SYLLABUS

Class – B.Com. V Sem. (Hons.)

Subject – Auditing

UNIT – I	Introduction, Meaning & Objectives, Fraud Errors Basic Principles and Techniques. Classification of Audit.
UNIT – II	Audit programme: Audit programme, audit books, auditor's working books. Test checking routine checking.
UNIT – III	Auditing planning: internal control, internal check & internal audit. Vouching & Verification of assets and liabilities.
UNIT – IV	Company auditors: Qualifications and disqualifications, appointment, removal, remuneration, right duties & liabilities.
UNIT – V	Recent trends in auditing, basic consideration of audit in EDP environment.

UNIT-I
INTRODUCTION TO AUDITING

Meaning and Objectives Of Auditing - According to AAS-1 An audit is an independent examination of financial information, of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to, expressing an opinion thereon.
The person conducting audit is known as the auditor, he makes a report to the person appointing him after due examination of the accounting records and the accounting statement in the form of an opinion on the financial statements. The opinion that he is called upon to express is whether the financial statement reflects a true and fair view.
A complete and comprehensive definition : "Auditing is a critical examination of the books of accounts of an organization, which is conducted by an independent individual skillfully on the basis of vouchers and other information, with an object to reporting that the profit and loss account prepared for a certain period expresses the true and fair profit or loss of the organization and the balance sheet of the organization, prepared on a certain date, depicts a true and fair picture of the financial position of the organization on the particular day".

Advantages of an Audit:

(a) Safeguards the financial interest of persons who is not under management of the entity, i.e., partners or shareholders.
(b) Acts as a moral check on the employees from committing frauds and errors.
(c) Helpful in setting liability for taxes, negotiating loans and determining the purchase consideration for a business.
(d) Useful for setting trade disputes whether it is a matter of performance bonus or increment or it is claim for the damages due to fire or other accident.
(e) Discover the areas of wastages and losses occurring due to the absence or inadequacy of internal checks or internal control measures.
(f) Audit report generally state the fact that whether proper books of account and related records have been properly kept so as to make the deficiencies or inadequacies good in this respect.
(g) As an appraisal function, audit reviews the existence effectiveness and continuity of various controls in the organizations and reports weaknesses, inadequacies, etc., in them.
(h) Audited accounts are of great help in the settlement of accounts at the time of admission or dissolution or death or retirement of partner.

Distinction between book keeping and Auditing

Point of Difference	Book keeping	Auditing
1. Nature	It includes actual recording of transactions.	It is analytical in nature. It is relating to verification of accounting records.
2. Commencement	It starts when business transactions take place.	It starts when accounts writing is over.
3. Object	The object is to record all the facts of business.	The object is to opine about truthfulness and fairness of financial statement.
4. Qualifications	No formal qualifications are required for a book keeper.	An auditor must possess formal professional qualifications.
5. Reporting	A Bookkeeper is not required to submit a report unless specially called for.	An auditor has to submit a report to the concerned authority in routine.
6. Status	A Book keeper is an employee of an organization.	An auditor is not an employee of an organization.
7.Scope	Recording of all the facts of business are necessary for the purpose.	How much transaction should be verified is a matter decided by the legislation and pronouncement of the institute.

Distinction between Accounting and Auditing:

Point of Difference	Accounting	Auditing
1. Meaning	It includes recording of all the day to day transactions in the books of accounts leading to preparation of financial statements to get meaningful information.	It is critical examination of the transactions recorded in the books of accounts.
2. Nature	It is concerned with finalization of final accounts.	It is concerned with verification of true and fair view of financial statement.
3. Objects	The object is to ascertain the operational results.	The object is to opine about truthfulness and fairness of financial statements.
4. Commencement	Accounting begins when book keeping ends.	Auditing begins when accounting ends.
5. Scope	It involves maintenance of books of accounts. It does not go beyond books of accounts.	It depends upon the agreement or upon the provisions of law and may go beyond books of accounts.
6. Qualifications	An accountant needs no formal qualifications.	An auditor needs prescribed qualifications.
7. Reporting	An accountant does not submit any report.	An auditor has to submit report in the prescribed form.
8. Status	An accountant is an employee of an organization.	An auditor is not an employee of an organization.
9. Errors and Frauds	Accountant may commit errors and frauds.	Auditor cannot afford to commit errors and frauds.

The objectives of audit:

1. Examination of the Truth and Fairness of Final Accounts
2. Discovery of Errors
3. Detection of Fraud
4. Prevention of Frauds and Errors
5. Advice to Management
6. Ascertaining true Financial Position of Business
7. Objectives determined by International Auditing Practices Committee

Basic Principles Governing an Audit

1. Integrity, objectivity and independence
2. Confidentiality
3. Skill and Competence
4. Work Performed by Others
5. Documentation
6. Planning
7. Audit Evidence
8. Accounting System and Internal Control
9. Audit Conclusions and Reporting

Types of Audit

(1) On the basis of need of audit
    a. External Need   b. Internal Need
(2) On the basis of period of audit
    (a) Continuous Audit   (b) Interim Audit   (c) Final/Annual Audit

1. **On the basis of Need**

a. The auditor appointed to satisfy the internal or managerial needs of the organization is known as INTERNAL AUDITOR. According to AAS-7 The internal audit function constitutes a separate component of internal control established with the objective of determining whether other internal controls are well designed and properly operated.

b. The auditor appointed to satisfy the External Needs of the organization is known as EXTERNAL AUDITOR.

c. If external need is a statutory need the same external auditor is known as STATUTORY AUDITOR. For example :

2. **On the basis of Period of Audit**

A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends at regular or irregular intervals during the period.

The following features of continuous audit come to light on analysis of the above definition.

(a) It is carried throughout the year.
(b) It is conducted at regular or irregular intervals depending on auditors professional judgment.
(c) The accounts are taken for scrutiny as and when prepared.
(d) Final accounts i.e. trial balance, profit and loss account and balance sheet are audited at the end of the year.

Advantages of Continuous Audit

(i) Exhaustive and intensive.
(ii) Greater possibility of exposure of errors and frauds.
(iii) Early detection of errors & Frauds.
(iv) Moral impact on employees.
(v) Quick preparation of final accounts.
(vi) Early planning for future.
(vii) Proper advice of auditor
(viii) Early rectifications of errors.
(ix) Facility for interim accounts.

Disadvantages of Continuous Audit

(i) Possibility of change in audited accounts.
(ii) Snags in routine work.
(iii) Adverse moral impact
(iv) More expensive
(v) Dislocation of sequence of work.
(vi) Mechanization of work
(vii) Sloth in work.

Annual Audit : Annual audit is one which is carried out only at the end of an accounting period, spicer and pegler have defined it as an audit which is not commenced until after end of the financial period and is then carried on until completed. Annual audit is also called periodical, final or completed audit.

Characteristics: The main Characteristics of annual audit are as follows :

(a) It is done at the close of the financial year books of account have been closed and final accounts drawn by the management of the entity.
(b) The audit work is completed at a stretch i.e. in a single continuous session.
(c) Generally this type of audit suitable to small organizations.

Interim Audit : An audit conducted between two annual audits is called interim audit. More commonly it is known in case of banks as half yearly review. Interim audit helps management to take timely and appropriate decisions for example declaration of interim dividend or valuation of shares to decide swap ratio in case of a merger. Interim audit is gaining statutory status now a days various regulating authorities like SEBI and RBI requires periodic audited financial statements in between the two annual audited financial statements. However, it is generally carried out by professionally qualified auditors.

Particulars	**Interim audit**	**Concurrent audit**
Meaning	An audit that is taken up between two annual audits is called an interim audit.	Refers to verification of transactions of on a continuous basis at various points of time during the same year.
Time period	A specific date, as per the client or regulatory authority's requirement is taken into account, e.g. 30 Sept., 31 Dec.	The period of verification is professional judgement of the auditor and sometimes determined by the auditee e.g. concurrent audits in public sector banks.
Financial statements	Financial statements are prepared and authenticated for the interim audit period.	Financial statements are not prepared for the period of concurrent audit.
Asset verification	Assets and liabilities are required to be verified for interim balance sheet purposes.	Assets and liabilities are generally verified only at year end.

Point of Difference	**Internal audit**	**Statutory Audit/external audit**
l. Appointment	Internal auditor is appointed by the management.	External auditor is appointed by the shareholders or the Government and also by management if prescribed in statute.
2. Independence	As appointed by and working for management cannot be said as independent.	Is fundamental personal characteristic required to discharge the duty.
3. Qualification	There are no prescribed qualification as such for internal audit.	The auditor must possess qualifications as prescribed by the law. For example CA in companies act and income tax act.
4. Responsibility	He is responsible to the management.	He is responsible to the shareholders or the Government.
5. Period	It may cover any period.	It covers normally one accounting period.
6.Object	To improve the existing system of operation.	To comment upon reliability of the financial statements.
7. Rights scope	It is determined by the management	It is determined by the law, terms of engagement and pronouncement of institute.

