersateachannualgeneralmeetingforratification.

Periodforwhichtheappointmentismade[sec139(2)]:

1. An individualcanbeappointedforatermnomorethanfiveyears.
2. An audit firm can be appointed for a consecutive term not more than two termsof fiveyears.
3. An individual or a firm which has completed its term shall not be eligible forreappointmentasauditorinthesamecompanyforfiveyearsfromthecompletionofterm.

Appointmentofauditorof Governmentcompanies(sec139(5)):

The comptroller andAuditor general shall in respect of financial year appoint an auditordulyqualifiedwithin180daysfromthecommencementoffinancialyearwhoshallholdofficetillconclusionofannualgeneralmeeting.

AppointmentofFirstAuditorbyBoardofDirectors[sec139(6)]:

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

AppointmentofFirstAuditorofGovernmentCompany[sec139(7)]:

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

Casualvacancyof anAuditor[sec139(8)]:

a. The casual vacancy of auditor, except in case of Government Company, shall befilled by the board of directors within 30 days but if it arises as a result ofresignation of the auditor it shall be approved by company at general meetingconvened within 3 months o recommendation of board. Such auditor shall holdofficetillconclusionofnextannualgeneral meeting.
b. Casualvacancy incaseofGovernmentCompany shallbefilled byComptrollerand Auditor General within 30 days if he fails to fill the vacancy, the board shallfillthevacancy withinnext30days.

Reappointmentof aretiringauditor[sec139(9)]:

Suchanauditorcanbereappointedatannualgeneralmeetingif.

a. Heisnotdisqualifiedforreappointment.
b. Hehasnotgivennoticetocompanyofhisunwillingness.
c. Aspecialresolutionhasnotbeenpassedatannualgeneralmeetingappointingsomeother personorproviding expresslythat he shallnotbereappointed.

Alltheaboveissubjecttotheprovisionsofsec139(1)

QUALIFICATIONSOFANAUDITOR:

a. A person shall be eligible for the appointment of an auditor of a company only if he is acharteredaccountant.
b. Where a firm including a limited liability partnership is appointed as an auditor of acompany, only the partners who are chartered accountants shall be authorized to actand signonbehalfoffirm.

DisqualificationsofanAuditor:

Thefollowingpersonsshallnotbeeligiblefortheappointmentasanauditorofacompany:

a. Anofficeroremployeeofthecompany.
b. A person who is a partner, or who is in employment or an officer or employee of thecompany.
c. A person or a firm who, whether directly or indirectly has business relationship with thecompany, or subsidiary of such holding company or associate company of such nature asmaybeprescribed.
d. A person whose relative is director or is in the employment of the company as directoror key managerialpersonnel.
e. A person who is in full time employment elsewhere or a person or a partner of a firmholding appointment as its auditor, if such persons or partner is at the date of suchappointmentorreappointmentholdingappointmentasauditorofmorethan20companies.
f. A person who has been convicted by a court of an offence involving fraud and a periodof10yearshasnotelapsed fromthedateofsuchconviction.

REMUNERATIONOFANAUDITOR(SEC142)

a. The remuneration of the Auditor of a company shall be fixed in its general meeting or insuch manneras maybedeterminedtherein.
b. TheRemunerationundersubsection(1)shall,inadditiontothefeepayabletoanauditor, include the expenses, if any, incurred by the auditor in connection with theaudit of the facility extended to him but does not include any remuneration paid to himbyanyother servicesrendered byhimattherequestofthecompany.

REMOVAL,RESIGNATION OFANAUDITOR

c. The Auditor appointed under section 139 may be removed from his office before expiryof is term only by a special resolution of the company after obtaining the previousapprovalofthecentralGovernment.
d. The Auditor who resigns from the company shall file within a period of thirty from thedate of resignation, a statement in a prescribed form with the company a registrar, theauditorshallalsofilesuchstatementwiththecomptrollerandauditor–general

indicatingthereasonsandotherfactsasmayberelevantwithregardtohisresignation.

RightsofanAuditor

a. Right to Access books of accounts: Every auditor of a company has right to free andcompleteaccessatallthe timesto thebooks,accountsand vouchersofthecompany
b. Right to obtain the information and explanation: An auditor is authorized to obtain suchinformation and explanation as the auditor may think necessary for the performance ofhisduty asauditor.
c. Right to receive notice: All notices of thecompany andother communications relatingtoanygeneralmeetingofthecompanyshallbeforwardedtotheauditorofthecompany. He is also authorized to attend the meetings and make any statement orexplanationwithregardtotheaccounts auditedbyhim.
d. Righttosign auditreport:onlythepersonappointed asauditorof thecompany,whereas firmsoappointedonlyapartnerinthefirmpracticinginIndia,maysigntheauditor‘sreport or authenticate any other document of the company required law to be signedorauthenticatedby auditor.
e. Right to seek legal and technical advice: The auditor of a company is entitled toseek thelegalandtechnicaladvice which maybeneeded in theperformanceofhisduties.
f. Righttoremuneration:oncompletionofhisworkanauditorisentitledtohisremuneration.
g. Right to be indemnified: for many purposes, an auditor is considered to be an officerthecompany. An officer has a right to be indemnified out of the assets of the companyagainst anyliability.

DUTIESOFANAUDITOR:

Dutiesundersection143(1):

a. The auditor has a duty to enquire whether loans and advances made by the companyhavebeenproperlysecuredwhetherthetermandtheconditionsthereofareprejudicialtotheinterestofthecompanyoritsmembers.
b. Duty to enquire whether assets of the company being shares or debentures and othersecuritieshavebeen soldat aprice lessthan atwhichthesewerepurchased.
c. Whether any shares have been allotted for cash, whether cash actually received andwhether the position in the account books and balance sheet is correct, regular and notmisleading.

Dutiesundersection143(2):

Theauditorhasthedutytoreportthemembersofthecompany,theaccountsexamined by him and every financial statement to be laid before the company in the generalmeeting. The auditor shall state in his report to the best of his information and knowledge, thesaid accounts and financial statements whether give a true and fair view or not, of the state ofcompany‘saffairs

Dutiesundersection143(3):

1. Hehasthedutytosoughtandobtainallinformationandexplanationwhicharenecessaryforhisaudit.
2. Hehasadutytoensurethatthebooksofaccountsasrequiredbylawhavebeenkeptbythecompany.

3. He has a duty to see whether the company has adequate internal financial controlsystems inplaceandtheiroperativeeffectiveness.
4. Hehasadutytoensurewhetherthecompany'sbalancesheetandprofitandlossaccount dealt within the report or in agreement with the books of account andreturns.

LIABILITIESOFANAUDITOR:

Theliabilitiesofanauditorcanbesummedunderfollowingheads:

1. Civilliabilities
2. CriminalLiabilities

1. CivilLiabilities:

(i) LiabilityforNegligence:

The liability of an auditor arises where it is proved that his client has suffered a loss dueto his professional negligence. The auditor may be held personally liable, if it is proved, that hadheexercisedreasonablecareandskill,hemusthavediscoveredthediscrepancy.Inacaseitwasheld that if anauditor failstoshow asmuchskill anddiligenceasis expectedofamanofordinaryprudence,hemustsufferttheconsequences.

