Unit -1

DEFINITION OF AUDITING

Auditing is a "systematic examination of the books and records of a business or other organization, in order to ascertain or verify and to report upon the facts regarding its financial operations and the results thereof"

ORIGIN OF AUDIT

It may be traced to middle ages, but the audit in the present sense can be traced after the introduction of large scale production, in consequence of Industrial Revolution during 18th century. Before this era, goods were produced by individuals, on small scale. There was not much capital. The individual who invested the capital usually himself maintained the accounts and therefore there was no necessity of checking them.

But stabilized governments, expansion of banking facilities and new means of communication have widened the scope of investment and business. The investor would naturally like to see that his investment is safe.

In such a case it is essential to get accounts audited in order to assure them that their investment is safe and that the directors and managing directors who deal with capital and accounts have presented true and fair accounts. To have an effective check the custom to appoint professional accountants began to develop

DEFINITION OF AUDIT

Spicer and Pegler have defined audit as" such as examination of the books ,accounts and vouchers of a business, as will enable the auditor to satisfy himself that the balance sheet is properly drawn up so as to give a true and fair view of the state of the affairs of the business and whether the profit and loss account gives a true and fair view of the profit or loss for the financial period, according to the best of his information and the explanations given to him and as shown by the books and if not in what respect he is not satisfied ".

DIFFERENCE BETWEEN BOOK-KEEPING, ACCOUNTANCY AND AUDITING

1. A Book-keeper and an accountant has to record the transaction in the books of accounts while an auditor has to check and verify such transactions and accounts and send a report to the persons who appointed him
2. Sometimes an auditor is asked to prepare from a set of books the trial balance, profit and loss account and balance sheet in which case he would be acting as an accountant and he would not be required to give his certificate at the foot of the balance sheet. He has to put his signature in token of his having prepared such a profit and loss account and balance sheet. On the other hand an auditor has not to prepare the trial balance , profit and loss accountant and the balance sheet. He has to report whether profit and loss account and the balance sheet prepared by the accountant exhibit a true and fair view of the state of affairs of the concern and in the case of a company they are drawn up according to the companies act.
3. Book –keeping is an art of recording the business transactions in the books of original entry and the ledger. This work to a great extent is being done by junior clerks or by machines in western countries. This work is mechanical nature and does not require a knowledge of principles of accountancy. On the other hand accountancy means compilation of accounts in such a way that one is in a position to know the state of affairs of the business. The man who performs this work is called an accountant. His work is to interpret and review the accounts and draw conclusions with a view to guide the management in chalking out the future policy of the business. But auditing means the verification of book entries and accounts to find out their accuracy. It is neither book-keeping, nor accountancy. His work is to find out whether the final accounts exhibit a true and fair view of the state of affairs of the concern or not and to report his findings to the shareholders

4. The spadework is done by the book-keeper and the accountant while the finishing touch is given by the auditor or as has been said that where the work of an accountant ends, the work of an auditor begins.

AUDITING AND INVESTIGATION

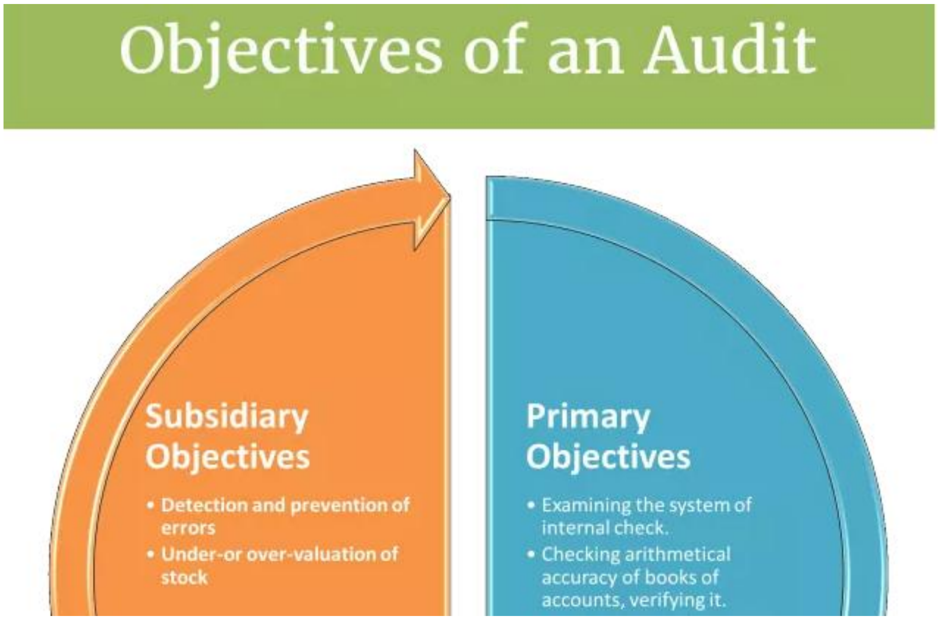
1. Audit is conducted to find out whether the balance sheet is properly drawn up and exhibits a true and fair view of the state of affairs of the concern while investigation is carried out with a certain object in view eg: to find out the profit-earning capacity, or the financial position of a concern or a fraud and the extent thereof
2. Investigation covers several years, say 3,5,or 7 years to find out the average earning capacity, financial position etc of a concern while audit relates to one year.
3. Investigation may be carried out on behalf of outsiders while audit is conducted on behalf of the proprietors only. However investigation may also be carried out on behalf of proprietors in some cases where fraud or defection is suspected

QUALITIES OF AN AUDITOR

1. It is very important for an auditor to be well versed in the fundamentals principles and theory of all branches of accounting eg: general accounting, cost accounts, income tax etc. It is not possible for a person to audit the accounts unless he himself knows how to prepare them. He should be aware of the latest development of the technique of accounting so that he may modify his procedure of work
2. He should not pass a transaction unless he knows that it is correct. This is possible only when one knows thoroughly well the principles of accounting
3. He should be able to grasp quickly the technical details of the business whose accounts he is auditing. If possible he should pay a visit to the works of his client before he commences his work
4. He should be prepared to ask on technical questions rather than show a false pride or fear of displaying his own ignorance
5. He should be quite familiar with the company and mercantile laws and must be a complete master of the principles of auditing
6. He must be tactful and scrupulously honest, as Lord Justice Lindley has said: "An auditor must be honest ie he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes what he certifies is true"
7. He must not be influenced, directly or indirectly by others in the discharge of his duties
8. Sometimes he is put in a very awkward position when his duty to his client is opposed to his own interests, in which case he must have the courage to carry out his duty faithfully and honestly even if such a step harms him. In the long run this policy will be of immense value to him. He will acquire a reputation for his honesty which will bring more business to him
9. He must be prepared to resign, rather than sign a balance sheet, which he knows does not exhibit a true and fair view of the state of affairs of the concern and thus give a false report
10. He should not disclose the secrets of his clients
11. He must have the tact to put intelligent questions to extract full information
12. He must not adopt an attitude of suspicion
13. He must be prepared to hear arguments and must be reasonable
14. He must be vigilant, cautious, methodical and accurate
15. He should have the ability to write the report clearly, correctly, concisely and forcefully

16. He should have an understanding of the general principles of economics
17. He should have thorough training in business organization, management and finance
18. Last but not the least he should have 'Common Sense'

OBJECTIVES OF AN AUDIT



The basic objectives of audit are to express an opinion on financial statements. To give the supposition about the budget reports, the inspector analyzes the fiscal reports to fulfill himself about reality and reasonableness of budgetary position and working aftereffects of the endeavor.

PRIMARY AND SECONDARY OBJECTIVES OF AUDIT

The objectives of audit are proving true and equality of results presented by profit and loss account and financial position presented by the balance sheet. Its objectives are classified into two groups which are given underneath:

1. Primary Objectives Of Audit

The main objectives of audit are called as primary objectives of audit. They are as under:

I. Inspecting the arrangement of an inside check.
ii. Checking arithmetical exactness of books of records, confirming posting, costing, adjusting and so forth.
iii. Confirming the credibility and legitimacy of exchanges.
iv. Checking the correct refinement of capital and income nature of exchanges.
v. Affirming the presence and estimation of benefits and liabilities.
vi. Checking whether all the statutory prerequisites are satisfied or not.
vii. Demonstrating genuine and decency of working outcomes displayed by salary articulation and money related position introduced by accounting report.