8. Test Check	He usually not relies on test check.	He can rely on test check.
9. Internal check	He usually not depends on internal check rather he targets to verify the same.	He can depend on internal check if it is satisfactory.
10. Termination	It is as per the agreement	It is as per the law.
11. Remuneration	It is fixed up by the management.	It is fixed up by the shareholders or the Government as per statute.

Efficiency Audit

The efficiency audit examines all the aspects of the business activities and their propriety. It is to be found out as to what modification or changes are required to enhance the overall efficiency. In this type of audit, the auditor not only examines the accounts and other activities of business but also tenders valuable advice so that the plans of the business may be implemented more effectively and economically with the object to achieving more success. Its objective is not to discover and detect errors and frauds but to find out ways and means to motivate each and every employee to work with sincerity, honesty and trust.

Propriety Audit : The auditor must look into whether the management has acted wisely or not. The auditor must see whether the decisions were taken in good faith or not. It is quite possible that some factors like nepotism, recommendations, bribe etc., might have overwhelmed the management and in spite of prudence, the management might have tilted to some degree by such extraneous considerations. The auditor must examine the decisions in the light of expenditure involved in implementing them. If the decisions, notwithstanding wisdom and faithfulness, have involved extravaganza, they cannot be justified.

Performance Audit : Performance audit implies the performance of the business or any component of it in the light of pre determined targets and cost involved. The present business structure is so complex that no single man can perform all the activities. Naturally, the management has to depend on his assistants and different jobs have to be entrusted to them. As a corollary, they are endowed with certain powers and their responsibilities are to be fixed. In the circumstance, it becomes necessary to examine and appraise as to what extent the individuals have discharged their duties.

Limitations of Audit

1. Auditing does not guarantee 100% correctness.
2. All frauds are not necessarily disclosed by audit.
3. The auditor expresses only his opinion.
4. Auditing is not a credential of the perfect honesty of employees.
5. Auditing does not certify the commercial prudence of transactions.
6. Auditing does not pay attentions to trivial.
7. Auditing is not supported by practical independence.

UNIT-II
The Audit Process

The steps in audit process are:

1. Appointment of auditor
2. Determination of Objective and Scope of audit
3. Obtaining Knowledge of Clients business
4. Evaluating accounting system, Internal control and Audit risk.
5. Audit Planning and programming, Determining the nature timing and extent of audit procedure and co-ordination of work.
6. Collection of audit evidence
7. Drawing conclusions and making report.

Preparation of Audit Programme

Audit programme is a description, memorandum or outline of the work to be done in an audit and often of the time allotted and personnel assignments, prepared by a Principal as a definition of audit scope, or by an auditor for the guidance and control of assistants. It is the auditors plan of action, specifying the procedures to be followed.

Objects of audit programme :

a. To obtain informations regarding the accounting system, policies and control techniques of the client.
b. To ascertain the extent to which internal control techniques can be banked upon.
c. To lay down the nature, time and extent of audit techniques to be adopted.
d. To co-ordinate the total works.

Characteristics of good audit programme

i. Explicit and clarity of expression.
ii. Segmentation of work in the light of different aspects of accounting.
iii. Logical flow of accounting documents
iv. Elasticity
v. Review of work
vi. According to scope of audit
vii. Based on evidences
viii. Record of movements and accomplishments.

Advantages of audit programme :	Disadvantages
i. Division of work as per ability	i. Mechanization of work
ii. Determination of responsibilities	ii. No motivation for free decision
iii. Progress of work	iii. Want of constructive thinking
iv. Change of employees won't affect work	iv. Want of moral influence
v. Uniformity in work	v. Planned frauds are undisclosed
vi. Protection in court of law	vi. Disabilities remain concealed
vii. Complete examination	vii. Plea against auditor
viii. Time saver	
ix Facility of review	
x. Pursuance of audit principles	

Audit Files

The maintenance of files is very important for the office of the auditor so as to enable him to keep them for easy and ready reference.

There are two types of audit files : (i) permanent audit file, and (ii) Current audit file.

The contents of permanent audit file are:

1. The rules which govern the company under audit such as Memorandum and Articles of Association in case of a company and partnership deed in case of a partnership firm.
2. Copies of minutes and extracts of agreements which are entered into between the client and others for rendering/obtaining services.
3. A brief description of the business, its nature, address, area of operation, etc.
4. Particulars about the organization of the business along with a list of officials, branches and departments under their charge.
5. Copy of instructions, if any, issued to the staff and of relevance to the auditor.
6. List of books and registers and names of persons dealing with them.
7. Important notes regarding the final accounts including the balance sheet and other financial statements.

The contents of current audit file are;

1. Audit programme duly amended and modified in accordance with the system of internal control in use.
2. Internal control questionnaires.
3. Flow chart covering the time budget.
4. All relevant notes properly filed and indexed.
5. Bank and petty cash reconciliations.
6. Brief notes for discussion with the client before completion of the work of audit.
7. Weaknesses inherent in the system of internal control.
8. The draft final accounts and balance sheet and their completed copies.

Advantages:

(a) Preparation of audit plan.
(b) Useful file for the use of auditor in forming an opinion.
(c) Provides materials in the field work in audit engagement.
(d) Provides information to suggest improvement in business operations and system of accounting.
(e) Maximizes efficiency in auditing procedures.

Audit working papers

Audit working papers are personal written materials which an Auditor prepares with regard to all audits and contains techniques adopted by the auditors, his decisions and conclusions and relevant information regarding financial statements.

Some papers included in Audit Working Papers;-

1. The agreement regarding the appointment if the auditor or letter of appointment
2. Technical Features of the audited business.
3. Audit Programme
4. Certificates of officials in regard to such important matters as bad debts, valuation of stock, unpaid expenses, accrued income etc
5. Certificate issued by the banks in regard to the bank balance of the client certain date, safe custody of documents etc.
6. Correspondence between the auditor and the debtors, creditors, etc. the client.
7. Rough trial balance.
8. Important extracts from the minute books
9. Particulars of investment.
10. Draft final accounts.

11. A copy of the auditors book.

Objects of keeping Audit-Working Papers;-

1. Certification of the correctness of record and report
2. Use as references, during discussion with the employer.
3. Defensive position of the auditor in case of legal dispute and court proceedings.
4. Guide for Subsequent examinations.
5. To co-ordinate and organize the work of audit clerks.

Ownership of Audit-Working Papers :-

These are the property of the auditor, whether prepared by him or presented to him by the owner of the business and therefore must be kept in safe custody.

Filing of Audit-Working Papers is a necessity. The auditor keeps these papers for his defense, reference, future guidance and as a proof of his. According to section 209 of the Indian Companies Act 1956, the books of accounts of a company must be kept safe up to 8 years after the relevant year.

Audit Note Book;-

An important component of Audit-Working papers is audit note- book basically maintained by the audit clerk in which he notes down the important points and enquires which he has to refer to officials clients or to discuss with his senior or the auditor himself.

Contents of audit note book:

1. Technical details about the business.
2. Queries for which explanations and information have to be demanded.
3. Missing vouchers and invoices whose duplicates have to be obtained.
4. Fraud and errors found in the books during the course of audit.
5. Details to be included in audit report.
6. Notes regarding system of maintaining accounts.
7. Information to be needed in future.
8. Names of officials who certify bad debts, depreciation, etc.
9. Record of all important correspondence.
10. Total of important ledger accounts.
11. Progress of audit work.
12. Record of suggestions made by the audit staff.

Advantages:-

1. Defense in court of law.
2. Yard-stick of the efficiency and diligence and skill of the auditor,
3. Guide for future.
4. Future references,
5. Permanent certificate of audit.

UNIT-III
VOUCHING

Vouching is the examination of transactions of a business together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in books.

Objects of Vouching

1. Authentication of accuracy and truth of book keeping entries.
2. Satisfaction of entries of business transactions.
3. Knowing the transactions unrelated with business.
4. Authentication of transactions.
5. Essence of auditing.

The auditor must take care of following while vouching.

1. Proper filing of vouchers in serial order.
2. Adoption of test check methodology for examining vouchers.
3. Comparison of evidences with accounting entries.
4. Voucher must be in name of the person or business whose account is audited.
5. It must be related with business transactions.
6. Voucher should relate to period under audit.
7. It must be in printed form.
8. The amount and calculations in voucher must be checked.
9. Voucher must be signed, authenticated and duly stamped.

Vouching of Cash Book

Cash Receipts :

(i) Internal check should be examined.
(ii) Issue of receipts and use of receipt books should be checked.
(iii) System of depositing the receipts into bank should be checked.
(iv) Auditor must obtain the list of all memorandum books like cash diary, Kuchi Rokar Bahi, Pucci Rokar Bahi, etc.
(v) Vouchers must be serially numbered and the name, amount date in vouchers must tally with the accounting records.
(vi) Accounting records unsupported by vouchers must be probed.
(vii) Soiled, unissued or cancelled receipts should not be torn but checked along with counterfoils.