(ii) Liabilityformisfeasance:

According to section (340), the court may assess damages against delinquent directorand other officers of the company, including an auditor for misfeasance or breach of trust. Incaseofanauditorwhoalsocomeswithinthedefinitionofofficerinsection2(59)forpurposeof the section, if he is guilty of neglect of duty or misfeasance, so as to cause loss of company inany way, proceedings may be taken under this section against him either independently orother officers or jointly with them. This section provides a simple way to the company torecover damages where an auditor or any other officer of the company is guilty of misfeasance.Thetimelimit forbringing anaction is5years.

2. CriminalLiabilities:

(i)Misstatementinprospectussection34:

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 knowingthem to be false, he shall be punishable with imprisonment for a minimum term of 6 monthsextendableto10years.

(ii)Noncompliancebyauditorwithsection143and145:

If the auditor does not comply with section 143 and 145 regarding making his report orsigning or authentication of any document and makes willful neglect on his part he shall bepunishablewithimprisonmentupto1yearandwithfinenotlessthantwentythousandextendable to five lakhs. In case an auditor knowingly or willfully with the intension to deceivethecompanyorShareholdersorcreditorsortaxauthorities,heshallbepunishablewithimprison mentupto1 year andfinenot lessthan1 lakh extendableuptotwentyfivelakhs.

(iii)Failuretoassistintheinvestigationsection217(6):

Where the central Government appoints an inspector to investigate the affairs of thecompany, it is the duty of the auditor to preserve and produce to the inspector all books andpapersrelatingtothe company.If an auditorfailsto assistthe inspector ininvestigationheshall be punishable with imprisonment up to 1 year and with fine not less than twenty five thousandextendableto1lakh

(iv)Penaltyforfalsificationofbookssection336:

Any officer including auditor of acompany which is being wound up, with an intentionto defraud or deceive any person, destroys, mutilates, alters, falsifies any books, papers orsecurities.Heshallbepunishablewithimprisonmentforatermnotlessthan3yearsextendableto 5years and withfinenot lessthan1 lakh extendabletothree lakhs.

(v)Penaltyfor deliberateactofcommissionoromissionsection448:

If anyofficer including auditor of the company deliberately make a statement in anyreturn,report,certificate,balancesheet,prospectusetc.whichfalseorwhichcontainsomission of material facts he shall be punishable with imprisonment for a term not less than 6months extendableto 10 years and fine not less than amount involved in fraud extendable to 3times ofsuchamount.

UnitIII: AuditandAccounting Standards

TypesofAudit

StatutoryAudit

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.

ConcurrentAudit

Its an audit which goes on 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 if 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.

StockAudit

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.

CostAudit

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.

CAGAudit

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 IndiaAuditing 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.

   ManagementAudit.

   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

ACCOUNTINGSTANDARDS

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 a tree 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 (SQCs**) 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 t 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 lays 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

StandardsonInternalAudit

PREFACETOTHEFRAMEWORKANDS TANDARDSONINTERNALAUDIT

Contents

Preface to the Standards on Internal Audit was, originally, issued inNovember,2004,revisedinJuly,2007,andwasrecommendatoryinnature. The revised Preface to the Framework and Standards on InternalAudit shall become mandatory from such date as notified by theCouncil.

∗IssuedinNovember,2018.

1. Introduction

This Preface to the Framework, Basic Principles and Standards onInternalAuditfacilitatesunderstandingofthescopeandauthorityofthepronouncementsoftheInternalAuditStandardsBoard,issuedundertheauthorityoftheCounciloftheInstituteofCharteredAccountantsofIndia.

2. InternalAuditStandardsBoard

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"CommitteeonInternalAudit".InNovember2008,theCouncilrenamedthisCommitteeasthe"InternalAuditStandardsBoard(hereinafterreferredas theBoard)".

2.2. TheobjectivesandfunctionsoftheBoardareasfollow:

(i) Toreviewexistingandemerginginternalauditingpracticesworldwideandidentifyareasinwhich StandardsonInternalAudit(SIAs)needtobedeveloped.

(ii) To formulate Standards on Internal Audit, which may be issuedundertheauthorityoftheCounciloftheInstitute.

(iii) ToformulateGuidanceNotesonissuesrelatingtointernalaudit, including those arising from the SIAs, or pertaining to anyspecific industry, which may be issued under the authority of theCounciloftheInstitute.

(iv) To continuously review the existing Standards and Guidance onInternalAuditandtoundertaketheirrevision,ifnecessary.

(v) ToformulateandreviewImplementationGuides,TechnicalGuides, Practice Manuals, Studies and other papers which maybe issued under its own authority for guidance of the members,as feltappropriatebytheBoard.

(vi) Toundertakeresearchandpromoteknowledgedisseminationinthe fieldof internalaudit.

3. FrameworkGoverningInternalAudits

3.1. Everystandardsettingprocessoperateswithinapre-definedframeworkwhichoutlinescertainfundamentalcomponentsinherentto the function or activity of internal audit. This is essential to ensure aconsistentapplicationofBasicPrinciples,BestPracticesandStandards to achieve a high level of quality consistent with theobjective ofinternalaudit.

3.2. The Framework Governing Internal Audits is an overarching documentto be read along with this Preface. It consist of Definition of InternalAudit, Code of Ethics and the following four components of internalaudit:

(a) BasicPrinciplesofInternalAudit

(b) KeyConcepts

(c) StandardsonInternalAudit,and

(d) Guidance

4. StandardsonInternalAudit(SIAs)

4.1. TheStandardsonInternalAudit(SIAs)areasetofminimumrequirements that apply to all members[1] of the ICAI while performinginternalauditofanyentityorbodycorporate.

4.2. As per Section 138 of Companies Act, 2013, the Board of a Companymay, besides aChartered Accountant,appointa cost accountant oranyotherprofessionaltoconductInternalAudits.TheICAIrecommendsthead optionoftheSIAsbynon-membersoftheICAIwho are performing internal audits so as to ensure a consistentapproachandqualityinthedischargeoftheirprofessionalduties.

5. MandatoryNatureofFrameworkandStandards

5.1. The Council of the ICAI has decided that the Standards will be mademandatory in aphased manner.

5.2. The SIAs shall initially be mandatory for members performing internalauditsinalllistedcompanies,asperSection138oftheCompanies

[1] The current law in India permits internal audit to be performed either by an entity's ownemployee (i.e., personnel on the payroll of the organization or its group company) or by aprofessional who is part of an external agency (e.g., a firm of practicing CharteredAccountantsundertakinginternalauditengagements).TheseSIAsapplytoICAImembers in both situations, irrespective of whether the internal audit is conducted bytheminthecapacityofanemployeeorasarepresentativeofanexternalagency.

Act, 2013,readwith Rule 13of Companies(Accounts)Rules2014from the effective date of the SIA, and all other companies from oneyearthereafter.

5.3. The mandatory status of a SIA implies that while carrying out aninternal audit, it shall be the duty of the members of the Institute toensurethattheycomplywiththeSIAsreadwiththePreface,Framework Governing Internal Audits and Basic Principles of InternalAudit.

5.4. If, for any reason, a member is unable to comply with any of the SIAsrequirements, or if there is a conflict between the SIA and othermandates,suchasaregulatoryrequirement,theinternalauditreport(or such similar communication) should draw attention to the materialdeparturestherefromalongwithappropriateexplanation.

6. StandardSettingProcess

6.1. TheBoarddevelopsandrevisesSIAsinconsultationwithStudyGroups (if required). Exposure drafts are thereafter released to variousinterest groups and public at large for their feedback and comments.The Board reviews the comments and thereafter places the SIA beforethe Council for its deliberation. The SIAs approved by the Council areissuedwith the finalchanges.