2. Subsidiary Objectives Of Audit

These are such objectives which are very useful in attaining primary objectives. They are as under:

i. Detection and prevention of errors
Errors are those oversights which are submitted because of imprudence or carelessness or absence of information or without having a personal stake. Errors might be submitted without or with any personal stake. Along these lines, they are to be checked cautiously. Errors are of different kinds. Some of them are as under:

- · Errors of standard
- · Errors of exclusion
- · Errors of commission
- · Compensating Errors

ii. Detection and prevention of frauds

Frauds are those mix-ups which are submitted intentionally with some personal stake on the heading of best dimension the executives. The board submits fakes to bamboozle assess, to demonstrate the adequacy of the board, to get more commission, to offer in the market or to keep up the market cost of an offer and so on. Recognition of extortion is the primary employment of a reviewer. Such Frauds are as per the following:

- · Misappropriation of money
- · Misappropriation of products
- · Manipulation of records or adulteration of records with no misappropriation

iii. Under or overvaluation of stock

Typically such Frauds are submitted by the best dimension administrators of the business. Along these lines, the clarification was given to the evaluator likewise stays false. Along these lines, an inspector ought to identify such Frauds utilizing expertise, learning, and realities.

iv. Other objectives

- · To give data to pay to assess specialist.
- · To fulfill the arrangement of organization Act.
- · To have a moral impact

TYPES OF AUDIT

Internal Audit
It take place within your business. As the business owner, you initiate the audit while someone else in your business conducts it.
Businesses that have shareholders or board members may use internal audits as a way to update them on their business's finances. And, internal audits are a good way to check in on financial goals.
Although there are many reasons you may conduct an internal audit, some common reasons include to:

- Propose improvements
- Monitor effectiveness
- Make sure your business is compliant with laws and regulations
- Review and verify financial information
- Evaluate risk management policies and procedures
- Examine operation processes

External audit

An external audit is conducted by a third party, such as an accountant, the IRS, or a tax agency. The external auditor has no connection to your business (e.g., not an employee). And, external auditors must follow generally accepted auditing standards (GAAS).

Like internal audits, the main objective of an external audit is to determine the accuracy of accounting records.

Investors and lenders typically require external audits to ensure the business's financial information and data is accurate and fair.

Audit reports

When your business is audited, external auditors usually give you an audit report. Audit reports include details of the audit process and what was found. And, the report includes whether your financial records are accurate, missing information, or inaccurate.

IRS tax audit

IRS tax audits are used to assess the accuracy of your company's filed tax returns. Auditors look for discrepancies in your business's tax liabilities to make sure your company did not overpay or underpay taxes. And, tax auditors review possible errors on your small business tax return.

Auditors usually conduct IRS audits randomly. IRS audits can be conducted via mail or through in-person interviews.

Financial audit

A financial audit is one of the most common types of audit. Most types of financial audits are external.

During a financial audit, the auditor analyzes the fairness and accuracy of a business's financial statements.

Auditors review transactions, procedures, and balances to conduct a financial audit. After the audit, the third party usually releases an audit opinion about your business to lenders, creditors, and investors.

Operational audit

Operational audits are similar to internal audits. An operational audit analyzes your company's goals, planning processes, procedures, and operation results.

Generally, operational audits are conducted internally. However, an operational audit can be external.

The goal of an operational audit is to fully evaluate your business's operations and determine ways to improve them.

Compliance audit

A compliance audit examines your business's policies and procedures to see if they comply with internal or external standards.

Compliance audits can help determine whether or not your business is compliant with paying workers' compensation or shareholder distributions. And, they can help determine if your business is compliant with IRS regulations.

Information system audit

Information systems audits mostly impact software and IT companies. Business owners use information system audits to detect issues relating to software development, data processing, and computer systems.

This type of audit ensures the system provides accurate information to users and makes sure unauthorized parties do not have access to private data.

Also, IT and non-software businesses should regularly conduct mini cybersecurity audits to ensure their systems are secure from fraud and hackers.

Payroll audit

A payroll audit examines your business's payroll processes to ensure they are accurate. When conducting payroll audits, look at different payroll factors, such as pay rates, wages, tax withholdings, and employee information.

Payroll audits are typically internal. Conducting internal payroll audits helps prevent possible external audits in the future.

Businesses should conduct internal payroll audits annually to check for errors in their payroll processes and remain compliant.

Pay audit

Pay audits allow you to identify pay discrepancies among your employees.

A pay audit can help you spot unequal pay at your company. During a pay audit, analyze things like disparities due to race, religion, age, and gender.

Pay audits can also help you ensure workers are paid fairly based on your business's industry and location.

Interim Audit

An audit conducted in between two annual audit to find out interim profits to enable to company to declare an interim dividend should be called interim audit. It is a kind of an audit which is conducted between two periodical or balance sheet audits

Continuous Audit

It is a detailed examination of the books of accounts at regular intervals. The auditor visits his clients at regular or irregular intervals during the financial year and checks each and every transaction. It is also called detailed audit

Statutory Audit

Where the appointment of auditors, manner of audit, contents of audit report etc are specifically mentioned in any enactment the audit conducted with reference to them is called statutory audit. It is compulsory audit and is to be carried out each year by an auditor called statutory auditor

Private Audit

There is no statutory or constitutional compulsion to get the accounts audited. Eg: the sole proprietor, partnership firms get their audited accounts without compulsion in view of advantage of having audit

Occasional Audit

This type of audit is conducted once a while whenever the need arises and the client desires it to be carried out. This is possible only in case of sole trader business or partnership

Balance sheet Audit

It means verification of the values of assets, liabilities, balances of reserves and provisions and the amount of profit earned or loss suffered by a firm during the year

Post and vouch Audit

It is that where an auditor checks each and every transaction right from its origin in the books of prime entries till they are posted.

Advantages of Audit

1. Errors and fraud are located at an early date and in future no attempt is made to commit such frauds or one is rather careful not to commit an error or a fraud as the accounts are subject to regular audit
2. The auditing of accounts keep the account clerks regular and vigilant as they know that the auditors would complain against them if the accounts are not prepared up-to-date or if there is any irregularity
3. In case of fire, insurance company may settle the claim on the basis of the audited accounts of the previous year
4. Money can be borrowed easily on the basis of previous audited balance sheet
5. If the business is to be sold as going concern there will not be much difficulty regarding the valuation of assets and goodwill as the accounts have already been subject to audit by an independent person
6. Income tax authorities generally accept the profit and loss accounts which has been prepared by a qualified auditor and they do not go into details of the accounts

7. The management may consult the auditor and seek his advice on certain technical points although it is not the duty of an auditor to give an advice
8. If the accounts have been prepared on a uniform basis, accounts of one year can be compared with other years and if there is any discrepancy the cause may be enquired into
9. Audited accounts are considered more or less correct by sales tax authorities
10. It would facilitate the settlement of accounts of a deceased partner

    Audit Programe

    It s a detailed plan of the auditing work to be performed , specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required.

    Advantages of audit programe

    1. It ensures that all necessary work has been done and nothing has been omitted
    2. The auditor is in a position to know about the progress of the work done by his assistant
    3. A uniformity of the work can be attained as the same programme will be followed at subsequent audits
    4. It simplifies the allocation of work to various grades of articled and audit clerks
    5. It facilitates the final review before the report is signed

       Disadvantages of Audit programme

       1. An efficient clerk loses his initiative because he adheres to the programme which had been fixed for him.
       2. Even if the audit progamme is well drawn up it may not cover everything
       3. The audit clerk may regard the work entrusted to him according to the programme as the maximum work to be done by him

UNIT-2

INTERNAL CONTROL

Spicer and Pegler defines " Internal control is best regarded as the whole system of controls, financial and otherwise established by the management in the conduct of a business including internal check, internal audit and other forms of control"

INTERNAL CHECK

L.R.Dicksee defines internal check as " such arrangements of book-keeping routine that errors and frauds are likely to be prevented or discovered by the very operation of the book-keeping itself"

INTERNAL AUDIT

It is "an independent appraisal activity within an organization for the review of accounting, financial and other operations as a basis for service to the management" defined by the Institute of Internal Auditors Inc Newyork

EVALUATIVE CRITERIA FOR GOOD INTERNAL CHECK

1. Division of Work: No one should be allowed to have right to perform the work from origin to end. For example, a transaction of sale may have to be split into display of article by a staff the preparation of invoice by another the receipts of cash against the invoice by third clerk, the delivery of article against the proof of receipted invoice by another clerk, checking of outward movement of article against delivery order by a clerk and so on.
2. Job Rotation: No individual clerk should be allowed to occupy a particular area of operation for long. Familiarity with and exclusiveness in a position offers a person greater flexibility to attempt manipulation with the system