Important points while vouching Cash Payments.

1. Actuality of payment.
2. Payment relates to audit year.
3. Payment for business
4. Payment to right person
5. Right amount to be paid.
6. Payment must be due with regard to date.
7. Authorization of payment.
8. No payment for ultravires acts
9. Legitimacy of payment
10. Correct accounting.

Vouching Sales Book

1. On the basis of copies of sales invoices.

2. Help from other books like orders received book, goods outward book, correspondence, etc.
3. Intensive examination of goods sold of the end of the year and beginning of new year.
4. Recording of only actual sales.
5. Help from statements of accounts of debtors.
6. Audit of totals and postings of sales book.

Vouching of Sales Returns Book

1. Vouching the records on the basis of copies of credit notes.
2. Checking of goods inward book and correspondence.
3. Examination of the records at the commencement of the next year.
4. Totals and ledger posting of sales returns to be carefully examined.

Vouching Purchases

1. Examination of purchase book on the basis of invoices.
2. Record of lost vouchers.
3. Help from goods inward book, challan form and packing notes.
4. Checking of totals & postings on the basis of invoices goods inward books, purchase order, challan form, goods receipt notes.

Vouching of Purchases Returns Book

1. Checking entries of purchases returns book on the basis of credit notes.
2. Tallying with goods outward book.
3. Checking the totals and postings in ledger.

Vouching of Journal

1. Opening entries shall be vouched with the balance sheet of previous year.
2. Closing entries to be vouched by checking the ledger postings.
3. Rectification entries must be checked thoroughly and must be countersigned.
4. Adjustment entries relating to outstanding and prepaid expenses, unearned income and accrued income must be vouched on the basis of relevant documents.
5. Transfer entries must be backed by proper authority.
6. Bad debts must be vouched on the basis of authorization and relevant correspondence with the debtors.
7. Consignment transactions must be checked by the account sale received from the agent.

Vouching Ledger Postings

1. Methodology of vouching, i.e., checking the ledger postings on the basis of entries in books of original entries.
2. Persons vouching the accounts.
3. Recording the errors.
4. Vouching the balances of accounts
5. Test checking of ledger postings.
6. Vouching of different ledgers – purchase ledger, sales ledger, etc.

Vouching of various receipts

1. Cash Sales & Credit Sales : Voucher, date, serial no., account head, sales invoices, charging of sales tax and excise duty, copy of delivery order, sales order, rates, quantity and authorization by sales/ marketing manager.
2. Receipt from debtor : Cash/Bank receipt voucher, date, serial no., account head, copy of invoice, sales order, rates quantity party ledger, bank statement, sales register.

3. Other Income (Interest dividend, etc) : Bank receipt voucher, date, serial no., account head copy of dividend warrant, interest warrant. TDS certificate, rates paid up value, investment register, bank book, bank statement.
4. Loan received : Receipt voucher, date, serial no., account head, (secured/unsecured) loan agreement, hypothecation or pledge deed, rates of interest, principal amount, resolution of board of directors, bank statement, ledger.
5. Rent Received : Cash/Bank receipt voucher, date, serial no., account head, rent agreement, rent receipt, TDS certificate, prepaid or outstanding rent, bank statement, ledger.
6. Sale of Investment : Voucher, account head, broker's note, copy of demat account, rate, quantity, bank statement, investment ledger.
7. Bills Receivable Discounted : Voucher date, account head, discounting charges, copy of B/R, bank advice, noting charges, bank statement/book, BR register.
8. Sale of Fixed Assets : Receipts voucher, sale agreement, sale value and wdv, authorization by BOD, fixed assets register, bank statement.
9. Royalty Received : Receipt voucher, account head, copy of agreement, TDS certificate, rates and quantity explored, produced or sold, royalty register, ban statement.
10. Insurance Claim : Receipt voucher, account head, copy of intimation of claim copy of sanction, loss assessors report, verify the amount of claim, insurance claim register, bank statement.
11. Recovery of Bad Debts : Voucher, account head, debtors control account, commission to factor, bank book, statement or list of bad debts written off in previous years.
12. Miscellaneous receipts (subscriptions amount received from, agents etc) : Voucher, counter fails of receipts, bank pass book, membership register, statements of agents, etc.

Vouching of Payments :

1. **Purchase of Goods** : Payment voucher, purchase order, builty, material received note, inspection report, bank statement, rates, quantity and terms of purchases, stores ledger, goods inward register, authorization, cash purchase register.
2. **Payment to Creditors** : Receipt by customer, statement of account, invoice copy, discount and allowances, and other deeds.
3. **Salaries & Wages** : Payment voucher, attendance register, salary sheet, wage roll, time keeping record, bank statement, PF, ESIC, overtime sheets, cash book or bank book, ledger,
4. **Payment for Acquisition of Assets** : Payment voucher, account head, sale/purchase agreement, title deed, bank statement, transfer deed, valuer certificate, stamp duty, broker's statement, auctioneer's note, fixed asset register, cash/bank book, authorization by BOD, Articles of association, etc.
5. **Payment of Taxes (Income Tax, Sales Tax)** : Computation of tax, copy of challan of advance tax, TDS certificates, challan of self assessment tax, return, etc.
6. **Travelling Expenses** : Voucher tour program, schedule, TADA rules, expense voucher, receipts,etc.
7. **Preliminary Expenses** : Memorandum & Articles of association, registry, Cheque no., bills & receipts, rate of stamps, vouchers, etc.

Verification of Assets & Liabilities

Verification is the process of substantiation involved in proving that a statement account or item is accurate and stated properly. It is an enquiry into the value, ownership & title, existence and possession, and presence of any charge on the assets as stated in the balance sheet.

Objects of Verification

1. Picture of true position.
2. Correct valuation.
3. Not exceeding the actual.
4. Not less than actual.

5. Existence and possession.
6. Ownership and title.
7. Without fraud or irregularity.
8. Arithmetical correctness.
9. Correct presentation in the balance sheet.

Position of Auditor as regards valuation of assets

An auditor is not a valuer or a technical expert. So he has to rely upon the valuation made by directors, partners, technical experts, surveyors, etc. However he must ensure that the valuation is fair and reasonable and based upon some accepted principles.

Verification of fixed assets

(i) Goodwill
- (a) Existence : Whether purchased or acquired. Self generated goodwill is not said to be in existence.
- (b) Records : Check the fixed asset register.
- (c) Right of Ownership : Check purchase agreement, purchase consideration and MOU between the parties.
- (d) Valuation and proper amortization as per AS-14, i.e. 5 years.
- (e) Proper presentation and disclosure.

(ii) Freehold Property :Which is in the name and title of owner.
- (a) Ownership:Check the sale deed.
- (b) Mortgage: Check the mortgage deed.
- (c) Change in asset due to sale, purchase or construction work should be enquired and duly recorded.
- (d) Revenue expenses regarding repairs and maintenance should be written off in P & L Account.
- (e) The auditor must enquire into the existence, valuation and presentation in balance sheet.

(iii) Leasehold Property : It has two owners and both have qualified rights over it. The following points to be considered :
- (a) Ownership : Lease deed should be examined.
- (b) Mortgage : Relevant deed should be perused.
- (c) Revenue expenses : To be charged to P & L.
- (d) Existence, valuation and presentation B/S to be checked.

(iv) Plant & Machinery
- (a) Existence : Physical verification to be conducted, additions and deductions to be checked.
- (b) Records : Check the fixed asset register.
- (c) Ownership : Invoice receipt and purchase order to be checked.
- (d) Revenue and capital expenditure should be properly accounted for.
- (e) Proper presentation and disclosure under the schedule of fixed assets.

(v) Furniture, fixture and fittings

The auditor has to verify the existence, records, changes ,ownership, valuation, presentation and disclosure in the balance sheet, along with depreciation.

(vi) Motor Vehicles

The auditor has to verify the existence, fixed asset register, log books, invoices, registration book, incidental charges like insurance and road tax, depreciation, licences etc.

(vii) Copyrights, patents, trademarks, loose tools

Check the existence ownership, valuation, presentation in balance sheet, respective registers, write off etc.

(viii) Investments

Ownership: name of client, pledge or lien of investments, Classification: trade or non trade, long term, short term, stock in trade.

Physical verification: obtain relevant certificates, etc.

Changes: broker's purchase note or sale note should be checked.

Valuation and disclosure :Current investments should be valued at lower of cost or fair market value. Long term investments should be valued at historical cost of acquisition.

(ix)Inventory

Classification of inventory : Stores and spare parts, loose tools, raw materials, material in process, finished goods, waste or by products.

Existence and records in the stock register to be verified.

Right of ownership : Invoices, documentary evidence to be checked.

Valuation : According to AS-2, valuation is done on cost or NRV whichever is lower.Method is FIFO or weighted average and method is not changed, unless required.

Presentation and disclosure in Balance Sheet.