6.2. Thedetailedprocessisexplainedunder Annexure1.

7. ContentsoftheStandards

7.1. SIAs shall be principle based and will clearly outline the objective ofissuing the particularStandardalongwith theessentialrequirementsforitscompliance.

7.2. Internal Auditors shall apply their best professional judgement in theimplementationofSIAsona“substanceoverform”basis.Implementation andTechnical guides issued by theBoardwould helptoprovidethenecessaryguidanceandclarificationinthisregard.

7.3. The essence of each Standard is captured under the following keysections:

(i) Introduction: To provide a brief background and scope of theStandardand itsapplicability.

(ii) Objective: Reasons for issuing the Standard and why it isrequired.

(iii) Requirements: The desired outcome and what is essential toensurecompliance withtheStandard.

(iv) ExplanatoryCommentsonImplementationandApplication:Certain parts of the Standardwhich needs to be elaborated,includingdefiningkeywordsandterms.

(v) EffectiveDate: Date from which theStandard is to be appliedand made mandatory.

7.4. TheStandards onInternalAudit,as andwhenissued,willbe classifiedandnumberedinaseriesformat,asfollows:

(i) 100Series :StandardsonKeyConcepts

(ii) 200Series :StandardsonInternalAuditManagement

(iii) 300–400Series : StandardsontheConductofAuditAssignments

(iv) 500Series : StandardsonSpecialisedAreas

(v) 600Series : StandardsonQualityControl

(vi) 700Series : Other/MiscellaneousMatters

8. Guidance

8.1. Guidance Notes on Internal Audit are primarily designed to provideguidanceonmattersofimplementationorclarificationontheirapplicability incertaincircumstances.

8.2. TheBoardmayissuethefollowingguides(asappropriate):

(i) ImplementationGuide:Bestpractices,methodologiesorapproachonhowbesttoapplyinternalauditproceduresinordertoachievetheobjectivesofthe SIA.

(ii) TechnicalGuide:Clarificationsastowhat extenttheSIA appliesin acertainindustry ora particularsituation,consideringthetechnicaloroperationaluniquenessofthe same,andhowbesttoachievetheobjectives oftheSIA.

8.3. TheImplementationandTechnicalGuidesarerecommendatoryinnature.TheInternalAuditorshouldordinarilyfollowthese recommendationsexceptwhere,underparticularcircumstances,itmaynotbe necessaryorappropriatetodoso.

9. EffectiveDate

9.1. The Preface to the Framework and Standards on Internal Audits isapplicable for all internal audits beginning on or after a date to benotifiedby theCouncil oftheInstitute.

9.2. In case of SIAs issued by the ICAI for which a Guidance Note isalreadyinexistence,theGuidanceNoteshallstandwithdrawnfromthedateonwhic htheStandardcomesintoeffect.

DETAILSOFTHESTANDARDSETTINGPROCESS

1. **Selection of Topics and Time-lines:** The Internal Audit StandardsBoard,onacontinuousbasis,andinconsultationwithitskeystakeholders,keepsidentifyingthebroadareasinwhichtheSIAsneed to be formulated (including the review and revision of prevailingSIAs) and prepares a priority list with time lines for the issuance of theSIAs.
2. **FormationofStudyGrouptoDraftStandards:** In the preparationanddraftingoftheSIAs,theBoardisassistedbyaStudyGroup(SG)of professionals constituted by the Board. In the formation of the SG,provisionismadefortheparticipationofacrosssectionofmembersofthe Institute. In certain situations the Board may also consider havingexpertprofessionalsontheSG,whoneednotnecessarilybemembersoftheICAI.TheSGisgenerallychairedbyamemberoftheBoardand convened by the Board. The SG is responsible for preparing andfinalising the Exposure Draft of the Standard and make it ready forreviewandapprovaloftheBoard.
3. **Review of Exposure Draft of SIA by the Board:** The Exposure Draft(ED)oftheStandardisputuptotheBoardfortheirreview,deliberationandapproval.OnthebasisofthedeliberationsoftheBoard, changes are made to the draft, and the final ED is made readyforexposurewithawidesetofstakeholders.

   WhileformulatingtheSIAs,theBoardtakesintoconsiderationtheapplicable laws, customs, business environment in India. The Boardalso,whereappropriate,takesintoconsiderationtheinternationalpracticesintheareaofinternalaudit,totheextenttheyarerelevantandapplicabletotheconditionsexistinginIndia.
4. **ExposureDraftOpenfor Commentsfor30days:** The ExposureDraftoftheproposedStandardisissuedforcommentsbythemembers of the Institute. The ED is also open for comments by non-members, including the regulators and other such bodies as well asgeneral public. The ED is also published in the monthly Journal of theInstituteand hosted on the website of the Institutewherefrom it isdownloadablefreeofchargeforcommentsbytheprofessionalaccountants and the public. The ED is also circulated to all themembersofCounciloftheICAI,theInstitute'spastPresidents,

RegionalCouncilsandthebranchesoftheInstitutefortheircomments.The ExposureDraftisalsocirculatedtootherexternalstakeholdersas listedin**Annexure2**.

The Exposure Draft is normally open for comments for a period of atleast 30 (thirty) days from the date of issuance, but this time may beextendedifconsidered necessary.

5. **FinalisationandSubmissiontoICAICouncil:**Aftertakingintoconsiderationthecommentsreceivedonthe ExposureDraft,theBoardwillupdatethedraftoftheproposedStandard,takeinputsofthe SG (if appropriate), finalise the Standard for consideration by theCounciloftheInstitute.

6. **ICAICouncilDeliberatesandApprovesSIA:** The Council of theInstitute will consider the final draft of the proposed Standard onInternalAuditandifnecessary,modifythesameinconsultationwiththeInternalAuditStandardsBoard.

7. **SIAIssuedwithFinalChanges:** The SIA will then be issued undertheauthorityoftheCouncil of theInstitute.

LISTOFSTAKEHOLDERSFORINPUTSONEXPOSUREDRAFTS

Preface

1. TheMinistryofCorporateAffairs
2. TheReserveBankofIndia
3. TheSecuritiesandExchangeBoardofIndia
4. TheInsuranceRegulatoryandDevelopmentAuthority
5. TheComptrollerandAuditorGeneralofIndia
6. TheControllerGeneralofAccounts
7. TheCentralBoardofDirectTaxes
8. TheCentralBoardofExciseandCustoms
9. TheInstituteofCostAccountantsofIndia
10. TheInstituteofCompanySecretariesofIndia
11. RecognisedStockExchangesinIndia
12. TheIndianBanks'Association
13. TheStandingConferenceofPublicEnterprises
14. TheNationalBankforAgriculturalandRuralDevelopment
15. TheIndianInstitute(s)ofManagement
16. TheTelecomRegulatoryAuthorityofIndia
17. TheCentralRegistrarofCo-operativeSocieties
18. Various Industry bodies/associations, such as, The Confederation ofIndian Industry, The Associated Chambers of Commerce and Industry,TheFederationofIndianChambersofCommerceandIndustry,etc.
19. Any other body considered relevant by the Board, keeping in view thenatureandrequirementsofSIAs.