3. Authority levels: There must be clear cut authority levels fro according sanctions to various transactions. Commensurate to the authority vested, responsibility must be extracted. Existence of authority levels result in review of operations of subordinates
4. Separation of custody and recording: There need s to be effective control by way of separation that the persons handling an asset cannot make entries for the transaction without any counter clerk. For example in a bank the payment effected by cashier are entered in his rough cash chits. Simultaneously the officer authorizing payments maintain a scroll of payments authorized
5. Accounting Controls: In order to ensure internal check with regard to recording of transactions in accounting records various cross checks must be introduced to ensure that the accounting records reflect reliable information . Use of control accounts, self-balancing system, preparation of reconciliation statements etc add checks to the system

VOUCHING OF CASH TRANSACTIONS

1. Opening balance: This should be compared with the balance shown in the duly audited balance sheet of the previous year. This is done to see that the actual balance has been brought down
2. Cash sales: There are greater chances of fraud under this head. The salesman may sell goods and may not make an entry in the cash book and thus misappropriate the money. The following system should be adopted to avoid fraud. The salesman should neither deliver the goods to the customer nor receive cash for the goods sold. He should prepare three carbon copies of the cash memo. When the goods are sold to customers to whom two copies of the cash memo are handed over.
3. Receipts from debtors: The auditor should vouch cash received from debtors to whom goods had been sold on credit in the past. The only evidence available on account of this item is the counterfoils of the receipts issued to debtors.
4. Income from interest, dividend : Interest received on account of fixed deposits in the bank should be vouched with the bank pass book. Sometimes a fictitious pass book is produced. Care must be taken to see that it is a genuine one. Dividends received can be vouched with the counterfoil of “tops” of dividend warrants or the letters covering the cheque. Interest received on securities can be vouched from the securities themselves or from tax deduction certificate issued by RB or from Investment Ledger as to date of receipt of interest, rate etc.
5. Loans : The receipt of loan should be vouched with the agreement with lender. He should see whether his client is entitled to raise loan. He should examine the rate of interest payable, terms of repayment and security offered which should be examined.
6. Rent received : The auditor should examine lease deeds and agreements to ascertain the amount of rent payable, the due date, provisions regarding repairs etc. Rent received may also be compared with ret rolls if they are maintained or list of various properties as in the case of owners of large estates
7. Bills receivable : Bills receivable books must be compared with cash book and pass book to see that the amount has been received on due date. Inquires should be made regarding the bills which have matured but the amount has not been received for them
8. Commission : Commission account should be checked with the accounts of the parties from whom commission has been received. Agreements with the parties regarding rate of commission should be inspected.
9. Sale of Investments: The amount received on account of sale of investments should be vouched with broker’s sold note. If they have been sold through the bank examine the bank advice. If they have been sold cum-dividend, he should see that dividend is

subsequently received and that the sale proceeds is properly apportioned between capital and revenue. If they have been sold ex-dividend , the auditor have to see that dividend has been received subsequently

10. Bad debts Dividend : The amount received from debtors who have become bankrupt should be vouched with the dividend warrants received from the official receiver or assignee indicating the total debt and the rate per rupee payable as dividend or any correspondence which might have been passed between the debtor or the official receiver and the client in regard to amount paid
11. Subscription : Subscription received by a club or school etc should be checked with register of subscribers and the counterfoils of the receipts
12. Insurance claim money: Insurance money received against a claim from an insurance company should be checked with correspondence passing between client and insurance company.
13. Share capital: In case of firms partnership deed should be examined to find out the amount of capital contributed by each partner
14. Sale of fixed assets: This item may be vouched with correspondence, auctioneer's account, sale contract, minute book of the board of directors or any other evidence available. He should see that the proper asset account has been credited with the amount. If there is any profit that should be credited to capital reserve account
15. Income from Hire-purchase agreement: Where money is received on account of the instalment relating to goods sold on hire-purchase system, the auditor should examine the agreement. It should be remembered that instalment includes interest also.
16. Miscellaneous receipts : Correspondence, contracts or any other document will help the auditor to vouch such transaction

    CREDIT SIDE OF CASH BOOK

    1. Payment to creditors: Money paid to creditors on open account can be vouched with the receipts issued by the creditors acknowledging the receipt of money. Money due to them can be compared with the accounts of the creditors and the actual invoices received from the suppliers of goods
    2. Wages : He should satisfy himself that the arrangement for the preparation of wage sheets and the system of payment is adequate so as not to leave any loophole or fraud.
    3. Capital expenditure: It means amount spent on acquiring fixed assets. The duty of an auditor is to see that the payment is in order that is duly authorized and that the money spent has been properly capitalized
    4. Loans : He should examine the receipt by the borrower and the loan agreement, pro-note or bills of exchange. He should read carefully terms of loan regarding the rate of interest, the dates on which interest has to be paid and the date of repayment of loan.
    5. Salaries : Salaries book should be examined. He should see that the total for the salaries nook for a particular month agrees with the cheque drawn for salaries or the item in the cash book under the cash column
    6. Agents and travelers commission : The agreement with travelers and the agents should be examined to ascertain the terms of appointment regarding the rate of commission. Calculation should be made and the receipt given by the traveler or the agent should be examined and compared with the cash book
    7. Travelling Allowance : He should see the rules and regulations regarding the payment of travelling allowance. Calculations should be made. If there is no such rules, he should recommend the management to frame such rules.

8. Insurance premium: Incase of new policy the cover note or the receipt from he insurance company and the policy itself should be examined. In case of renewal the renewal receipt for the premium should be examined
9. Bills payable: Returned bills duly cancelled should be examined. It would be sufficient evidence of the amount having been paid. Reference may be made to the bank pass and bills payable books.
10. Bills receivable discounted and dishonoured : Bills receivable which has been discounted with the bank and which have been dishonoured can be vouched with the entry in the bank pass book. The auditor should see that the account of the acceptor or the previous endorser is debited with the amount of the bill noting charges and other expenses if any
11. Freight, carriage and custom duties: The statements of account regarding the payment of freight and carriage, submitted by the shippers, clearing or forwarding agents together with receipts issued by them, should be examined to see that the payment has been duly made and accounted for. He should see that allowances in respect of rebates have been brought into account
12. Bank charges: Bank charges such as commission, interest on overdraft and loan etc should be examined with pass bank. He should check the calculation of interest
13. Partner's drawings : Partnership deed should be examined as to what is the maximum amount and time for which a partner can draw money and whether he is to be charged any interest on drawings. He should vouch this entry with the partner's drawing book or account and see that the signature of the partner is there against such entry
14. Postage : The postage book should be compared with cash book or the petty cash book and the balance of stamps in hand should be counted. Where a franking machine is in use the receipts issued by the post office for the payments made should be examined
15. Petty cash: There are greater chances of misappropriation of cash as there are no vouchers for a number of petty payments. He should therefore make an enquiry into the internal check system of petty cash payment. The petty cash book should be maintained under imprest system.
16. Director's fee: As a general rule the directors of a company cannot claim any remuneration unless the articles expressly provide for it. In case they are not entitled to get any monthly salary. He should examine the articles of association to find out fee payable to the directors.
17. Miscellaneous expenses, such as rent, rates taxes: He should examine the vouchers as usual and see that the expenses are properly appropriated between periods where necessary
18. Bank Account: These transactions in the cash book should be compared with pass book. Payments into bank should be vouched with the counterfoil of the paying-in-book. Sometimes customers pay directly into the clients bank account.