(x)Debtors, Loans and Advances

List of debtors to be obtained.

Correspondence with debtors.

Inquiry into discount and bad debts, provision for bad debts.

Securities.

Presentation and disclosure in Balance Sheet.

Classification of debtors according to age, security and reliability, bad and doubtful.

Loans and Advances.

Names & Amounts involved.

Terms and Conditions of loan.

Regularity of repayment.

Steps for recovery/repayment of overdues.

Verification of Liabilities

Steps for verification

1. Examination of records .
2. Direct confirmation procedure.
3. Examination of disclosure.
4. Analytical review procedure.
5. Obtaining Management Representations.

The nature, timing and extent of substantive procedures to be performed is a matter of professional judgement of the auditor which is based on the auditor's evaluation of the effectiveness of the related internal controls.

UNIT-IV

COMPANY AUDITOR

Qualification of a Company Auditor:

(1) Chartered Accountants - Sec. 226(1) :

- A person shall be qualified for appointment as an auditor of a company only if the is a Chartered Accountant holding a certificate of practice, within the meaning of the chartered accountant act, 1949.
- A Firm where of all partners practicing in India are qualified for appointment, as aforesaid, may be appointed by its firm name to be the auditors of a company. In case of appointment of firm, any partner so practicing may act in the name of the firm.

(2) Restricted State Auditors – Sec. 226 (2) :

Subject to rules make by Central Government u/s 226(2)(b), the holder of a certificate granted under the law in force entitling him to act as an auditor of companies in the whole or in any part of part B states, immediately before the commencement of the part states (Laws), 1951 is entitled to act as an auditor of companies registered anywhere in India.

Disqualified for being appointed as auditor of a Company

Disqualifications of Auditors: under section 226(3) of the Companies Act, 1956 the following persons are not qualified for appointment as auditor of a company:

	Nature of Disqualification	Purpose
(a)	A body corporate	It has limited liability.
(b)	An officer or employee of the Company	Officers and Employees of the Company are prohibited from acting as Auditors, in other to promote independence of the Company auditor. Such officers may not be allowed to uphold their views and express their opinion on the financial statements freely.
(c)	A partner or employee of an officer or employee of the company.	Financial and Personal relationship with officers and employees of the Company are prohibited, in order to promote independence of the Company Auditor.
(d)	A person who is indebted to the company for an amount exceeding Rs. 1,000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs. 1,000/-.	This prohibition intends to ensure that the auditor is not under any financial obligation to the Company. Financial freedom will promote the independence of the Company Auditor.
(e)	A person holding any security of the Company after a period of one year from the date of commencement of the Companies Amendment Act, 2000. (Note: Security means an instruments which carries voting rights)	This prohibit also ensures that the auditor is not under any financial or other obligation to the Company.

Further Disqualifications:

- Holding-Subsidiary – Sec. 226(4) : A person is not eligible for appointment as auditor of any company, if he is disqualified acting as auditor of any other body corporate, which is either (a) a Holding Company of (b) Subsidiary Company or (c) Co-subsidiary Company.
- Subsequent Disqualification – Sec. 226(5) : If an auditor, after his appointment, becomes subject to any of the above disqualifications, he shall be deemed to have automatically vacated his office.
- Other Disqualification: The person shall not be qualified for appointment if he is otherwise disqualified e.g. when a person ceases to be a member of the ICAI, in case of insolvency, in case of a person of unsound mind etc.

Appointment of Auditors by Shareholders.

* **Appointment:** Under Section 224 (1), every company shall, at each annual general meeting, appoint an auditor (s). Appointment in a general meeting of the company means appointment by the shareholders of the company.
* **Certificate from Auditor :** Before appointment or re-appointment at the AGM, the Company shall obtain from the auditor(s), a certificate to be effect that the appointment, if made, will be within the ceiling limits specified u/s 224(1B).
* **Tenure of Office:** The auditor shall hold appointment form the conclusion of one AGM till the conclusion of the next AGM.
* **Intimation :** The Company shall give intimation of appointment to the concerned auditor within seven of the appointment
* **Intimation to Previous Auditor :** The appointed auditor shall communicate to the previous auditor about the appointment and enquire whether there is any professional reason why the appointment should not be accepted. This forms part of the Chartered Account's Code of Conduct.
* **Acceptance :** The auditor, on receipt of the intimation from the company about his appointment, is required to send a written communication to the ROC in Furm-23 B within 30 days of the receipt of the intimation stating whether he has accepted or declined the appointment.

Appointment of First Auditors.

- **Appointment by Board:** Section 224 (5) specifies that the Board of Directors can appointment the first auditor of a Company..
- **Time of Appointment :** The appointment shall be made by the Directors within one months, from the date of incorporation of the Company.
- **Tenure of Office :** The First Auditor shall office till the conclusion of the first AGM.
- **Failure :** If the Board fails to appoint the first auditor within one months of registration, the company in general meeting is empowered to make the appointment.
- **Members' Power of Removal :** The Company may, at a general meeting, remove such an auditor or all or any of them and appoint another or others in his or their place, on a nomination being made by any member of the company, notice being given to the members of the company, not less than 14 days before the date of the meeting.
- **Provision in Articles:** An auditor cannot be appointed as first auditor simply because his name has been stated in the articles of association.

- **Intimation:** The Company need not send any intimation to the First Auditor, of their appointment.
- **Acceptance:** The first auditors are themselves not required to information the ROC about their acceptance or refusal of such an appointment.

Re-appointment of Auditors at the AGM

* **Continuity in Office:** The office of auditor in a company is a continuing one. The audit& shall, hold office from the conclusion of the AGM in which he is appointed till the conclusion of the next AGM.
* **Reappointment at AGM :** Companies are required to appoint at auditor or auditors in the AGM as a routine feature except in cases of (a) appointment of First Auditor, (b) appointment or filling of casual vacancies in the office of the auditor etc.
* **Resolution :** The retiring auditor cannot be deemed to be re-appointed automatically at the AGM. A specific resolution is required to re-appoint the auditors.
* **Passing of Resolution :** The formal resolution to re-appoint auditors should have been passed at the AGM. Mere absence of a resolution to the effect that the retiring auditors shall not be re-appointed is not sufficient.
* **When AGM is not held :** When AGM is not held, the auditor continues to hold office till such date the AGM is actually held. The Companies Act provides that the Auditor shall hold office till the conclusion of the next AGM.

Circumstances, the retiring auditor of a Company cannot be reappointed

Section 224(2) provides that a retiring auditor cannot be reappointed, subject to Section 224(1B) and 224A, in the following circumstances :

(a) If the retiring auditor is disqualified for re-appointment u/s 224(3).

(b) If the retiring auditor has given the company a notice in writing of his unwillingness to be reappointed

(c) If a resolution has been passed at that AGM appointing somebody instead of the retiring auditor or providing expressly that retiring auditor shall not be reappointed; or

(d) If notice has been given of an intended resolution to appoint some person (s) in the place of the retiring auditor, and by reason of the death, incapacity or disqualification of that person (s), the intended resolution cannot be proceeded with.

Also, the reappointment is subject to Section 224(1B) and 224B. These provisions are:

* **Section 224(16):** The appointment should be within the prescribed ceiling limit in respect Auditor or Audit firm.
* **Section 224 (A) :** Special Resolution is required to be passed at the AGM in case of a comply in which not less than 25% of the subscribed share capital is held, either singly or in aggregate bodies and institutions..

Causal vacancy:

1. **Meaning :** 'Casual Vacancy" has not been defined in the Companies Act. It stands for a vacancy credited by the auditor ceasing to act he was valid appointed and the appointment was accepted. This may arise due to a variety of reasons like resignation, disqualification, dissolution of the firm etc.

2. **Filling** up of Casual Vacancy :

Casual Vacancy caused by	**Appointing Authority**
Reasons other resignation of existing Auditor	Board of Directors- Board Resolution
Resignation of Existing Auditor	Company is a General Meeting - Appropriate Resolution subject to Section 224 A.

3. **Period** of **Holding,** Office : The Auditor shall hold office from the date of his appointment till the conclusion of the next AGM.
4. **Does** Refusal to accept constitute **Casual Vacancy ?** When the auditor appointed to fill up a casual vacancy, refuses to accept, the appointment is not fully complete. It shall be deemed that the casual vacancy continues and has not been filled up.

Appointment of auditor by the Central Government in case the auditor is not appointment in the AGM. Nov. 97.

- Section 224(3) of the Act provides that where at the AGM, no auditors are appointed or e-appointed, the Central Government may appoint a person to fill the vacancy.
- Under Section 224(1), the Company shall give notice of the fact within seven days to the Central Government, of its power becoming exercisable.
- If the Company fails to give such notice, the Company and every officer of the Company who is in default shall be punishable with fine, which may extend to Rs. 5,000.
- Where a Company is required to appoint an auditor at an AGM by passing a special resolution; hut omits' or fails to pass such resolution due to any reason, it shall be deemed that no auditor has been appointed by the company at its AGM, and thereupon the provisions of Sec. 224(3) of the Act will be attracted.