PenalProvisions

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. 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 suomoto (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 ≥ Rs. 500 crore; or
  - Paid up Capital ≥ Rs. 500 crore; or
  - Annual turnover ≥ 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 ≥ Rs. 500 crores; or
  - Paid up Capital ≥ Rs. 500 crores; or
  - Annual turnover ≥ 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'SREPORT

Preface

Managementauditor'sreport

In the end, the management auditor prepares a report. On the basis of findings anddefinite information, the auditor prepares a report making suggestions for improvement in theworking of the management. His report should give a correct assessment of the working oforganization.Heshouldnothesitateincriticizingthemanagement.Hisrecommendationsshouldbeconstructive andnotmerelycondemningin nature.Hisreportmayincludethefollowingmatters:

1. Whetherthemanagement;andthestaffrelationsarehealthy.
2. Whetherthereturntoshareholdersisadequate.
3. Whetherthemethodsofproductionareout-dated.
4. Comparisonofoperatingefficiencyoftheorganizationwithotherconcerns.
5. Rateofthereturnoninvestment.

ContentsofAuditReport

Under section 227 (2) every auditor is required to make report to the shareholders onthe accountants examined by him and every balance sheet and profit and loss A/c and everydocument declared by law to be part of or annexed to the balance sheet and profit or loss A/Cwhich are placed before the shareholders of the company at the general meeting during tenureof his office. The report has to state whether, in his opinion and to the best of his informationand according to the explanations given to him, the said accountants give the informationrequiredbytheCompanies Act in manner sorequiredandgive atrue andfair view.

In the case of the balance sheet, of the state of the company's affairs as at the end of itsfinancial year; and in the case of profit and loss account, of the profit or loss account for itsfinancialyear.Sub-section(iii)ofthesection227requiredthattheauditor'sreportshallalsostate.

a. Whether he has obtained all the information and explanations which to the bestofhisknowledge andbelief werenecessaryforthe purposeofhisaudit;
b. Whether in his opinion, proper books of account as required by law have beenkeptbythecompanysofarasappearsfromhissexaminationofthesebooks,and proper returns adequate for the purposes of his audits have been receivedfromthebranchesnotvisited byhim.
c. Whether the report on the accounts of any branch office audited under section228 by a person other than the company's auditor has been forwarded to himandhowhehasdealtwith the same inpreparingthe auditor'sreport.
d. Whether the company's balance sheet and profit and loss A/C dealt with by thereport are in agreement with the books of accounts andreturns.If any of thematters as referred to in section 227 (2) and (3) is answered in the negative orwith the qualification the auditor has to state in his report the reasons for suchanswer.

TheAuditor'sreportshallalsoincludeastatementonsuchadditionalmattersas specifiedbytheCentralGovernmentundersection227(4-A)oftheCompaniesAct,Thissection empowers the Central Government to order the inclusion of certain matters in the auditor‘sreport. The Institute of Chartered Accountants of India requires the auditor‘s to ensure that theaccounting standards are implemented in the presentation of financial statements covered bytheirauditreports.Thedeviation shouldbe reportedinthereport

DifferencebetweenInvestigationandAudit

- AnAuditiscarriedouttoensurethatthebalanceSheetandtheprofitandLossA/Cshowatrueandfa irpicture.But,ontheotherhand,aninvestigationiscarriedoutonfor some predefined purpose e.g. to know the financial position of the company or itsearningcapacity.
- An Audit is limited only for an examination of the accounts of the concern but theinvestigation covers not only examination of accounts, it involves probing deep into thematterandlookingforrequiredinformationfarbehindthebookswhenevernecessary.
- The Investigation is not legally compulsory but audit is statutorily compulsory incase ofjointstockcompanies.
- Auditing can only be conducted by a chartered accountant but it is not necessarythat aninvestigator mustbea Charteredaccountant.
- Anauditisalwayscarriedoutonbehalfoftheownerofthebusiness,buttheinvestigation may be conducted on behalf of the proprietor of the business, in case hesuspectsanyfraud, oronbehalfoftheoutsideparties.
- Anaudit always relates toa period of 1 year or 6 months but the investigationmaycover several years.
- Investigation is done when the books of accounts are already subject to a regularauditi.e.
- Theinvestigationstartswheretheauditends.
- Unlikeauditor,aninvestigatorisnotboundbyaccountingconventions,policiesandDisclosurere quirements.
- Qualifiedopinion/report

Qualifiedreportisgivenbytheauditorineitherof thesetwocases:

- When thefinancialstatementsarematerially misstateddue tomisstatementinoneparticularaccountbalance,classoftransactionordisclosurethatdoesnoth avepervasive effectonthefinancialstatements.
- Whentheauditorisunabletoobtainauditevidenceregardingparticularaccountbalance,classoft ransactionordisclosurethatdoesnothavepervasiveeffectonthefinancialstatements.

The report is mostly like a Clear Opinion Report and only includes a paragraph viz. Basisfor Qualification after Scope paragraph and before Opinion paragraph. Opinion paragraph inadditiontoitsstandardwordingincludes–exceptfortheafterdescribedinBasisforQualification paragraphthefinancialstatements givetrueandfair view.‖

Detailedbelow:

A **Qualified Opinion** report is issued when the auditor encountered one of the two typesof situations which do not comply with generally accepted accounting principles, however therest of the financial statements are fairly presented. This type of opinion is very similar to anunqualifiedor"cleanopinion",butthereportstatesthatthefinancialstatementsarefairly presented with a certain exception which is otherwise misstated. The two types of situationswhichwouldcauseanauditortoissuethisopinionovertheunqualifiedopinion are:

Single deviation from GAAP– this type of qualification occurs when one or more areasof the financial statements do not conform with GAAP (e.g. are misstated), but do not affect therest of the financial statements from being fairly presented when taken as a whole. Examples ofthisincludeacompanydedicatedtoaretailbusinessthatdidnotcorrectlycalculatethedepreciationexp enseofitsbuilding.Evenifthisexpenseisconsideredmaterial,sincetherestof the financial statements do conform withgaap, then the auditor qualifies the opinion bydescribing the depreciation misstatement in the report and continues to issue a clean opinionontherestofthefinancialstatements.

Limitation of scope – this type of qualification occurs when the auditor could not auditone or more areas of the financial statements, and although they could not be verified, the restofthefinancialstatementswereauditedandtheyconformtoGAAP.Examplesofthisincludean auditor not being able to observe and test a company's inventory of goods. If the auditoraudited the rest of the financial statements and is reasonably sure that they conform withGAAP, then the auditor simply states that the financial statements are fairly presented, with theexception oftheinventory whichcouldnotbeaudited.

The wording of the qualified report is very similar to the unqualified opinion, but anexplanatory paragraph is added to explain the reasons for the qualification after the scopeparagraphbutbeforetheopinionparagraph. Theintroductory paragraphisleftexactly thesame as in the unqualified opinion, while the scope and the opinion paragraphs receive a slightmodificationin line withthequalificationin theexplanatoryparagraph.

The scope paragraph is edited to include the following phrase in the first sentence, sothat the user may be immediately aware of the qualification. This placement also informs theuserthat,exceptforthequalification,therestoftheauditwasperformedwithoutqualifications:

"Exceptasdiscussedinthefollowingparagraph,weconductedouraudit..."