VOUCHING OF TRADING TRANSACTION

1. Internal check as regards purchase:
   a. All the orders sent should be recorder in the purchase order book which is
      Should have two carbon copies one to be sent to supplier of the goods and other to be retained for reference purpose
   b. When the goods are received the gatekeeper or the storekeeper should make a record in the goods inward register after having checked the quantity, weight etc

c. The invoice should then be checked with goods inward book maintained by storekeeper and the delivery note, if any to see that the goods received are correctly recorded in the stock register according to invoice
d. Another clerk should check the invoice regarding calculation etc

DUTY OF AN AUDITOR IN CONNECTION WITH CREDIT PURCHASES

1. Whether the invoice is in the name of his client as sometimes invoice have been produced for goods which have never been purchased for the business or goods might have been purchased by an official of the company for his personal use while the payment is made through company
2. Who is authorized to place orders for goods? Only a responsible officer should be allowed to do so
3. The date of the invoice should relate to the period under review. This is done to prevent the production of old invoices for which the payments had already been made
4. The auditor should check the casts and cross casts of the purchases book
5. If an invoice runs into several page the auditor should see that the grand total is correct

Purchase return: When the goods are returned to the seller being not according to the sample or of inferior quality a credit note should be obtained if the price has already been paid. If the price has not been paid a note should be sent to the cash department to send less amount to the seller

Credit sales: The auditor should now proceed to vouch day book or sales book which records only credit sales. The auditor has to be more careful in the case of vouching sales as documentary evidence is not as conclusive as in case of purchases. He should enquire into the internal check system regarding sales which may be outlined

INTERNAL CHECK AS REGARDS CREDIT SALES

a. Whenever an order is received it should be recorded in the order received book giving details regarding the date on which the order was received the name of the customer the particulars about the goods date of delivery mode of transport
b. The order copy of it sent to dispatch department
c. A responsible official will now mark the rate at which the goods are to be charged
d. A clerk will now make the extensions

DUTIES OF AN AUDITOR IN CONNECTION WITH CREDIT SALES

1. He should see that the internal check system is efficient. If not he should disown responsibility
2. He should compare the data of the copy of the invoice with data in sales book
3. He should check the casts and cross casts of sales book
4. The cancelled invoices should be checked with duplicate copy of invoice
5. If there is a significant difference of trade discount allowed to two different purchasers he should inquire into the reason of such a distinction

Sales return : When the goods are returned from customers being defective or on account of any other reasons they should be entered by the gatekeeper in the register known as gate keeper's return inward book and stock register

Goods sold on sale or return system

Sometimes goods are sold to customers on approval ie the goods are delivered to customer on condition tht if he does not approve of the goods he can return them within a particular period

Goods sent on consignment

When the goods are sent out to agents to be sold at owner's risk a separate book called consignment outward journal should be maintained if the number of such transactions is large

Packages and empties

When customers are supplied with packages eg casks, jars, bags, crates, canes etc which the customers have to return a good system of record should be adopted

Journal

All those entries which cannot be passed through any other book of prime entry are passed through journal. The use of the journal will depend upon the size of the business and consequently the number of entries

Bought ledger

The auditor should now proceed to check the bought ledger ie the ledger which contains the creditors accounts. The opening balance of different accounts in the brought ledger should be checked with the previous year's audited balance sheet or the schedule of the creditors duly checked by the previous auditor

Sales ledger

The opening debit balances will be checked from the previous audited balance sheet or thee schedule of debtors duly checked by the previous auditor. The accounts in this ledger will be checked from the previous audited balance sheet and subsidiary books, such as sales journal, sales return book, cash book, journal, allowance book, bills receivable book etc.

AUDIT OF IMPERSONAL LEDGER

1. OUTSTANDING ASSETS AND LIABILITIES

   Outstanding assets or intangible include

   a. Income receivable
   b. Prepaid expense
   c. Deferred revenue expenditure

a. Income receivable : Income might have accrued but might not have been received at the date of the balance sheet eg: rent might have accrued but the tenants might not have paid, dividend by a company might have been declared but it might not have been received the borrower might not have paid the interest due at the date of closing the books might not have been received. It must be credited to profit and loss account
b. Prepaid expenses: In certain cases expenses are paid for a definite period but a part or whole of such expenditure may be for the subsequent period and which is not covered by the period under audit. Therefore to debit the profit and loss account for current year with whole of the amount will be unduly burdening the profit and loss account and the net profit or loss arrived at, without any adjustment is incorrect. The whole of the expenses should not therefore be debited to profit and loss account of the current year but a part of it paid for the subsequent years should be deducted from the total expenses.
c. Deferred revenue expenditure : Expenditure which though of revenue nature is spread over a number of years because its benefit is derived during those years. Such an expenditure is called Deferred Revenue Expenditure. Sometimes heavy expenses is incurred the advantage of which will be derived in subsequent years eg: expenditure incurred in launching an advertisement campaign , development expenses in the case of mines and plantations, experimental expenses, research expenses, plant rearrangements and removing costs etc. The whole of such expenses should not be debited to profit and loss account of the year in which such an expenses has been incurred but a part of it should be carried over. If a part of such expenses is not carried over to subsequent years and whole of it is debited to the year in which it is incurred, the profit and loss account of that year will be unnecessarily burdened although the advantage of such an expenses would be derived in subsequent years also.

   Advertising : when a new article is introduced in the market abnormally heavy expenses is incurred for advertising or in the establishment of a new department or business. Such an expenses is in fact in the form of capital expenses. This should however be written off within a period of a few years and the profit and loss account should be debited with the amount to be written off every year and the balance shown as an asset until it is completely wiped off.

Preliminary expenses : heavy preliminary expenses may be incurred in connection with the formation of company or the establishment of a new department. In such a case the whole of the of the expenses should be spread over a period of say 2,5 or 7 years. Such expenses is of capital nature but as it is not represented by any assets it should be written off as stated above and profit and loss account of such years should be proportionally debited.

Alteration and heavy repairs to plant etc: Sometimes heavy expenditure is incurred to make alterations to plant and machinery or getting it overhauled to suit the changed conditions of the business. It is not of capital expenses but for improving the earning capacity of the business. This type of alteration is not an annual feature and hence all such expenses should not be debited to profit and loss account of the year in which it is incurred

OUTSTANDING LIABILITIES

1. Unearned income: Income might have been received though a part or the whole of it is not applicable to the current year but will be earned during the following year eg: rent received in advance. Such an income which is not applicable to the year under audit should not be credited to profit and loss account of the current but should be shown as liability in the balance sheet.
2. Unpaid expenses: Expenses incurred during the year but for which payment has not been made and will have to be made next year are called unpaid expenses. In such case profit and loss account should be debited with amount and credited with unpaid expenses account and shown as a liability in the balance sheet.
    a. Purchases: It sometimes happens that gods are purchased at the close of the year and entered in the stock book when received but as the relative invoice has not been received no entry is made in the purchase book. A schedule of such purchase should be prepared and the total debited to purchases account and credited to outstanding liabilities account
    b. Rent, rates, taxes ,electricity ,water etc: In order to arrive at the correct profit or loss, provision for all liabilities for rent, rates, taxes etc which have accrued but for which no payment has been made by the time the books are closed must be made.
    c. Wage and salaries : The books are generally closed on the last day of the month and the wages and salaries are paid on the first day of the following month. In such a case the wages and salaries will not be debited to profit and loss account of the year under audit as no payments are made.
    d. Audit fee: It will be fair to debit profit and loss account of the year under review if the work of audit has commenced before closing of the books and the audit fee payable should be brought as outstanding liability.
    e. Freight and carriage : Sometimes the clearing and forwarding agents do not send the account regarding the freight, carriage, commission etc before the close of the annual accounts. It is therefore necessary that an estimate should be made of such charges which should be debited to profit and loss accout and brought as an outstanding liability
    f. Traveller’s and agent’s commission: The auditor should examine the commission account and see that any commission earned by travellers and agents but not paid at the date of the balance sheet is brought into account and shown as outstanding liability

g. Interest payable: Interest payable at the date of balance sheet should be shown as an outstanding liability. The auditor should examine the ledger account to find out how much interest is to be paid. He should calculate the amount
h. Commission to sales manager: He should verify by referring to the agreement with sales manager regarding the rate of commission, the sales should be verified from the sales book, commission paid should be verified by making calculations, receipts issued by sales manager, the counterfoils of cheque and cash book

INTERNAL CHECK VS INTERNAL AUIDT

Similarities: Both Internal Check and Internal Audit are part of the whole system of internal control, as such both are complementary and go together.

Dissimilarities: There is a lot of difference b/w Internal Check and Internal Audit. Both differ from each other in the following respects:

1. Meaning: Internal Check is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.
Internal Audit is an independent appraisal of the operations and records of the company.

2. Object: The purpose of Internal Audit is to detect the errors and frauds which have already been committed.
The purpose of Internal Check is to prevent or minimize he possibilities of errors, frauds or irregularities.

3. Need for separate staff: for carrying out Internal Audit, a separate staff of employees is engaged for the purpose.
For internal check, no new appointment is made. It, in fact represents only the arrangement of duties of the staff in a particular way.

4. Nature of work: The work involved in the Internal Audit is just like that of a watch man. Internal auditor has to report, from time to time, to the management about the various in efficiencies and suggest improvements. It is also his duty to see that the internal check system does not become static.
Internal Check, on the other hand, represents a process under which the work goes on uninterruptedly and the checking too is more or less automatic.