Auditor of a Company to be appointed by a special resolution:

Section 224A of the Act states that special resolution is required for appointing or reappointed at each AGM, the auditor in the case of a company in which not less than 25% of the subscribed share capital is held, whether singly or in any combination by:

(a) A public Financial Institution or a Government Company or the Central Government of any State Government.
(b) Any financial or other institution established by a Provincial or State Act in which a State Government hold spot, less than 51% of the subscribed share capital.
(c) A Nationalized Bank or an Insurance Company carrying on general insurance business.

Where a company referred to above does not appoint an auditor by a special resolution in its AGM, the Central Government shall have the power to appoint a person to fill the vacancy under section 224(3).

For determining 2S% holding, the material date shall be the date of the AGM in which the special resolution is required to be passed. In cases where the holding is less than 25% on the date of notice but exceeds 25% as on the date of AGM, it is advisable for the company to adjourn the meeting, issue another notice to the members for appointment of auditors by special resolution and pass the special resolution at the adjourned meeting.

Appointment of Auditors of Government Company

1. Government Company - Section 617:

A Government company means any company in which not less than 51% of the paid-up share capital is held

(a) By the Central Government or

(b) By any State Government or Government of

(c) Partly by the Central Government and partly by one of more State Governments.

It includes a company, which is a subsidiary of a Government company as thus defined.

2. Appointment - Section 619

The auditor of a Government Company shall be appointed or re-appointed by the Comptroller and Auditor General Of India. r [Earlier, the appointment were made by the Central Government on the Advice of the Comptroller and Auditor General?

3. Section 6198 Companies

The aforesaid provisions also apply to the companies specified u/s 6I9B of the Act, even though they are not government companies. The Companies specified u/s 619 are "any company in which not less than 51% of the paid-up share capital is held by one or more of the following or any combination thereof :"

(a) The Central Government and one of more Government Companies ;

(b) Any State Government or Government and one or more Government Companies

(c) The Central Government, one of the State Government and one Of more Government Companies.

(d) The Central Government, one of more Corporations owned Of Controlled by the Central Governments;

(e) The Central Government, one or more State Government and one or more Corporation owned or controlled by the Government;

(f) One or Corporation owned or controlled by the Central Government or the State Government;

Ceiling on Number of Company Audits. [RTP]

1. Restriction on Appointment - Sec. 224(1B) : No company or its Board of Director shall appoint or reappointment any person or firm as its auditors ii

* Such person is in full time employment elsewhere or
* Such person or firm holds the office of auditor of the specified number of companies or more than the specified number of companies.

In the case of a firm of auditors, 'specified number of companies' means the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

2. Ceiling Limit : The ceiling limit is 20 company Audits per person. Of this 20, not more than 10 shall be in respect of Companies having paid up Capital of Rs.25 lakhs or more .

* In the case of individual Chartered Accounted or Proprietary Firm, the ceiling limit shall be 20 company Audits. In case of Partnership Firm, the ceiling limit shall be 20 Company Audits per partner who is not in full-time employment elsewhere. In case of a firm having 5 partners the overall ceiling will be 5 x 20 = 100 company audits of which not more than 50 should be in companies having paid up capital of Rs.25 lakhs or more.
* Where a Chartered Accountant is a partner in a number of firm all the limits in which

he is partners or proprietor will be together entitled to 20 company audits on his account.

* Where the partners of a firm also holds office in his individual capacity the total number of company audits shall not exceed 20 in his individual capacity and all firm taken together.

3. Computations of Ceiling limit

Included Audits	Excluded Audits
Part Audit: When an auditor is appointed to audit branch of company even a part of a company's accounts, the part will be of the ceiling. Considered as a unit of audit for the purpose of calculation of the ceiling. **Joint Audit:** When two or more auditors are appointed shall not be as Auditors, each of the joint auditors is considered a part auditor for the purpose. Hence, any joint audit held by auditor will be included as one audit unit. **Section 25 Companies:** Non-profit companies would be included for the purpose of ceiling.	* **Branch Audit :** Audit of a is not included in the computation * **Audit of Corporation,** which are not companies shall not be included for ceiling purpose. * **Audit of Foreign Companies** shall not be included. * **Guarantee Companies:** Guarantee and not having share capital will not be included in the ceiling. * **Private Companies:** Audit of Private Limited Companies will not be included for ceiling u/s 224 (18). * **Special Audit** u/s 233A or Investigation of Companies will not be included for ceiling purposes.

4. ICAI Notification: ICAI has issued a notification which specified restricts the number of audits to be handled by a member to 30, **including audit of private companies.** This restriction in intended to uphold the principles of fairness and to provide equitable opportunities to all practicating members.

Note: Readers may note that this provision is an additional restriction and does not override the law.

Remuneration to Audito:

* **What are the provisions of the Companies Act, 1956 with regard to the remuneration of an auditor? Nov 95.**
* **How should the auditor's remuneration be disclosed in the company's p & L A/c ? Nov 95.**

Fixing of Remuneration - Section 224 (8): The Company Auditor's remunerations is fixed:

(a) By the Directors when auditors are appointed before the first AGM or to fill a casual vacancy (other than one caused by the resignation of the auditor).
(b) By the Central Government when the appointment is made by it; and
(c) By the Company in general meeting or in such manner as the Company in general meeting may determine Including those cases wherein the auditor is appointment by the CMG of India u/s 619 of the Act.

For this purpose, the expression "remuneration" shall include any sums paid by the company in respect of auditor's expenses. **Disclosure Requirements:** As per Schedule VI, Para II, Clause (48), the Profit and Loss Account must disclose the remuneration paid to the auditors in the following manner.

(a) As Auditor
(b) As advisor, or in any other capacity, in respect of :
i. Taxation matters
ii. Company law matters
iii. Management services.
(c) In any other manner.

How may the Company auditor be removed (a) On the expiry of his term, (b) Before the expiry or rim term of office? Nov 90

* **X Ltd wants to remove their auditors AB & Co. Explain in brief the procedure to be followed by the company in the following case: (a) Removal on the expiry of their term of office (b) Removal before the expiry of their term of office, Nov. 93.**
* **Can a property appointed auditor be removed before the expiry of his term? If yes, explain the procedure for the same. May 88, Nov 94.**
* **XYZ & Co. Ltd. wants to remove their existing auditors before the expiry of their term. Give your views. Nov. 98.**

REMOVAL ON THE EXPIRY OF TERMS OF OFFICE: Section 225 lays down the procedure for removal of the auditor on the expiry of his term of office, as under

(a) Special Notice: Special Notice is required for a resolution at an AGM for (a) Appointment as auditor a person other than the retiring auditor or for (b) providing expressly that the retiring auditor shall not be reappointed.
(b) Time of Notice - The concerned member shall give the. Company, a special notice about his intention to move resolution to this effect at the ensuing AGM at least 14 days before such meeting.
(c) Circulation of Notice: On receipt of such a notice, the company shall forthwith send a copy thereof to the retiring auditor as well as to the members of the company. Special notice is to be sent to all members of the company at lent 7 days before the date of the AGM in terms of Section 190 (2).
(d) Retiring Auditor's Rights : The retiring has the rights of (a) making are presentation of reasonable length to the company and (b) requesting that such representation be circulated among the members. He can also require that the representations be read out at the AGM. He has the right to be heard orally at We AGM.
(e) Company's Duties: Where the retiring auditor makes a representation in writing to the

members of the company, the company and shall, unless the representation is received by it too for it to do so.
* State the fact of the representations being made in any notice of the resolution given to the members of the company.
* Send a copy of the representation to every Member of the company to whom the notice of the meeting is sent.

(f) Situations when representations need not be circulated : In the following situations, the representation S need not be circulated to members :
   I. When the representations are received too late by the company.
   II. If the Company Law Board is satisfied, that he right of representative is being misused by the auditor to secure needless publicity for defamatory matter, on the application made by the Company or any other aggrieved person.

(g) Procedure at AGM: If a copy of the representation is not sent as the same was received too late or because Of the company's default, the auditor may required that the representation shall be read out at the meeting. He also has the right to be heard orally at AGM. At the AGM, if a special resolution is required in terms of Section 224 A, the same should be duly passed.

(h) Certification from Appointment Auditor: Before any appointment or re-appointment of auditors is made at an annual general meeting, a written certification is to be obtained the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 224(1B).

REMOVAL BEFORE EXPIRTY OF TERM OF OFFICE:

Particulars	Removal of First Auditors	Removal of Existing Auditor other than the First Auditor
Provision	Section 224(5) proviso.	Section 224(7)
Authority empowered to remove	Company in a General Meeting	Company In A General Meeting.
Approval of Central Govt.	Previous approval of central government is not required.	Previous approval of Central Government is required.
Procedure	* Obtain nomination of new auditor by any member of the company. * Send a special notice of at least 14 days to all members and the existing auditor, intimating the proposed changes. * If the member's nomination for a new auditor is accepted a resolution to this effect should be passed.	* Obtain previous approval of Central Government. * Send intimation of the proposal for change in auditor to members and the existing auditor. * Comply with the procedure outline in section 225(3). 225(3) outline above * Pass the appropriate resolution at the General meeting for appointment of new auditors.