Theopinionparagraphisalsoeditedtoincludeanadditionalphraseinthefirstsentence,sothattheu serisremindedthattheauditor'sopinionexplicitlyexcludesthequalification expressed. Depending on the type of qualification, the phrase is edited to eitherstate the qualification and the adjustments needed to correct it, or state the scope limitationandthat adjustmentscouldhavebutnotnecessarilybeen requiredinorder tocorrect it.
For a qualification arising from a deviation from GAAP, the following phrase is added to theopinionparagraph,usingthedepreciation examplementionedabove:

"In our opinion, except for the effects of the Company's incorrect determination ofdepreciation expense, the financial statement referred to in the first paragraph presents fairly,in allmaterialrespects,thefinancialpositionof…"

Foraqualificationarisingfromascopeoflimitation,thefollowingphraseisaddedtotheopinion paragraph,usingtheinventoryexample mentionedabove:

"In our opinion, except for the effects of such adjustments, if any, as might have beendetermined to be necessary had we been able to perform proper tests and procedures on theCompany'sinventory,thefinancialstatementreferredtointhefirstparagraphpresentsfairly,in allmaterial respects,thefinancialposition ofUnqualifiedOpinion

Anopinionissaidtobe**unqualified**,orunmodified,whentheAuditorconcludesthattheFinancialStatementsgiveatrueandfairviewinaccordancewiththefinancialreportingframeworkusedforthepreparationandpresentationoftheFinancialStatements.AnAuditorgivesaCleanopinionorUnqualifiedOpinionwhenheorshedoesnothaveanysignificantreservation in respect of matters contained in the Financial Statements. The most frequent typeofreportisreferredtoasthe"UnqualifiedOpinion",andisregardedbymanyas theequivalentofa"cleanbillofhealth"toapatient,whichhasledmanytocallitthe"CleanOpinion",butinreality it is not a clean bill of health, because the Auditor can only provide reasonable assuranceregardingtheFinancialStatements,notthehealthofthecompanyitself,ortheintegrityofcompanyrecordsnotpartofthefoundationoftheFinancialStatements.Thistypeofreportisissued by an auditor when the financial statements arefreeofmaterialmisstatementsandarepresentedfairlyinaccordancewiththeGenerallyAcceptedAccountingPrinciples(GAAP),whichinotherwordsmeansthatthecompany'sfinancialcondition, position, and operations are fairly presented in the financial statements. It is the besttypeof reportanauditormay receivefrom anexternal auditor.

AnUnqualifiedOpinionindicatesthefollowing:

- TheFinancialStatementshavebeenpreparedusingtheGenerallyAcceptedAccountingPrinciples whichhavebeenconsistentlyapplied;
- TheFinancialStatementscomplywithrelevantstatutoryrequirementsandregulations;
- Thereisadequatedisclosureofallmaterialmattersrelevanttotheproperpresentationofthefinancialinformationsubjecttostatutoryrequirements,whereapplicable;
- Any changes in the accounting principles or in the method of their application and theeffectsthereofhavebeenproperlydeterminedanddisclosedintheFinancialStatements.

ObjectivesofInvestigation

Therealobjectiveofconductinganinvestigationbyanauditoronbehalfofhisclientisto 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 ofdesired field of activity with a view on some special purpose as determined by the person onwhose behalf the investigation is undertaken. In short investigation is to ascertain the financialposition andearning capacityofabusinessonbehalfofacertainperson.

Thecommonobjectivesofinvestigationarelistedbelow:

1) Proposedpurchaseofbusiness.
2) Proposedsaleofbusiness.
3) Reasonsforlowprofitability.
4) Causeofhigh employeeturnover.

5) Reliabilityofbusinessdata.
6) Proposedinvestmentinparticularsecurities.
7) Suspectedfraud.
8) Joininginexistingpartnershipbusiness.
9) Borrowingfunds.
10) Lendingfunds.
11) Proposedpurchaseof controllingsharesinacompany.
12) Suspectedmisfeasanceagainstdirectors.
13) Detectionofundisclosedincomefortaxpurposes.
14) Suspectedmisappropriationbytrustees.

DUTIESOFANAUDITOR

Dutiesofanauditorcanbestatedundertwoheads:

A. DutiesundertheCompaniesAct
B. Dutiesasperthe LegalDecisions

A. DutiesundertheCompaniesAct

TheauditorhasthefollowingdutiesundertheCompaniesAct:

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 beenproperlysecuredandwhetherthetermsonwhichtheyhavebeenmadearenotprejudicialtoth e interestofthecompany of itsmembers;
(ii) whether transactions of the company which are represented merely by book entries arenotprejudicialtotheinterests ofthecompany;
(iii) where the company is not an investment company within the meaning of Section 372 ora 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 theywerepurchasedbythecompany;
(iv) Whetherloansandadvancesmadebythecompanyhavebeen shownasdeposits.
(v) Whetherpersonalexpenseshavebeenchargedtorevenueaccounts;
(vi) Whether it is stated in the books and papers of the company that any shares have beenallotted 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 theaccountbooksandthebalancesheetiscorrect,regular andnotmisleading.

Tomakereporttotheshareholders:(Section 227(2,3 &4))

The auditor of the company is duty bound to make report to the members of thecompany on the accounts examined by him and on every balance sheet, every profit and lossaccount laid before the company in the general meeting during his tenure of office. The auditorhas to make a report to the members and not to the directors, though his appointment mayhave been made by the directors. The duty of the auditor is over as soon as he submits thereport to the Secretary of the company. It is none of his concern to know whether the same hasreachedtothehands ofthemembersofthecompany.

TheAuditReportmustexpresslystatethefollowingbesidesothernecessarythings;

(a) Whetherinhisopinionandtothebestofhisinformationandaccordingtotheexplanations given to him the accounts give the information required by the Act and inthemannersorequired.
(b) Whether the balance sheet gives true and fair viewofthe company's affairs asat theend of the financial year and the profit and loss account gives a true and fair view of theprofit andlossofitsfinancialyear;
(c) whether he has obtained all the information and explanations required by him for thepurposes ofhisaudit;
(d) whether, in his opinion, proper books of account as required bylaw have been kept bythe company, and proper returns for the purposes of his audit have been received fromthebranchesnotvisited byhim;
(e) whether the company's balance-sheet and profit and loss account dealt with by thereport areinagreementwith thebooksof account andreturns.

Dutytostatethereasonsfortheanswersinnegative

In case of the answers to any of the points stated above are in negative, the auditor isrequiredtoexplainthereasonfortheanswer inhisreport.

1. **Dutytoincludeinthereportthemattersasdirectedbythe Centralgovernment:**

Section227(4A)empowerstheCentralGovernmenttorequirebyorder,thattheauditor's report will include a statement on such matters as may be specified therein. BeforemakinganysuchordertheCentralGovernmentmayconsulttheInstituteofCharteredAccountants of India in regard to the classes of description or companies and other ancilliarymattersproposedtobespecifiedtherein.

2. **Dutytosigntheauditreport(Section229)**

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

3. **DutytogiveareportupontheProspectus(Section56(1))**

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

4. **DutytocertifytheStatutoryReport (Section165(4))**

Theauditorhastocertifythecorrectnessofthe StatutoryReportwithregardtothefollowing:

(a) The numberofshares whichhavebeenallottedbythecompany whetherforcashorforconsideration otherthancash;
(b) Thetotalamountofcashreceivedbythecompanyinrespectofallthesharesallotted,distinguished asaforesaid;
(c) Anabstractofthereceiptofthecompanyandthepaymentsmade.