5. Timing of work: Internal Audit starts when the accounting process of different transactions is finished.
Internal Check is an operation during the course of transaction.

6. Internal audit: It is a device for checking the work, whereas internal check is a device for doing the work.

7. In Internal Audit Errors and Frauds are detected after the completion of work, whereas in Internal Check the Errors and Frauds are discovered during the course of work.

8. Scope of work: The scope of Internal Check is very limited. The scope of Internal Audit is comparatively board.

9. Involvement: A large number of employees are needed for the implementation of Internal Check System.
Whereas, a much smaller number of persons are needed for implementing Internal Audit implementation.

MEANING OF AUDIT NOTE BOOK

It is maintained by audit clerk. It contains Technical details about the business. Queries for which explanation and information have to be demanded. Fraud and errors found in the books during the course of audit. Details which are to be included in the audit report. Notes regarding the system of maintaining the accounts. Information to be needed in future. Names of officials who certify bad debts.Record of all important correspondence. Totals of important ledger accounts. Progress of audit report. Record of suggestions made by the audit staff.

ADVANTAGES OF AUDIT NOTEBOOK

- The auditor is enable to record important points.
- Auditor can produce this book as documentary evidence in a suit filed against him.
- A note book makes the work of audit convenient as all the important details about audit can be recorded.
- Such a book can help in making an assessment of the knowledge, efficiency and audit clerks.
- It makes the procedure of subsequent audit more easy.
- It provides the key to evaluate the efficiency of the audit staff.

DISADVANTAGES OF AUDIT NOTE BOOK

- It develops a fault finding attitude in the minds of the audit staff.
- It places too much reliance on the staff of the client for its preparation.
- If an audit note book is prepared negligently, the auditor can use it as an evidence of negligence in the courts of law.
- Very often, it creates misunderstanding between the clients staff and the auditing staff.

AUDIT WORKING PAPER

- Audit working papers are those papers and documents which consists of details about accounts which are under audit.

Such details may be

1. Schedules of debtors and creditors.
2. Certificates of officials in regard to such important matters as bad debts, unpaid expenses etc.
3. Certificates issued by banks in regard to bank balance.
4. Correspondence between the auditor and debtors, creditors.
5. Rough trail balance.
6. Important extracts from minute book.
7. Particulars of investment.
8. Draft final accounts.
9. A copy of auditor’s book.

PURPOSE OF AUDIT WORKING PAPER

1. Represents the volume of work which has been performed by the auditor and his staff.
2. The various minute details and aspects of the audit report can be well sustained on the basis of findings summarized in the report.
3. The working paper become an asset for the auditor on the occasions when he has to defend himself against the charges.
4. The auditor can co-ordinate and organize the work of audit clerks with the help of working papers.

5. The auditor’s detailed advice to his client in regard to improving the system of internal check and efficiency of the accounting system. 6. The working papers act as a guide to the auditor in subsequent examinations.

REASONS FOR PREPARING WORKING PAPER

- Basis for planning the audit Record the evidence accumulated and the results of the audit tests
- Data for determining the proper type of audit report
- Basis for review by supervisors and partners Evidence audit works being performed in accordance with approved auditing standards
- working papers are the evidence of work done by the auditor, he should prepare working papers in order to provide evidence that audit was properly performed according to ISA standards.
- Working papers support auditor, in-case he is being sued in court by the client, for negligence of audit work.
- Assist in the planning and performance of the audit.
- Assist in the supervision and review of audit work.
- Record the audit evidence resulting from the audit work performed tosupport the auditor’s opinion. Purposes Served By Work Papers
- Audit working papers serve four major purposes:
- They constitute a permanent record of the objectives and scope of the audit, as well as the work performed during the audit. Work papers organize and coordinate all phases of the audit
- They contain the back-up material in support of the audit findings
- Detailed supporting material for use in discussion with operating personnel.
- A source of evidence in litigation and in administrative actions.
- A basis for supervisory review and evaluation of audit performance.
- A permanent record for use in planning and carrying out future audits.
- Demonstrate that auditors have complied with the Standards for the Professional Practice of Internal Auditors

FUNCTIONS OF WORKING PAPER

1. Helpful in making genuine audit report

Working papers are used for making genuine audit report. Without knowing the reality of different facts which are written in working papers, auditor cannot make audit report which shows accurate view of companys financialstatements.

.2. Uses as evidence.

Sometime, any party may behave like a neglect person, at that time, theseworking papers will become the evidence of reported facts.

3. Direction to auditing procedure.

Working papers are also good guide to direct the audit procedure. If auditor wants to do audit work step by step, he should collect all working papers which are required for auditing and set it according to the steps of auditing. Doing this, auditing work may be easy

UNIT-3

VERIFICATION AND VAUATION OF ASSETS AND LIABILTIES

Verification means proving the truth or confirmation. It involves the following

a. Comparing the ledger accounts with balance sheet
b. Verifying the existence of the assets on the date of balance sheet
c. Satisfying that they are free from any charge or mortgage

d. Verifying their proper value
e. Assets were acquired for business

Fixed assets: They are acquired for permanent equipment and not for resale in the ordinary course of business. They are not consumed in the very process of manufacture.

Modes of valuation of fixed assets: Fixed assets should be verified at cost price less total depreciation in their value by constant one. They are to be valued at original or historical cost less total depreciation.

Floating assets or current assets and mode of their valuation : They are those assets which are acquired for resale or produced for the purpose of sale or converting them into cash.

Wasting assets: they are those assets which are depleted gradually gradually or exhausted in the process of working such as mine, quarry, an oil well etc

Intangible assets : They are those assets which cannot be seen or felt or touched. Goodwill , copyright, patents , trademarks.

Cash – in hand: sometimes the accountants accepts a certificate from the management regarding the amount of cash- in-hand. This procedure is objectionable. The auditor should visit business house at the close of the financial year or on the following morning and actually count the cash in hand and compare it with balance shown by cash book

Cash at bank: To verify cash at bank the auditor should examine bank pass book and compare it with balance as shown by bank column of cash book. If he does not do so he will be held liable. There may be still a difference as some of the cheques sent out for collection might not have been encashed and some of the cheques issued though recorded in cash book might not have been presented for payment at bank and so on

Loans : It may have been advanced against security of land and property, security of stock and share, security of goods, security of insurance policies, personal security of the borrower

Loans against security of land and property: The auditor has not only to examine the loan account in the ledger but he has to examine the documents relating to security. If the land or property has been mortgaged the auditor should examine mortgage deed and find out whether mortgage is properly executed in favour of client.

Loan against security of stock and shares: The auditor should get a list of such stock and shares which have been held as security. He should see that such shares, are transferred to his client

Loans against security of goods: He should that the warehouse rent has been paid by the borrower and in case it has not been paid the amount should be added to loan and margin between security and loan should be ascertained . If the margin is small more security must be demanded.

Loan against insurance policy: Last receipt for the payment of premium paid should be examined. If the premium has been paid by his client to prevent the policy lapsing the auditor should see that the amount has been debited to loan account

Loan against personal property security: Incase the loan has been granted against personal security the auditor should make an inquiry regarding financial position of the surety as the value of security depends on his financial position

Bills receivable : The auditor should examine the impersonal ledger when the bills receivable is in hand. Some of the bills might have been sent for collection in which case an inquiry should be made from bank.

Investments : If there are large number of investments as in case of banks and insurance companies the auditor should ask for schedule of investments held by his client.

Stock in hand: The correctness of profit and loss account of a concern depends to a great extent upon the correctness of value of stock of goods in hand at the close of period. The auditor therefore has to take stock or value it. He cannot with certainty say that the stock in hand mentioned in balance sheet is correct. He has to see that the stock taking method followed by the client is correct and therefore there is no risk of any mistake .

Book debts: The auditor should see that the debts as shown in the balance sheet are recoverable. If they are doubtful, provision should be made. If they are bad they should not be shown on the asset side.

Endowment policies: It is taken to provide funds for redeeming some liability falling due at later date or to replace an asset later on. The most common forms of such policies is sinking fund policies for redemption of debentures

Patent and trademarks: If the client hold a large number of patent or trade marks the auditor should seek him to prepare a schedule giving the description of patent, registered numbers, dates on which they were acquired and the unexpired period.