The company many remove the auditors before the expiry of their term after following procedure-

You have been appointment the sole auditor of a company where you were one of the

joint auditors for the immediately preceding year and the said joint auditor is **not re-appointed. State the various steps you would take for ascertaining the compliance of the requirement of the Companies Act before accepting the audit Nov.95.**

When one of the joint auditors of the previous year is appointed at the sole Auditor for the next year, it is similar to non reappointment of one of the retiring joint auditors. The provisions of Section 225 of the Act, relating to non re-appointment of the erstwhile colleague are attracted. The following steps should be taken:

ASPECT	AUDITOR'S DUTIES
special notice	Ensure that u/s 225 (1) was duly received by the company from a membered least 14 days before the AGM date. This notice should contain an express intention of the member for proposing the resolution for appointment a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.
Circulation of Notice	Verify whether the said notice has been sent to all the member at least 7 day before the date of the AGM as per Sec. 190(2). See whether the said was also sent to the retiring auditor as per Sec.225 (2).
Circulation of Representation	See whether the representation, if any, received from the retiring auditor was sent to the members of the company as per sec. 225(3).
Conduct of Resolution at AGM	* Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM. * See that the proposed resolution as per special notice was properly passed. * Ensure that the provisions of the Section 224(2) are fully complied with. * In case special resolution is required u/s 224 A. see whether the resolution passed for the appointment of the auditor is a special resolution.
Company's Communication to Auditor	Obtain a certificate copy of the relevant minutes of AGM and also a written communication of the appointment as a sole auditor from the company within 7 days of appointment.

Before accepting your appointment as auditor of **a limited company, what steps wills you take to ensure that your appointment is valid?**

To ensure that the appointment is valid, the incoming auditor should take the following steps before accepting his appointment.

- **(a)** **Ceiling Limit:** Ensure that a certificate has been issued u/s 224 so that total number of companies audits held by him will not exceed the specified number with the new appointment.
- **(b)** **Resolution at AGM:** Inspect General Meeting minutes Book to see that the appointment is duly recorded.
- **(c)** **Compliance with** law: Satisfy that the legal procedure contemplated in Section 224 and 225 of the Act dealing with removal of existing auditor, if required, has been followed. Also see whether See. 224 A (special resolution) and Sec. 619B (C & AG Appointment) are attracted and complied with, if required.
- **(d)** **Code of Conduct :** Communicate with the previous auditor, if any, to ascertain any profession reasons for not accepting the appointment.

Powers of an auditor of a company:

The powers of auditors of a Company are described below

1. Right of Access to books and vouchers:

* The Company Auditor shall have a **right of access** at all times to the books and accounts and vouchers of the company whether kept at the head office of the company or elsewhere.
* **Books and Accounts** includes all books, which have any bearing or are likely to have any bearing on the accounts whether these are the usual financial books or the statutory or statistical books, memoranda books etc.
* **Voucher** will include any correspondence, which may in any way serve to vouch for the accuracy of the accounts.
* The right of access **"at all times"** implies that an auditor can inspect the books, accounts and vouchers usually during the normal working hours of the business of the client while holding the office of the auditor.

2. Right to obtain information and explanations

- The Company Auditor is entitled to require from the officers of the company such information and explanations and explanations as the auditor may think necessary for the performance of his duties".
- This power enable the auditor to obtain all the relevant infomiation. If proper explanations are not previded, he has the right to report such action to the member of the company.

3. Right to visit branch offices and access to branch accounts:

- Where the accounts of any branch office are audited by any other person, the Company Auditor is entitled to visit the branch office if the deems it necessary to do so for the performance of his duties as auditor.
- Further he has also a right of access at all time to the books, accounts and vouches of the company maintained at the branch office.
- If the his opinion proper returns adequate for the purpose of his audit have not been received from branches not visited by him, he has to state fact if, the report.

4. Right to receive notice and to attend general meetings -Section 231:

- All notices of and other communications relations to, any general meeting of a company which any member of the company is entitled to have sent to him are required to be forwarded to the auditors of a company.
- The auditor shall be entitled to attend any general meeting and to be heard at any general meeting which concerns him as auditor.

Scope of statutory duties of an auditor of a company. May 89 What are the duties of the Company auditor:

1. "True and Fair View" :

- The auditor shall make a report to the member of the company on the accounts examined by him, and on every balance sheet and profit toss account and on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account, which a-e laid before the company in general meeting during his tenure of office.
- The report has to be on the accounts of the company as well as on the balance sheet and the profit and loss account including the documents annexed thereto.
- The auditor's duty to report on the financial statements is not with reference to the statement of a particulars year. All such statements pertaining to any accounting period, which are laid before the company at a general meeting during his tenure of office, have to be reported upon by the auditor.
- The duty to make a report implies that the auditor has to examine the relevant accounts and the financial statements arid express his opinion on them. Primarily, the auditor is required to state whether the financial statements of the company present a true and fair view of its state of affairs and working results.

2. Disclosure of information - Section, 227 (2) :

- The company auditor shall state, "whether in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by this Act in the manner so required".
- This provision make it obligation for the auditor to ensure that the financial statement's given the information in accordance with the Companies Act or in accordance with the requirements of specific Acts governing certain classes of companies.

3. Obtaining Information and Explanations - Section 227(3):

- The auditor's report shall also state whether he has obtained all the information and explanations, which to the best of his knowledge and belief were necessary for the purpose of his audit.
- The auditor has the power to seek such information and explanation, as the considers necessary for the performance of his audit. This clause specifically required him to state whether or not he has obtained all such information and explanations.
- If the auditor has not been able to obtain material information or explanations, he may have to qualify his opinion regarding the truth and fairness of the financial statements. Sometimes, he may decide to express his inability to give an opinion on the truth and fairness of the financial statements in the absence of the required information.

4. Proper Books of Account - Section 227 (3):

- The auditor should state in his report "whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him".

5. Dealing with Branch Auditors Report - Section 227(3):

- The Auditor's Report shall state "whether the report on the accounts of any branch office audited u/s 228 by a person other than the company auditor has been forwarded to him as required by Section 228(3)(c) and how he has dealt with the same in preparing the auditor's report."

* The auditor's report should also state whether the company's balance sheet and profit and loss account dealt with the report are in agreement with the books of account and returns.

6. Reasons for Qualification - Section 227(4);

- If any of the matters in the auditor's report is answered in negative or with a qualification, the auditor's report shall also state the reasons for such an answer.
- The qualification is required to be indicated in **bold type** or in italic type.

7. Inquiry and Reporting u/s 227 (1A):

- Section 227 of the Companies Act specifies six matters to be looked into by a company auditor. The auditor is not required to report on the matters specified in section 227 (IA), unless he has any special comments to make to any of the items referred to: therein. If he is satisfied as a result of the enquiring, he has no further duty to report that he is so satisfied. The matters specified for enquiry are
  (a) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its members;
  (b) Whether transactions of the company, which are represented merely by book entries, are not prejudicial to the interests of the company;
  (c) Where the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the. assets of the company as consist of shares, debentures, and other securities have been sold as a price less than that at which they were purchased by the company
  (D) Whether loans and advances made by the company have been shown as deposits
  (E) Whether personal expenses have been charged to revenue account.
  (F) Where it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

8. Duty under MAOCARO, 1988 - Section 227(4A):

- The Central Government has the power to direct by a general or a special order that, in the case of specified companies, the auditor' report shall include a statement of such matters as may be specified in its order. The order applies to every company which is engaged or which proposed to engage in one or more of the following activities:
  (a) Manufacturing, mining or processing :
  (b) Supplying and rendering services;
  (c) Trading; and
  (d) Business of financing, investment, chit fund, nidhi, or mutual benefit societies.

9. Signing/Authentication-Section 229:

- The auditor shall sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor:

10. Certification of Statutory Report-Section 165:

- The auditor shall certify the statutory report issued to the members. He is also required to make a report to members as required by Part II of Second Schedule to the Company Act, 1956.

Signing of the Audit Report

* **Signing-Section 229:** Only the person appointed as the auditor of the company or where a firm is so appointed, only a partner in the firm practicing in India may sign the auditor's report or sign or authenticate any other document of the company required by laws to be

signed or authenticated by the auditor.