5. **DutytodeclarethesolvencyoftheDirectors,(Section488(2)(b))**

Theauditorhastodeclarethatsolvencyofthedirectorsincaseofthe VoluntaryLiquidation ofthecompany,

6. **Duty to give a report upon the Profit and Loss Account and the Balance Sheet enclosed withtheDeclarationofSolvency. (Section 488(2)(b))**

The auditor has to give his report upon the profit and loss account and thebalancesheet which is enclosed with the Declaration of solvency made by the Directors of the company,in thecaseofVoluntaryLiquidationoftheCompany,

7. **DutytoassisttheInvestigators(Section240(v)(b)).**

In case the affairs of the company are to be investigated, the auditor should assist theInvestigators in every possible manner. He should produce his working papers relating to auditwhen asked forbytheInvestigators.

8. **DutytoassisttheAdvocateGeneral**

IftheAdvocateGeneralismakinganyenquiryagainstthedirectors,theauditorisdutyboundtohelphimi nhiswork.

B. DutiesAccordingtotheLegalDecisions

Certain matters have been taken to the court of law from time to time and the courtshaveintheirdecisionsfixedcertaindutiesupontheauditors.Thesedutiesinshortareenumeratedhe re.

1. **Dutytoinformthemembersandshareholdersaboutthecontraventionoftheprovis ionsofthecompanyLaw.**
2. Duty to enroll himself with the Institute of Chartered Accountants of India and toobtain acertificatetopractice fromit.
3. Dutytoacquainthimselfwiththeprovisionsofthecompanylawandalsoenquirefromhis predecessorabout itinwriting,
4. Dutynottocanvassforandalsoapproachandpressanymemberofthecompanyforhisapp ointmentasanauditorof thecompany.
5. Dutytoenquireaboutthetrueandfairstateofaffairsofthecompanyandsubmithisproperr eport.
6. Dutytoverifyhimself cash inhandandnottobenegligentinhiswork.
7. DutytoseetheDebentureTrustDeedandverifywhetherthedebenturesissuedbythe company are accordingtothetermslaiddowninthetrustDeed.
8. Dutytoverifytheinvestmentshimself.
9. Dutytoperform histaskwith ability,careandskill.
10. Dutytoverifytheinventoriesandtheledgeraccounts.
11. DutytopersonallyinspectallsecuritiesandseethattheyareinthesafecustodyoftheSecret ary oftheCompany.

Variouscourtshavepenalizedtheauditorsfornon-performanceoftheabovestatedduties andtherefore,theauditorshouldtakenoteofthesedutiesalso.

ClassesofInvestigation:

TherearemanytypesofInvestigation,butcertainmainclassescanbeidentified. Followingaresomeoftheareaswheretheinvestigationismostlycalledfor:

1. Investigationonbehalfofapersonorcompanywhowantstopurchasearunningbusiness.
2. Investigationonbehalfofapersonwhoisinterestedtojoinasapartnerinapartnershipfirm .

3. Investigationonbehalfofapersonwhowantstolendmoneytoabusinessorinterestedtoknowitsfinancialposition.

4. Investigationonbehalfoftheowner/shareholderofthebusinesswhosuspectsafraud.
5. Investigationonbehalfofthetaxauthorityforassessingactualtaxliability.

Comprehensiveaudit:

The primary purpose of a comprehensive audit is to ascertain the economy, efficiencyand effectiveness of an organization's operations and use of resources. Comprehensive auditsare also called "value for money" audits and are designed to be wide ranging and thorough,integratingfinancialauditing,corporatecompliance,operationalauditproceduresandmanagementreviews.Comprehensiveauditshavealsobeenperformedonregionalgovernmentstocombatfraudandcorruption.

Levels

Comprehensiveauditscanbeperformedontheentirecompanyoratthelevelofa specific department, such as finance management, human resources or information systems.Anyauditofapubliccompanyisrequiredtobeconductedbyanaccountingfirmregisteredwith the Public Company Accounting Oversight Board (PCAOB) and should include the full rangeofthecompany's activities.

Risk

Riskassessmentisapartofacomprehensiveaudit.Itisbasedonthenature,quantity and quality of evidence, and the professional independent auditor's judgment in interpretingthe evidence. It also includes the company's internal controls over financial reporting to reducetheriskoferrororfraud.

Responsibility

A comprehensive audit examines the Management Control Framework (MCF) of thecompany, which would identify the division of responsibility within the company or the areascovered 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 thecompany'sinternalcontrolsoverfinancialreporting.Itistheauditor'sprofessionalresponsibilitytoexerciseprofessionalskepticismthatincludesaninquiringmindandindependent criticalassessment.

Recommendations

Acomprehensiveauditreportwillincluderecommendationsonhowtoimproveproceduresandactivitiesandenhanceeconomy,efficiencyandeffectivenessinallareascoveredbytheaudit.Itwillalsoincludetheauditor'sopiniononthecompany'sfinancialstatements.

MeaningandDefinitionsofcostaudit:

Cost Audit is a critical review undertaken to verify the correctness of Cost Accounts andtocheckthatcostaccountingprinciplesandplanninghavebeenefficientlyfollowed.Itisnoteworthy that India is the only country which has introduced statutory cost audit to regulateabout45vitalindustriesofthecountry.CostAudithasbeendefinedbythechartedinstituteof managementaccountants(CIMA)oflandloanstheverificationofcostaccountsandacheckon theadherencetothecostaccountingplan.‖

Thisdefinitionimpliesthefollowing:

(i) The objects of cost accounting with reference to which the cost accounting planmust have been drawn up have to bekept inmind to see whether or not theplan itself and the figures collected will lead to the achievement of the goal orobjective set. For instance, if the objective is to achieve maximum efficiency, theplan and the analysis of data will be different from the case where the onlyobjectiveistofixprices.

(ii) It has to be examined whether the methods laid down for ascertaining costs andotherrelevantdecisions are being implemented. Treatmentand determinationof abnormal losses of gains or treatment of certain expenses as direct or indirectare cases inpoint.

(iii) Thecorrectnessofthefigureshastobevouched.

Statutory Cost Audit is a system of audit introduced by the Government of India for thereviewexaminationandappraisalofthecostaccountingrecordandaddedinformationrequiredtobemaintainedbyspecifiedindustries(ICWA ofIndia).

The concept of cost audit has been elaborated by ICWA as an audit of efficiency ofminutedetailsofexpenditure,whiletheworkisinprogressandnotapostmortemexamination.Financialauditisafaitaccompli,costauditismainlyapreventivemeasure,aguideformanagementpolicyanddecisionin addition,tobeingabarometerof performance‘.

Cost Audit can be called efficiency audit. It is evidenced by amendment in section 209which reads. ‗The object of the amendment of the section is to ensure specified companyproperrecordsrelatingtoutilizationofmateriallaborareavailablewhichwouldmakeefficiencyaudit(cost-audit)possible‘.

ManagementAuditingistheprocessof–auditingthequalityofmanagersthroughappraising themasindividualmanagersandappraisingthequalityofthetotalsystemofmanaginginanenterprise.‖Thusmanagementauditaimsatassessinghowmanagersperformdifferentfunctionsofmanagement,e.g.,planning, coordinating,motivating,etc.

AdvantagesofCostAudit:

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

The former aims at prevention of frauds and errors and with presentation of Profit andLoss Account and Balance Sheet which exhibit a true and fair view of the state of affairs (ofprofitearnedduringtheyearand offinancial position atthe endof theyear).