Copy right: This is a sole right to produce a book or an article. The life of copyright is the lifetime of the author and fifty years after his death. Expecting this all the remarks relating to patents apply to this type of assets

Assets in foreign country: If documents relating to property in a foreign country are at head office, the auditor should examine them. However if they are not available a certificate from local auditors should be sought and examined

Furniture and fixtures: The auditor should verify with the help of invoices. Any additions made during the year should be verified in the usual way. Any expenses incurred in purchase of this asset should be debited to furniture account

Plant and machinery: This item is also verified by reference to the original invoices, correspondence. Expenses incurred on customs duty, freight, erection of machinery should be debited to machinery account while repairs should be charged to revenue account

Loose tools, patterns ,dies : Such assets have short useful life and the value per unit is also low. Hence no separate account is maintained for each unit. There is a danger of pilferage of such assets and therefore proper supervision over these should be exercised

Property : The auditor is not competent to examine the title deeds relating to a property. In such a case he should insist upon the client to get a get certificate regarding their validity from the solicitor.

Goodwill : It is defined as the assessed value of the reputation of a business or as the difference between purchase price and the nest assets which are purchased and the excess amount so paid represents the goodwill acquired by the business

Verification of liabilities

1. Capital: If it is first audit of the company the auditor should examine memorandum of association and the articles of association of the company. He should examine the cash book, pass book and minutes book of the board of directors to find out number and difference classes of shares issued the amount received on each and balance due from memorandum and articles and minutes of board of directors should be examined
2. Reserve accounts and funds: For audit of these two items reserves and funds must be examined
3. Debentures and mortgages : The auditor must enquire into powers of company to borrow funds
4. Trade creditors: The auditor should ask for a schedule of the creditors and check with the purchase ledger which in its turn may be checked with books of original entry with purchase invoice, credit notes, good inward book, return outward book , bills payable, cash book
5. Bills payable: The auditor should verify this item from bills payable book and the bills payable account. The bills payable already paid should be checked from the cash book and examine the returned bills payable.
6. Outstanding expenses: The auditor should get a certificate from a responsible official to see that all expenses for the current year are included and that the payment for each

expenses such as interest, discounts, salaries, wages, legal expenses which have not been paid are included

7. Loans : Reference may be made to the agreement and correspondence for getting the loan. If interest on the loan has not been paid he should see that it is shown as liability. If loan has been secured by mortgaging any property it should be indicated in the balance sheet.

DEPRECIATION: It is derived from Latin word Depretium which means decrease in the value of fixed or capital assets. Depreciation is defined as decrease in the value of an asset on account of natural wear and tear or effluxion of time.

Difference between depreciation and fluctuation

1. Depreciation always decrease in value of an asset while fluctuation means either a decrease or increase in value of an asset
2. Depreciation is always a permanent decrease while fluctuation is a temporary rise or fall in the market value of an asset
3. Depreciation relates to fixed assets while fluctuation relates to current assets
4. Depreciation is a charge against profit while fluctuation does not affect profit

   Objects of depreciation

   1. The depreciation is to be determined and provided in the accounts to find out the correct cost of production.
   2. If depreciation is not provided the asset will appear in the balance sheet at a value higher than its worth. Hence the balance sheet will not show true and fair view of financial position
   3. The real objective of providing depreciation is to keep the capital intact.
   4. It is necessary to provide depreciation legally in case of company

      Factors determining quantum of depreciation

      1. Original cost of the asset: The original cost of the asset means spent for acquiring, installing, commissioning etc. The asset may be purchased from outside or it may be fabricated within entity.
      2. Estimated residual value of the asset : After the asset ceases to be use it is disposed . but it may have some residual value. The amount of scarp value is to be estimated at the time of acquisition of the asset.
      3. Estimated life of the asset: It is expressed in terms of units of measurement It may be shorter than physical life of an asset.

Methods of providing deprecation :

1. Single charge method: Under this method a definite sum of money representing a proportion of total amount of depreciation and repairs over the life of the asset is debited to revenue account and credited to depreciation and repair reserve account.
2. Depletion unit method: This method is used in case of wasting assets such as mine, quarry, oil wells etc. The contents of the mine are estimated in terms of tons, gallons. A minimum amount of annual charge is sometimes adopted irrespective of production has not reached minimum
3. Production unit method: Under this method the depreciation is provided according to number of units of goods manufactured. It is difficult to estimate number of units of goods the machine will manufacture before it becomes scrap
4. Efficiency hour method: This method takes into consideration the working hours of machine. It is also called as machine hour method or units of production method or hours

of service method. Suppose the life of the machine is estimated to be 10,000 hours and the cost of machine is Rs10,000 the efficiency rate is Re1.

5. The use or mileage method: The method is applied in case of those assets the use of which can be measured in terms of miles and not in terms of times. Eg: a car , bus, motor cycle etc. For instance it is estimated that a car worth Rs 10,000 will run for about 40,000 miles and then it will become a mere a scarp
6. Revaluation method: Where it is possible to provide for depreciation on mathematical terms the asset is revalued at the time of balance sheet. Eg in case of loose tools, livestock, jars, bottles, packages etc ie asset which have short life. The difference between book value of such assets an revaluation is the measure of depreciation
7. Insurance policy method: The endowment Insurance policy is taken on the life of an asset so that at the end of the definite period the insurance company will pay the assured sum with the help of which the asset can be re- purchased .
8. Annuity method: This method of depreciation is provided where it is desired to retain the money in the business. Under this system it is supposed that money invested in the purchase of the asset earns interest at a fixed rate which is debited to asset account at reduced value and according to annuity table a certain fixed amount of depreciation is charged every year for estimated life of an asset which will be reduced to nil or its residual value by the year. It is adopted in lease where its life is definite
9. Depreciation fund method: It is also called as redemption fund or amortization fund or sinking fund method. Under this method an equal amount is written off every year and profit and loss account is debited while depreciation fund account is credited during the estimated life of the asset
10. Reducing instalment method: It is also called as written down value or diminishing or declining value method. Under this method a fixed percentage is written off every year on the diminished book value of the asset till the asset is reduced to its scrap value. Taking out previous example if the rate at which depreciation is provided is 10%, depreciation charges for first year will be Rs 100 in the second year Rs90 and in third year Rs81 and so on.
11. Fixed instalment method: It is also called as straight line or original cost method. Under this method a percentage of original cost of asset concerned less residual value if any is written off till the end of estimated life. The percentage is fixed by taking into consideration the original cost of the asset, its estimated life and its residual value. Eg: a piece of machinery cost Rs1000 its estimated life is 10 years while its residual value is Rs100. Now using this machinery for 10years the scrap value will be sold for Rs 100 at the end of 10 years.
12. Global method: under this method depreciation is provided according to the rate of depreciation is charged. The method is very unscientific and should not be adopted. It is not permissible under companies act 2013 because fixed assets are to be distinguished from one another.

    Duties of an auditor regarding depreciation:

    1. The auditor should check that the cost of the asset are properly stated. He must check capitalization entries keeping in mind the relevant accounting conventions. He must vouch the entries with such records as minutes of directors, purchase bills, delivery notes, expenses voucher, commencement certificate etc.
    2. The auditor must bear in mind that adequate amount of depreciation is to be provided for in accounts. Regardless of non-availability of profits, availability of assets in market at a cheaper rate

3. The auditor must ascertain that the scarp value and useful life of the asset are fairly estimated. He must also check that the method of depreciation adopted is suited to the entity
4. Once a method of providing depreciation is chosen it should be consistently applied. Change of method of providing for depreciation is allowed only on rare circumstances
5. The auditor must devise checks to ensure the accuracy of depreciation
6. The auditor must check that the depreciation is properly disclosed in financial statements

Reserves : It means part of profit which is set aside for any known or unknown contingency, liability , diminution in the value of assets etc. The American Institute of Accountants defines reserve as " the use of term reserve be limited to indicate that an undivided portion of the asset is being held or retained for general or specific purpose"

General reserve: It is an amount set aside out of profits or surplus to provide additional working capital or to strengthen liquid resources of the business or that they may be available for any unknown contingency. It is usually treated as revenue reserve. It is considered as undistributed profit.

Specific reserve or provision : The reserve which is a charge against reserve for the purpose of providing for losses and contingencies which may result in loses is called specific reserve. It must be created whether there is any profit or not and even if there is a loss, it is a must.