- **Individual CA :** When a single Chartered Accountant is practicing in his own name, there cannot be any question of any firm name. He shall sign only in his individual name. [Also refer MS-28].
- **Firm :** If a firm of CA's is appointed ass auditor, only a partner in the firm may sing the auditor's report. The partner concerned should invariable sign in his own hand for an on behalf of the firm appointed to audit the company's accounts.
- **Reading and Inspection - Sec 230:** The auditor's report must be before the shareholders of the Company in General Meeting and should be kept open for the inspection by every members of the Company.
- **Non-compliance with Sec. 225 to 231 :** The auditor need not send a copy of his report to or allow inspection thereof by each member of the Company in general meeting. For non-compliance with Section 225 to 231, the Company, and every officer of the company who is in default, will be liable to a fine, which may extend up to Rs.5,00-C)
- **Penalty for non-compliance** -Sec, 233: Non-compliance with Section 227 (reporting) and Section 229 (signing) the report shall attract a maximum fine of Rs.10,000/- if the default is willful.

Allen Craig Co (London) Ltd.	The duty of auditor's after having signed the report to be annexed to a Balance Sheet, is confined only to forwarding that report to the Secretary of the Company. It will be for the Secretary or the Directors to convene a General Meeting and send the Balance Sheet and report to members (or other persons) entitled to receive it.

Advantages and disadvantages of Joint Audit:

Joint Audit means that more than one firm/individual is appointed as the Statutory Auditors of the Company. It implies pooling together the resources and expertise of two or more firms to perform and expert job.

The advantages and disadvantages of Joint Audit are as under:

Advantages	Disadvantages
• Pooling and sharing of expertise • Better quality of work performance. • Advantage of mutual consolation. • Improved services to Client Company. • Lower costs to carry out the audit work.	• Co-ordinate problems in conduct of work. • Lack of clear definition of responsibility • Problems when firm of different standing are associated. • Areas of common concern being neglected • Sharing of fees.

AAS-12 Responsibility of Joint Auditor's lays down the professional responsibility in case of joint audit situations.

Cost auditor is appointed:

- **General Meaning :** Cost Audit is the audit of cost records. It is audit process for verifying the cost of manufacturing or products of any article on the basis of accounts as regards utilization of material or labour or other items of costs, maintained by the company.
- **Examples :** Cost Audit is applicable in respect of industries like Cement, Motor Vehicles,

Drugs, Fridges, Fans, Motors, Pumps etc.

- **Cost Audit u/s 2338 :** The Central Government may, if it feels necessary, direct by an order that an audit of the cost, records kept by a company u/s 209 (1)(d) shall be conducted by a Cost Accountant within the meaning of the cost and Works Accounts Act, 1959 in such a manner as may be specified.
- **Cost Auditor:** The Cost Auditor shall be conducted by a Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959. However, Chartered Accountants having prescribed qualifications may also be directed, by a notification, to conduct cost audit, if the Central Government is of the opinion that sufficient number of cost accounts are not available. As at present, no such notification is in force.
- **Appointment:** The Cost Auditor shall be appointed by the Board of Directors of the company in accordance with the provisions of section 224(18) and with the Previous approval of the Central Government. A written certificate shall be obtained from the proposed Cost Auditor that his appointment, if made, will be within the limits prescribed u/s 224 (18).
- **Disqualifications of Cost Auditor**: The following persons shall not be appointed or re-appointed as the Cost Auditor of the Company.

  A) A person covered by Section 226(3 or 226 (4) - Disqualifications for Company Auditors,

  B) Auditor of the Company appointed u/s 224 (i.e. Company Auditor shall not be the Cost Auditor)

  C) A person who acquires any of the above disqualifications, subsequent to his appointment.

  D) **Additional Audit :** Cost Audit is not a substitute for annual financial audit. The Cost u/s 233B shall be in the regul3r financial audit conducted by the auditor appointed u/s 224. Also, the Cost Audit need not be conducted every year. It is conducted only for those years or periods specified by the Central Government.

  E) **Powers:** The Cost Auditor shall have the same Powers and duties in relation to the Cost Audit, as the Compact Auditor has ills 227.

  F) **Duties:** The Cost Auditor shall report to the Central Government in the form prescribed under the Cost Audit Report Rules, 1968 A copy of the report shall be forwarded to the Company.

  G) **Company's Duties :** The duties of the Company in relation to Cost Audit are:

  1. To appoint the Cost Auditor with the previous approval of the Central Government - 233B(2)
  2. To give all facilities and assistance to the Cost Auditor - 2330 (6)
  3. To give to the Central Government, full information and explanation on every reservations and qualification contained in the Cost Audit Report, within 30 days from the date of receipt - 2330(7)
  4. To circulate the copies of Cost Audit Report to members along with the notice of AGM, based on Central Government's direction in their behalf - 233B (10)

Compare and Contract between Special Audit u/s 233 A and cost Audit u/s 233B.
Common Points:

- **Initiative of Central Government -** Both audits are based on the Central Government's direction.
- **Power and Duties of Auditors -** The auditor u/s 233A and 2338 shall have same powers as the Company Auditors.
- **Reporting -** Both auditor's report directly to the Central Government. A Copy of the cost audit report shall be given to the Company.

- **Action on Report -** The Central Government may take such action on the report as it considers necessary in accordance with the provisions of this Act or any other law for the time being in force.
- **Circulation to Members -** The Central Government may require that a copy of, or relevant extracts from, the reports shall be circulated to members of the Company.

Contract Points:

Particulars	Special Audit	Cost Audit
Government Section	233A	**2338**
Circumstances	• That the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices; or • That the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or • That the financial position of the company is such as to endanger its solvency.	The Company should be one for which maintenance of Cost Records u/s 209 (1) (d) should have been prescribed.
Appointing Authority	By Central Government directly.	By the Board of Directors with the previous approval of Central Government.
Auditor	(a) A Chartered Accountant u/s 2(1)(b) of the Chartered Accountants Act, 1949, whether or not he is in practice, or (b) I he Company Auditor himself.	A Cost Accountant as per the CWA Act, 1959. It is specifically provided that the Company Auditor shall not be appointed as the Cost Auditor.
Audit Report	Directly sent to the Central Government. A copy shall be sent if the Government does not take any action on the report for four months.	To Central Government, with a copy to the Company. The C.A. shit submit information on reservations and qualifications in the report.
Auditors' Remuneration	Determined by the Central Government (which determination shall be final)	It shall be decided by the Board of Directors.

Statutory Report

*** What are the auditor's duties regarding the Statutory Report?**

The auditor has to certify as correct that part of the Statutory Report, which relates to:

(a) The shares allotted by the Company.
(b) Cash received in Fespes.1 of such shares and
(c) Other receipts and payments of the Company

Under section 165 (1), the auditor shall certify as correct, an Abstract of receipts and payments made upto a date within 7 day 01, exhibiting under distinctive heads, Receipts of the Company from Shares, Debentures and other sources payments made and balance left in hand.

The following matters deserve the auditors' attention in the audit of Statutory Report u/s 165.

Documents to be seen	Auditors Duties
Memorandum of Association	Obtain the Memorandum and Articles of Association and the Prospectus and notes * Amount of Authorized Capital * Composition of Capital * Terms of issue, * Particulars of underwriting contract, if any and rate of underwing commission * Shares agreed to be issued for consideration other than cash and * Particulars of important agreements entered into by the company.
Minutes Book	Examine the minutes book and note the sanction and decision of the Directors for various payment like preliminary expenses, brokerage, underwriting commission etc.
Internal Control analysis	Examine the internal control system and internal check over amounts collected by the Company.
Cash Book Verification	On the basis of underlying evidence and payment vouchers, vouch the following: * Underwriting Commission - by reference to agreement. * Brokerage (Sec.76.) - based on applications bearing brokers' stamps etc. * Preliminary Expenses - based on agreement within 7 days of the report - e.g. purchase of another business as a going concern etc. purchase of fixed assets etc.
Bank Statements	* Check the details of amounts deposits in the bank and withdrawals thereof with the entries in the Bank Pass Book. * Obtain a certificate from the Bank as to the bank balance as at the date upto which the Statutory Report has been prepared. * Scrutinize the Bank Reconciliation Statement and obtain explanations if required.
General Ledger	Verify that the amounts receivable and payable which have been adjusted in the books of account but have been excluded from the balance of receipts and payments.

UNIT-V
Audit Techniques and EDP Environment

There are two terms – 'Procedure and techniques', which are often used interchangeably, in fact, however a distinction does exist. "Procedure may comprise a number of techniques and represents the broad frame of the manner of handling the audit work. Techniques stands for the methods employed for carrying out the procedure." For example procedure Known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

Audit Procedures –
As per AAS-1 on basic principles governing an audit states, the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedure to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. Therefore, audit procedure are broadly classified in two categories – compliance procedure and substantive procedure.

1) **Compliance procedure** are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. In obtaining audit evidence from compliance. Procedures, the auditor is concerned with assertions that the control exists, the control is operating effectively and the control has so operated through the period of intended reliance. So the auditor is concerned with the existence effective and continuity of the control system.
2) **Substantive procedure** are tests designed to obtain evidence as to the competences, accuracy and validity of the data produced by accounting system. They are of two types –
   a) Tests of details of transactions and balances.
   b) Analysis of significant ratios and trends including the resulting investigation of unusual fluctuations and items.