Itisconcernedwithtotalityofexpenditureandrevenueratherthanitsfunctional analysis. Cost Audit will establish the accuracy of cost of each product, job, activity, etc., and isconcerned with proper analysis of information and its estimation so that management gets thenecessary information promptly. Apart from reliability of data, cost audit should afford certainincidental advantages. Rather, it should be said that cost audit will help consolidate and realizeadvantages expected from a system of costing. Following statement of the HR Gokhale Ex-ministerof Law,Justice andCompanyAffairsemphasizesthe socialadvantage ofcostaudit.

Theobjectiveofthismeasure(costaudit)istoprotectconsumersfromunwarrantedincreasein prices. Reasonableness of the prices charged canonly be ensured by correct determinationof costs and the margin charged by producers and their retailers. Another object underlyingthisstepistomaketheindustriescoveredbysuchrulesalertandefficientandalsotomakethem knowtheir rational cost with a view to reducing it to the extent possible. Thus by resorting to thismethod, the interest of consumer is safeguarded and it is definite step towards removal ofsocialinjustice.

TypesofCostAudit:

ThemaintypesofCostauditarethefollowing:

(i) CostAuditasanAidtoManagement:

The aimis tosee thatallinformationplacedbefore managementis relevant, reliableand prompt so that management can discharge its duties well. It must also be seen that norelevant orpertinentinformationissuppressed.

(ii) CostAuditonBehalfofaCustomer:

Often contracts are placed on ―Cost Plus‖ basis. In other words, the customer willdetermine 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 toestablish correctcostand, therefore,price.

(iii) CostAuditonBehalfofGovernment:

Sometimes the Government is approached with request for financial help or protection.Beforetakingadecisionontherequest,theGovernmentmaychoosetogetcostaccountsofthe applicant audited to establish whether the need for help is genuine or is a result of mereinefficiency.

(iv) CostAuditunderStatute:

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 gettheir 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 gettheircostaccounts audited.

The powers and duties and manner of appointment of the cost auditor are the same asthat of external financial auditor and the same disqualifications will apply. The cost auditor willsubmithisreporttotheCompanyLawBoardwithacopytothecompany.Therighttoinvestigate allaspectsofcostaccountsispresumablygrantedto thecostauditor.

(v) CostAuditonBehalfoftheTradeAssociation:

Sometimestradeassociationsseektomaintainpricesatacertainlevel.Forthispurpose, 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 therelativeefficiency ofproductiveprocesses.

AdvantagestoManagement:

(i) Errorsinfollowingcostingprinciplesandtechniquesaredetected.Inconsistenciesand frauds can also be detected. This keeps everyone alert andpromotesefficiency.
(ii) Costauditcanservetomeasureperformanceofmanagersandbetterperformancecanber ewarded.
(iii) Ithelpstoprepareaccuratecostreportsandthisbusinessplanningcanbemoreaccurate.
(iv) Inter-firm comparisons can be made with ease and this might be a veryusefulproposition ifindustrialintelligence isgood.
(v) Cost audit can give an idea about the comparative operational efficiency of eachdepartment of division; and may thus pin-point deficiencies and also encourageto operateina competitive spirit.

AdvantagestoManagement/CostAccountant:
Importantadvantagesare:

(i) Histaskisfacilitatedsinceerrors,deficiencies,etc.,arepointedout.Costingplanscanbep reparedtotakecareof thesethings.
(ii) Costauditmayhelpineasierreconciliationofcostandfinancialaccounts.
(iii) Ifthecostauditorisanoutsiderandisanexpert,hecancertainlygivesomepracticalandsou ndadvicetostreamlinecostingsystemsandorganization.
(iv) Costaudithelpstofocusattentionofmanagementontheproblemsfacedbythecostaccou ntant.Thishelpshimtorealizehisgoalsandobjectiveswithease.

AdvantagestoStatutoryAuditor:

(i) Audited cost data helps him to determine the value of stocks, remunerationofmanagerialpersonnel,etc.,witheaseandaccuracy.
(ii) Data and statements of cost audit help him to prepare his audit programme andplansothatheconcentratesmoreonthoseaspectswhichhavenotbeenadequatelycov eredbycostaudit.

AdvantagestoConsumers:

(i) Thedirectbenefitaccrueswhereastatutorycostaudithasbeendonetofixareasonablepric efortheconsumers.
(ii) Sincecostauditaimsatensuringefficiencyintheorganization,thismayalsogetreflectedi nreduced prices totheconsumers.

AdvantagestoLabour:

(i) Ifcostauditisdonethoroughlylabouralsostandstogainthroughincreasedprofitabilityint he shapeofbonusand otherbenefits.

(ii) Alsoitbringsintofocustheroleoflabourinimprovingefficiencyintermofincreasedproductivity.

AdvantagestoShareholders:

(i) There is correct valuation of all kinds of inventories. This may project a truepicture oftheorganization before shareholders and other investors and help themto assessitsperformance.

(ii) Externalcostaudithighlightsefficiencyorinefficiency,utilizationofmanpowerandotherresources, adequacyofreturn,etc.

AdvantagestoGovernmentandEconomy:

(iii) Ithelpsthegovernmenttosettleaccountswherecost-pluscontractshavebeenmade.

(iv) The government can intervene to protect the interests of the consumers,labour,shareholdersand investorsfromexploit-age orinefficientmanagements.

(v) Atthenationallevel,costauditpromotescostconsciousnessandoverallefficiency.This means that every rupee invested produces the maximum quantityofgoods andservices.

Definitionofperformanceaudit:

Performance auditing has been variously defined. A working definition is as follows:"Performanceauditingisanassessmentoftheactivitiesofanorganizationtoseeiftheresourcesarebeingmanagedwithdueregardforeconomy,efficiencyandeffectivenessandaccountabilityrequirements arebeingmetreasonably."

Inthisdefinitionthekeywordsare:

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

a. Assessment:

It means that the auditor formulates a judgment on the basis of relevant and reliableevidence. The judgment may contain a certain amount of subjectivity and hence may becontested by the auditor management. But to the extent it is based on agreed facts and isarrivedataftercarryingoutgenerally acceptedauditingproceduresitistreatedasvalid.

b. Activities:

Performanceauditingextendstofinancialaswellasnon-financialactivitiesofan organization. It reviews the main operations of the organization. Obviously, it implies thatauditors would require some understanding of technical operations of the auditee. This maynecessitateassociationofsocialorphysicalscientistsorotherspecialistswiththeauditors.

c. Organization:

Performanceauditingtakesanoverviewoftheactivitiesandfunctionsofanorganization as a whole. In exceptional cases, it may review an isolated project or a programmeas well. But for generalized conclusions it is necessary that the organisation is reviewed as awhole initsoperationalenvironment.

d. Resources:

Theresourcesofanorganizationconsistofmoney,men,materials,andmachines. Performanceauditingreviewsalltheseresources.

e. Management:

Management covers such functions as planning, organisation, resourcing, directing andcontrolling.Performanceauditingreviewsallthesephasesofmanagementcycle.Itisnotconcerned merely withthe'use'ofresources.

f. Economy:

Review of economy is a primary element in performance auditing. Economy meansacquiringresourcesatthelowest cost keepinginviewtheobjectivesoftheorganization.

g. Efficiency:

Efficiencyreferstotherelationshipofinputsandoutputs.Itrelatestoutilizationofresource.

h. Effectiveness:

Itmeanstheextenttowhichanorganizationachievesitsobjectives.

i. Accountabilityrequirements:

Public managers are responsible to carry out the policies of the legislature by translatingthemintoappropriate programmes. Certainresourcesareprovidedtothemtoimplementtheseprogrammes.Theyareexpectedtoreportbacktothelegislatureabouttheresultsoftheirprogrammes.Traditionally,thereporttothelegislatureispresentedintheformofappropriation accounts, which is, as a matter of fact, a report of the financial results. Withincreased emphasis on receiving value for money and reducing waste in public spending, moreand more legislatures are demanding reports on operations of government departments andagencies.

j. Reasonability:

The performance auditing adopts the approach of a reasonable manager. It does notturn an oblique eye to the constraints of the management. Instead it takes into account thetotal environment in which executive departments operate. It does not base its judgement onhind-sightwisdom.