Difference between reserve and provision

S.No	Reserve	Provision
1	It is an appropriation of profit	It is an carriage against profit
2	The reserve is debited by creating profit and loss appropriation account for the redemption of known liability	It is made by debiting profit and loss account for specific contingency or expected loss
3	The amount allocated for reserve depends on profits of the company. If there is no profits reserve must be created	The amount allocated for provision does not depend upon profits of the company. If there is loss provision has to be made
4	A reserve is created not with view to meeting any definite liability and hence it is left to directors of the company to make any provision or not to make any provision at all	The duty of an auditor in connection with provision is to see that adequate provision is made to meet loss
5	Making of reserve is discretionary and is a matter of financial prudence except when articles provide or in case of companies of special nature	Making of provision is must
6	It is usually shown on the	The provision is generally

	liability side of the balance sheet as it is not specific reserve	shown on assets side of the balance sheet

Reserve for bad debts: This reserve is created to meet any future loss if the debtors fail to pay the whole or part of debt owing by them. When the amount of loss which will take place is known provision should be made for the exact amount. The reserve account is debited and the account of particular debtor is credited

Reserve for discount on debtors and creditors: It is the custom that when debtors make payment within the prescribed period a certain amount of discount is allowed to them. Similarly business house when making payment to creditors earns discount. The debtors should not be shown at their book value but the actual amount realizable from them should be shown

Sinking fund: It is a kind of reserve by which a provision is made to reduce a liability, to replace a wasting asset, to replace depreciating asset and to renew a lease. A sinking fund is a form of specific reserve set aside for the redemption of a long term debt or the replacement of wasting or a depreciating asset

Difference between sinking fund for redemption of liability and sinking fund for redemption of an asset

S.No	Sinking fund for redemption of liability	Sinking fund for redemption of an asset
1	It is made out of divisible profit	It is made by debiting reserve account
2	After liability is redeemed the sinking fund is no longer required and as it is the undistributed profit it may be distributed to shareholders or may be transferred to general reserve account	When the asset is replaced, sinking fund no longer exists as it is transferred to original assets to close that asset account
3	After expiry of period the gilt edged securities are sold and cash so realized is applied for the payment of liability or debentures	In case of redemption of asset the cash realized by the sale of securities is used to replace the existing asset

Reserve for development funds: In case of reserve fund the surplus is invested outside the business in securities and is represented by such investments. Some accountants argue that funds indicate that the money is invested outside and therefore it is but appropriate that such a reserve should be named reserve fund

Capital reserve: It is defined as " any reserve which cannot legally be distributed amongst the shareholders". It is created out of capital nature. It includes profit made on redemption of debentures in market at discount, premium received on the issue of shares and debentures, assets replacement fund etc

Duties of an auditor in case of reserve :

1. The auditor should see that capital profit which have been transferred to capital reserve account are readily surplus of capital over the assets and liabilities
2. That capital reserve is utilized according to articles and law
3. Capital profits may be transferred to revenue account and distributed or utilized in writing off provisions losses provided it is made clear the accounts to distinguish such profit from ordinary trading profit of the business.
4. It may be invested either in the business itself or may be invested outside the business

   Secret reserve: It is defined as " any reserve which is not apparent on the face of balance sheet". It is called as hidden reserve or internal reserve or inner reserve. It is an understatement of assets or an overstatement of liabilities accompanied by a corresponding under statement of capital.

How secret reserve is created?

1. By providing excessive depreciation on fixed asset
2. By writing down the goodwill to a nominal value
3. By not writing up value of an asset the price of which has permanently gone up
4. By providing more reserve than necessary for bad and doubtful debts or discount on sundry debtors
5. By overvaluing liabilities

Duties of an auditor in case of secret reserve

1. He has to disclose the fact that secret reserve has been created if it has been done.
2. In case of companies such as banking companies etc the auditor should carefully enquire into the necessity of creating such reserve. If he finds that the intention is honest and that it is in the best interest of the company to create a secret reserve
3. If the auditor finds that intention of the directors is not honest eg: to fabricate improper dealings in the shares of the company he must disclose the fact in his report

UNIT-1V

AUDIT OF JOINT STOCK COMPANY

An **auditor** has to study the Company Law so as to familiarize himself with his rights and duties. There are provisions in the law in regard to issue of Share Capital, preparation of Memorandum of Association and Articles of Association, appointment of Director and Managing Directors, issue of Prospectus and other important matters which an auditor has to study for the successful conduct of a company's accounts.

Preparation by the Auditor before Audit:

The auditor should go through the following preliminaries before he begins his actual work:

1. To see that his appointment is in order;
2. Inspection of documents books and registers;
3. Inspection of contracts;
4. Study of previous year's Balance Sheet and Auditor's Report;
5. Obtaining a schedule of books and persons handling them;
6. Study of internal check system; and
7. Certificate of incorporation and commencement of business.

1. To see that his Appointment is in order:

(a) If he is appointed as the first (newly appointed) auditor of the company by the Board of Directors, he should ask for a copy of the resolution by the Directors authorising his appointment.

(b) If he is appointed in place of a retiring auditor, he should enquire from the retiring auditor whether due notice was served and the provisions of section 225 were complied with or not. It would be a breach of professional etiquette if he does not enquire from him in writing about the circumstances which led to his removal.

(c) If he is appointed by the shareholders at the Annual General Meeting, he should obtain a copy of the resolution. He should inform the Registrar within 30 days of the receipt of the appointment letter in writing that he has accepted or refused to accept the appointment. He should ensure that proper notice or nomination was given, otherwise his appointment will be invalid.

The auditor should correspond in writing with the previous auditor, informing the latter of the fact of his appointment.

(d) If he is appointed to fill a casual vacancy caused by the death of the previous auditor, he should obtain a copy of the resolution passed by the Directors so as to ensure that his appointment is valid.

(e) Under section 224(6) of the Companies Act, a General Meeting of the shareholders should be called to appoint a new auditor in place of the auditor who has resigned. Thus, the vacancy caused by the resignation has to be filled by the company in a General Meeting and not by the Board of Directors.
The auditor should see that his appointment is regular under such circumstances. He should, however, enquire from the auditor who has resigned, about the circumstances in which he has resigned and then decide whether he should accept the appointment or not.

2. Inspection of Documents, Books and Registers

Documents:

1. Memorandum-

Under the provisions of section 13 of the Companies Act, the Memorandum of every company shall state:

(a) the name of the company with 'Limited' as the last word of the name in the case of a public limited company and with 'Private Limited' as the last words of the name in the case of a private limited company;

(b) The State in which the registered office of the company is to be situated;

(c) In the case of a company in existence immediately before commencement of the Companies (Amendment) Act, 1956, the objects of the company.

(d) In the case of a company formed after such commencement –

(1) The main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

(ii) Other objects of the company not included in Sub-section (i); and

(e) In the case of companies (other than trading corporations), with objects not confined to one State, the States to whose territories the objects extend.

(2) The Memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.

(3) The Memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributors among themselves, such amount as may be required, not exceeding a specified amount.

(4) In the case of a company having a Share Capital:

(a) Unless the company is an unlimited company, the Memorandum shall also state amount of Share Capital with which the company is to be registered and the divisions thereof into shares of a fixed amount;

(b) No subscriber of the Memorandum shall take less than one share; and

(c) Each subscriber of the Memorandum shall write against his name the number of shares he takes.

Under section 17, a special resolution has to be passed for alteration of Memorandum so as to change the place of its registered office from one State to another or with respect to the objects of the Company and the alteration shall not take effect until and except in so far as it is confirmed by the Company Law Board on petition.

Such an alteration has to be registered within three months from the date of the order and be filed by the company with the Registrar as provided by section 18 of the Act.

Auditor's Duty:

The auditor should proceed in the following way in examining the Memorandum of Association:

(1) He should very carefully examine the ‘Object Clause’ of the Memorandum to ensure that the company is carrying on the work as specified.
(2) He should check the ‘Capital Clause’ and see that the issue of share capital is within the ‘Authorised Capital’.
(3) If the Authorised Capital has been increased according to law, it should be verified and traced out.
(4) If the Memorandum has been altered, it should be seen that such an alteration has been made within the provisions of sections 17 and 18 of the Companies Act.

2. Articles of Association:

Under section 26, every company is required to have the Articles of Association. The Articles of Association of a company limited by shares may adopt all or any of the regulations of Table A in Schedule I.

The Articles of Association contain regulations to control the internal administration of the company, viz., regulation for day-to-day work, relationship between its members, their rights and responsibilities, etc. Since the Articles of Association are framed by the company for its use, they may be altered by a special resolution as and when necessary, subject to the provisions of the Companies Act and to the conditions contained in its Memorandum.

According to section 30, the Articles will be printed and divided into paragraphs, numbered consecutively and signed by each subscriber of the Memorandum of Association (who shall add his address, description and occupation, if any) in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

As quoted earlier, a special resolution subject to the provisions of this Act and to be conditions contained in its Memorandum, has to be passed to alter the Articles of Association when such an alteration has been approved by the Central Government under section 31.