Audit Techniques –
Audit techniques on the other hand refers to collection and accumulation of audit evidence some of the techniques commonly adopted by the auditors are the following –
   a) Posting checking
   b) Casting checking
   c) Physical examination and count
   d) Confirmation
   e) Inquiry
   f) Year-end scrutiny
   g) Re-computation
   h) Tracing in subsequent period bank reconciliation.

AUDIT TRAIL
An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the find output. The work of an auditor would be hardly affected if "Audit trail" is maintained.

"A simplified representation of the documentation in a manually created audit trail."
- ✶ In a manual accounting system it is possible to relate the recording of a transaction of each success stage enabling an auditor to locate and identify all document from beginning to end for the purpose of examining documents, totaling and cross-referencing.
- ✶ In first and early second generation. Computer systems, such a complete and trail was generally available, however with the advent of modern machines, the EDP environment has become more complex. This led to use of exception reporting by the management which effectively

eliminated the audit trail between input and output. The lack of visible evidence may occur at different stages in the accounting process, for example –

- Input documents may be non-existent where sales orders are entered online. In addition, accounting transaction such as discounts and interest calculations, may be generated by computer programmes with no visible authorization of individual transactions.
- The system may not produce a visible audit trail of transactions. Processed through the computer. Delivery notes and suppliers invoices may be matched by a computer programme. In addition, programmed control procedure such as checking customer credit limit, may provide visible evidence only on an exception basis. In such cases, there may no visible evidence that all transactions have been processed.
- Output reports may not be produced by system or a printed report may only contain summary totals while supporting details are retained in computer files.
  No doubt to management's own healthy skepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor. The documentation in such a trail might again be portrayed as shown, in an over simplified way, 9+3 once again clear from the diagram that these is an abundance of documentation 4pm which the auditor can use his traditional symbols of scrutiny, in the form of coloured ticks and rubber stamps. Specifically –

- ✶ The output itself is as complete and as detailed as in any manual system.
- ✶ The trail, from beginning to end, is complete, so that all documents may be identified by located for purposes of vouching, totaling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction. In case audit trail is missing the auditor employs computer Assisted Audit Techniques (CAATs) to ensure the validity of accounting data.

Special Audit Techniques –
In an absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques. The absence of input documents or the lack of visible audit trail may require the use of computer assisted audit techniques (CAATs) i.e. using the computers an audit tool. The auditor can use the computer to test.

- ✶ The logic and controls existing within the system.
- ✶ The records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. The effectiveness and efficiency of auditing. Procedure may be enhanced through the use of CAATs. Properly two common types of CAATs are in vogue, viz, test pack or test data and audit software or computer audit programmes.

INTERNAL CONTROLS IN AN EDP ENVIRONMENT

The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedure designed into computer porgrammes. Such manual and computer controls affect the EDP environment (General EDP Control) and the specific controls over the accounting applications (EDP Application Controls).

EDP means (Electronic Data Processing) for the audit or a computer based systems. For audit process of enterprise.
General EDP Controls – The purpose of general EDP controls is to establish a framework of overall control over the EDP activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include.

a. Organization and management control are designed to establish an organizational framework over EDP activities, including –
    i. Policies and procedures relating to control functional.
    ii. Appropriate segregation of incompatible functions.
b. Application systems development and maintenance controls are designed to establish control over –
    i. Testing, conversion, implementation and documentation of new or revised system.
    ii. Changes to application systems.
    iii. Access to system documentation
    iv. Acquisition of application systems from third parties
c. Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that –
    i. The systems are used for authorized purposes only
    ii. Access to computer operations is restricted to authorized personnel.
    iii. Only authorized programs are used.
    iv. Processing errors are detected and corrected.
d. Systems Software Controls include –
    i. Authorization, approval, testing, implementation and documentation of new systems software and systems software modifications.
    ii. Restrictions of access to systems software and documentation to authorized personal.
e. Data entry and program controls are designed to provide reasonable assurance that –
    i. An authorization structure is established over transactions being entered into the system.
    ii. Access to data and programmes is restricted to authorized personal.
    iii. Offsite back-up of data and computer programmes.
    iv. Recovery procedures for use in the event of theft, loss or international or accidental destruction.
    v. Provision for offsite forecasting in the event of disaster.

II) **EDP Application Controls –** The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorized and recorded; and are processed completely, accurately and on a timely basis. These include –

a) Controls over input are designed to provide reasonable assurance that –
    ✶ Transactions are properly authorized before being processed by the computer.
    ✶ Transactions are accurately converted into machine, readable from and recorded in the computer data files.
    ✶ Transactions are not lost, added, duplicated or improperly changed.
    ✶ Incorrect transaction are rejected, corrected and if necessary, re submitted on a timely basis.
b) Controls over processing and computer data files are designed to provide reasonable assurance that –
    ✶ Transactions, including system generated transactions are properly processed by the computer.
    ✶ Transactions are not lost; added; duplicated or improperly changed.
    ✶ Processing errors are identified and corrected on a timely basis.
c) Controls over output are designed to provide reasonable assurance that –
    ✶ Results of processing are accurate.
    ✶ Access to output is restricted to authorized personnel.
    ✶ Output is provided to appropriate authorized personnel on a timely basis.

DOES OBJECTIVES AND SCOPE OF AN AUDIT CHANGE IN EDP ENVIRONMENT

The principle objectives of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements. If any, is to ensure that the financial statement reflect a true and fair view. The scope of an audit of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the institute. This would involve assessment of reliability and sufficiency of the information contained in the accounting records and other source data by study and evaluation of accounting system and internal controls in operation.

The overall objectives and scope of an audit does not change in an EDP environment but the use of a computer changes the processing and storage of financial information and may affect the organization and procedures employed by the entity to achieve adequate internal control. Accordingly; the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls and nature, timing and extent of his other audit procedures may be affected by an EDP environment. The computerization of accounts would also have an impact on the increase in fraud and errors.

Thus when auditing in an EDP environment; the auditor should have sufficient understanding of computer hardware, software and processing systems to plan. The engagement and to understand how EDP affects the study and evaluation of internal control and application of auditing procedures including computer assisted audit techniques. The auditor should also have sufficient Knowledge of EDP to implement the auditing procedures, depending on the particular audit approach adopted.

Thus, it is clear from the above that overall objective and scope of audit does not change irrespective of fact that whether the accounting information is generated manually or through EDP.

"DOING AN AUDIT IN AN EDP ENVIRONMENT IS SIMPLER SINCE THE TRIAL BALANCE ALWAYS TALLIES."

Though it is true that in an EDP environment the trial balance always tallies, the same cannot imply that the job of an auditor becomes simpler. There can still be some errors of omissions like omission of certain entries, compensating errors, duplication of entries etc. in the books of accounts even when the trial balance tallied. In today's complex business environment, the importance of trial balance in an audit has to be gauzed not from the view point of arithmetical accuracy but the nature of transaction to be recorded which in fact have become very complex.

The emergence of new forms of financial instruments like option and futures derivatives, off-balance sheet financing etc. have given rise to further complexities in recording and disclosure of transactions. In an audit besides the tallying of a trial balance, there are also other issues like estimation of depreciation, valuation of inventories, etc. which still require judgment to be exercised by the auditor. The total time taken in an audit may still be considerably higher even though the trial balance has tallied then an audit where the trial balance has not tallied, that responsibility will still remain even in an EDP environment. Therefore, simply because of EDP environment and the trial balance has tallied do not make the audit simpler.

Different design and procedural aspects of EDP systems –

The different design and procedural aspects of EDP systems are –

1) **Consistency of performance** – EDP systems perform functions exactly as programmed and are potentially more reliable than manual systems.
2) **Programmed control procedures –** The nature of computer processing allow the design of internal control. Procedures in computer programmes. These procedures can be designed to provide controls with limited visibility (protection of data against unauthorized access may be

provided by passwords), use with manual intervention, review of reports printed for exception and error reporting, and reasonableness and limit checks of data.

3) **Single transaction update of multiple or data base computer file** – A single input to the accounting system may automatically update all records associated with the transaction.
4) **System generated transactions** – certain transactions may be initiated by the EDP system itself without the need. For an input document the authorization of such transaction may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the EDP system.
5) **Vulnerability of data and programme storage media** – Large volumes of data and the computer programmes used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft or international or accidental destructions.

ASSISTED COMPUTER AUDIT TECHNIQUES (CAATs) REQUIRED IN EDP AUDIT –

The use of computer may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of computer assisted audit techniques are –

1) Absence of input documents
2) Lack of visible transaction trail
3) Lack of visible output
4) Absence of appropriate control
5) Unauthorized access to data and computer programmes.

Advantages of CAATs –

Audit effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence for example –

1) Some transactions may be tasted more effectively
2) Appling analytical review procedures.
3) An auditor can save the time
4) Effective test checking and examination in depth.