PerformanceMeasuresforeffectiveness

Appropriateperformancemeasurestoassesstheeffectivenessofprojectsareverydifficulttodevise.Therearethreemainproblems:

a. **Problemofjointers:**

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 ofteachers and the. Supply of equipment. It may be very difficult in practice to analyse theeffect ofindividualpolicies.

b. **Externalfactors:**

Sometimes factors outside the control of the management affect the outcome ofaprojectorprogramme.Forexample,income andsocialstatusoftheconsumers.

c. **Cost:**

Sometimesprogrammescannotbecarriedoutinthemosteffectivemannerdue to prohibitive cost. For example, it may be more effective to have more teachers than toprovidemore books.Butthe costoftheformermaybeprohibitivelyhigh.

Because of these difficulties in the measurement of effectiveness the auditor shouldmove cautiously. The best method should be to devise performance indicators in consultationwiththemanagement.Buttheauditorshouldkeepinviewanynationalorinternationalstandards already available. Similarly, the objectives laid down in the plan may be taken as abench mark for some of the outcomes. In no case should the auditor restrict his audit criteria totheoriginal planonly.

SourcesofPerformanceMeasures:

Thereareanumberofsourcesofeffectivenessmeasures,suchasfollowing:

Citizensurveys:

Especiallyinareasofsocialservices,police,garbagecollectionetc.Forreliableresults,extremecareneed beexercised in determiningsamplesize andpreparingquestionnaires.
Trainedobserverratings:Trainedobserversareusedtorateconditionsinaparticulararea,usingpre-designatedratingcriteriasuchasstreetcleaning.

Industrystandards:

Comparisonoftheresultsofaprogrammewithprevalentstandardsinthatareaorwithothersimilarprogrammes

Internalrecords:

Reviewofinternalrecordssuchasoccupancyrateforresidentialhomes,usercomplaints,etc.sometimes providesvitalinformationfor measuring'effectiveness.

Normally,theauditorisnotexpectedtocarryouttheaboveexercisehimself.Hisprimary duty is to see if the auditor has a reliable system to evaluate its own effectiveness. Inthatcase, he wouldfocus his attentionon theadequacy of theseprocedures. In case theauditor does not have a reliable mechanism to measure its own effectiveness the auditor mayhavetodoithimself.

The main focus of effectiveness auditing is on the assessment of the extent to which anagency failed to attain the intended goals. But a simple explanation of possible reasons forshortfall in achievement of goals is not enough. For example, it is not enough to say that theagencycouldnotachieveitsgoalsbecauseofcost overrun ortimeover-run.

Insteaditisnecessarythattheauditorshouldanalyzethereasonsintofollowingtwocategories.

a. Factors that could have been influenced by the agency. They would emerge from ananswer to the question: did the agency perform its task in the most appropriate way,seen in relationtotheassignmentthat itintended tocarryout?
b. FactorsthatcouldnotbeinfluencedbytheagencysuchasGovernmentpolicy,applicable rules, socio-political environment, appropriation of funds and availability oftrained manpower,etc.

TechnicalGuideonAuditinHotelIndustry

India is fortunate to have a domestic market that supports the growth of the travelindustry even when the world economy is experiencing a downturn. However, domestic travelhas probably never been given its due. Even today, it is the statistics on the foreign travellersthat garner attention; though, it is the less represented domestic segment that forms the majorcomponentofrevenue generated bytheIndiantravelindustry.

The domestic demand for hotels in India has historically been higher than the demandfromforeigners.Thoughalargeportionofdomesticdemandoriginatesfromcommercialactivity, anincreasing number ofIndians are taking annual holidays, bothwithinthe countryand overseas. Many States within India such as Kerala, Rajasthan, Goa have started focusingtheirefforts ontheIndiantraveller.

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

The World Travel and Tourism Council (WTTC) has predicted that India has the potentialto become the number one tourist destination in the world with the demand growing at 10.1per centperannumandwill receive25milliontouristsby theyear 2015.

Other than hotels, there are lots of standalonerestaurants which are alsocontributingtoeconomicactivityandtherearebrandedchainsofrestaurantswhichareclaimingprominenceacrossIndia.Similarly,standaloneSPA,medicaltourism,etc.,aredrivingthedemand andneedforexpansion ofhotelroomrequirements.

FactorsaffectingHotelIndustry

There are various factors which affect the growth of the Hotel industry, viz., economic,political,competition,substitutes, strengthofsuppliersandofcourseemployees.

EconomicFactors

Various key economic factors like interest rates, taxation changes, economic growth,inflationandexchangeratesaffecttheHotelindustryasmuchasanyotherbusiness.However, even global recession which has even though not affected India much had major impact inhotels as foreign tourist arrival dropped considerably. Hence, economic circumstances of notonlyIndia but global economic factors also affect the industry performance. This phenomenonhasbeenwitnessedeveninthepastlikeduringthe 1997Asianeconomiccrisis.

Politicalfactors

Political stability in the country is considered important for the growth of any industry inthe country. The political stability is even more necessary for the growth of Hotel industry. InthepastAfghanwar,Mumbaiterrorattacks,etc.,haveforcedforeigncountriestobringintravel adversarieswhichpoorlyaffected theHotelindustry.

Competition

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

Substitutes

Of late due, to ever raising room rates especially in five star Hotels category, lots ofsubstituteshave emergedtocater to travellers whospendconsiderableamounts onHotelstays. For instance, video conferencing has obviated the need for businessmen to travel longdistances,stayinhotelsandhaveface-to-facemeetings.Similarly,mostcorporateshavestarted using own guesthouses / shared service apartments resulting in reduction in the Hotelcapacity.

StrengthofSuppliers

Theexistenceofreliablesourcesthatcouldprovidetimelyhighqualitygoodsandservices at competitive rates, is a very important factor for growth of the Hotel industry. Theexistence of such sources is of even greater necessity for purchase of perishable goods thatneed to be procured on a daily basis. In the scenario where outsourcing of certain services (likeback of the housecleaning services, Kitchen Stewarding) is gaining wider acceptance for thepurpose of converting fixed overheads into variable overheads, the strength of suppliers intermsoftheirabilitytoprovideconsistentlytimelyservices,assumes greatsignificance.

Employees

Employees are always considered as the key asset in a service-oriented industry. Thequality and competence of employees, not only of those who interact directly with the guestsbut also of those who provide support services, are critical to the success of a hotel. Everincreasing employee cost also results in reduction in manpower. Hotels in India in the pasthadoperatedwith an average of 2, and are some cases, 3 employees per room as compared totheinternationalbenchmarkof1.5or lessemployees per room.