A printed copy of the Articles should be filed by the company within one month of the date of receipt of the order of approval.

Thus, the Memorandum of the company, its articles, if any, and the agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager, shall be presented to the Registrar of the State in which the registered office of the company is situated as provided by section 33.

Under section 36, Memorandum and Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles.

All monies payable by any member to the company under the Memorandum or Articles shall be a debt due from him to the company.

Auditor’s Duty:

The auditor should examine the Articles of Association of the company for the following matters:
(i) Issue of Share Capital.
(ii) Calls on shares.
(iii) Calls in advance.
(iv) Calls in arrears.
(v) Forfeiture and re-issue of shares.
(vi) Transmission of shares.
(vii) Payment of commission of shares.
(viii) Rights of various classes of shareholders.
(ix) Appointment, remuneration, rights and duties of Managing Director or Manager.
(x) Appointment, remuneration, qualification shares, rights and duties of Directors.
(xi) Alteration of Share Capital.

(xii) Dividends and Reserves.
(xiii) Borrowing powers of the Company and Directors, etc.
(xiv) Appointment, rights and duties of the auditor.
(xv) Accounts and Audit of the Company.
(xvi) Underwriting of Shares.
(xvii) Meetings and their procedure.
(xviii) How to inform Shareholders.
(xix) Voting Powers of the Shareholders.
(xx) Payment of interest out of capital.
(xxi) How far Table A has been followed in framing the Articles of Association?

The auditor should go through the Articles very carefully and see specially that the regulations contained are in accordance with the law. He should further see that for alteration of the Articles, section 31 has been followed.

It is to be noted that if a company has not adopted its own Articles, Table A of the Companies Act will be applicable.

In the case of Leeds Estate Building and Investment Society Ltd. vs. Shepherd (1887), it was held that an auditor has no defence with him to say that he could not see the Articles of Association when he knew of their existence.

3. Prospectus:

Matters to be stated and reports to be set out in Prospectus are given in section 56 of the Companies Act. A Prospectus is issued with the objective of inviting public to purchase the share of the company. Ordinarily, all matters dealt with above in the Articles of Association are found in the Prospectus.

Auditor's Duty:

The auditor should examine the Prospectus for the following matter:

(i) Amount of capital to be issued, classification of shares and right of shareholders attached therewith,
(ii) Amount payable on allotment and calls,
(iii) Amount of minimum subscription,
(iv) Particulars of any contract entered into with the vendors for the purchase of business,
(v) Amount payable for underwriting commission on shares or debentures,
(vi) Amount of preliminary expenses paid or payable,
(vii) Qualifications, remuneration, etc. of Directors,
(viii) Appointment, remuneration, etc. of Managers.
(ix) Particulars of any material contracts entered into within two years of the date of issue of the prospectus.

Books and Registers:

Under section 209 every company shall keep at its registered office proper Books of Account with respect to:

(a) All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;
(b) All sales and purchases of goods by the company;
(c) The assets and liabilities of the company; and
(d) In the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed if such class of companies is required by the Central Government to include such particulars in the Books of Account.

All or any of the Books of Account may be kept at such other place in India as the Board of Directors may decide. When the Board of Directors so decides, the company shall, within seven days of the decision, file with the Registrar a notice in writing giving the full address of that other place.

Where a company has a Branch Office, whether in or outside India, the company shall be deemed to have complied with the provisions given above, if proper Books of Account relating to the transactions effected at the Branch Office are kept at that office and proper summarized returns, made up to dates at intervals of not more than three months, are sent by the Branch Office to the company at the registered office or the other place referred to earlier.

For the purpose of sub-section (1) and (2), proper books of account shall not be deemed to be kept with respect to the matters specified therein-

(a) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions; and

(b) if such books are not kept on accrual basis and according to the double entry system of accounting.

The Books of Account and other books and papers shall be open to inspection by any Director during business hours.

The Books of Account of every company relating to a period of not less than eight years immediately proceeding the current year shall be preserved in good order. In the case of a company incorporated less than eight years before the current year, the Books of Account for the entire period preceding the current year shall be preserved.

The Managing Director or Manager is made responsible for maintaining and preserving the Books of Account. The Board of Directors of the company, if there is no Managing Director or Manager, will be responsible for maintaining the books. In default, anyone responsible will be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one thousand rupees; or with both.

1. Register of Members:

Every company will keep in one or more books a Register of its Members and enter therein the following particulars (under section 150):

(a) The name and address, and the occupations, if any, of each member;

(b) The shares held by each member, the amount paid thereon, etc;

(c) The date at which each person was entered in the register as a member; and

(d) The date at which any person ceased to be a member.

Provided that where the company has converted any of its shares into stock and has given notice of the conversion to the Registrar, the register shall show the amount of stock held by each of the members converted instead of the shares so converted which were previously held by him.

If default is made in complying with these provisions, the company and every officer of the company, who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

Register of Charges:

Under section 143, every company is required to keep at its registered office a Register of Charges and enter therein all charges on the undertaking or on any property of the company-giving in each case:

(i) A short description of property charged,

(ii) The amount of the charge, and

(iii) Except in the case of securities to bearer, the names of the persons entitled to the charges.

If any officer of the company knowingly omits, or willfully authorizes or permits the omission of any entry required to be made, he shall be punishable with fine which may extend to five hundred rupees.

3. Register of Directors

Under section 303 of the Companies Act, every company is required to keep at its registered office a register of its Directors, Managing Director, Manager and Secretary containing their names, addresses, nationality, father's or husband's name in full, occupation and his business or occupation, if any.

If default is made in complying with the provisions of this section, the company and every officer of the company, who is in default, shall be punishable which may extend to fifty rupees for every day during which the default continues.

4. Register of Directors' Shareholdings

Under section 307, a separate register has to be maintained by every company to record the number, description and amount of any shares or debentures of the company or any other body corporate being the company's subsidiary or holding company, or a subsidiary of the company's holding company, which are held by him or in trust for him or of which he has any right to become the holder whether on payment or not.

5. Register of Contracts, Companies and Firms in which Directors are Interested:

According to section 301, every company is required to keep one or more registers in which separate particulars of all contracts or arrangements, e.g., dates of contract or arrangement, names of the parties, principal terms and conditions and the date of the meeting of the Board of Directors on which the contract is considered, will be entered.

Auditor has to see whether the register is kept as per requirements of the Act and is in order.

6. Index of Members:

Under section 151, every company having more than fifty members shall, unless the Register of Members is in such a form as in itself to constitute an index, keep an index (which may be in the form of card index) of the names of the members of the company and shall, within fourteen days after the date on which any alteration is made in the Register of Members, make the necessary alteration in the index.

The index will contain a sufficient indication to enable the entries relating to each member and will be kept at the same place at which the Register of Members will be kept.

In default, the company and every officer who is in default shall be punishable with fine which may extend to fifty rupees.

7. Register and Index of Debenture holders:

Under section 152, every company shall keep in one or more books a Register of the holders of its Debentures and enter therein the particulars relating to the names, addresses, occupations, etc., about the Debenture holders.

In default, the company and every officer of the company shall be punishable with fine which may extend to fifty rupees.

8. Register of all investments made by the company in Shares:

Under section 372(6), every company shall keep a Register of Investments made by it in shares of any other body or bodies corporate showing names of such corporate bodies in which investment has been made, date of investment, date on which body corporate came in the same group and the names of all body corporate in the same group as investing company.

9. Register of Loans:

According to section 370 of the Companies Act, every lending company shall keep a register in respect of loans made, guarantees given and the date on which the loans have been made.

10. Register of Public Deposit:

Under section 58(A), every company shall maintain a separate register in which all public deposits are to be recorded.

11. Register of Investments:

According to section 49 of the Companies Act, it is provided that "all investments of a company shall be made and held in its own name." If the company's nominee or director becomes on its behalf a director in another company and is required to hold qualification shares, they may be held jointly in the name of the company and such person. A separate register shall be maintained by the company for such investment.

12. Foreign Register of Members and Debenture holders:

Under sections 157 and 158, if it is authorized by the Articles of Association, a company may keep a register of members and debenture holders in the State or country outside India where they are resident. Such a register is kept in that state or country as a branch register. It is known as Foreign Register.

3. Inspection of Contracts:

Next, the auditor should examine the contracts which have been entered into between a company and other parties, e.g.

(i) Contracts with the vendors of any property.

(ii) Contracts with the brokers and underwriters.

(iii) Contracts with the promoters for the preliminary expenses, etc.

Usually, brief particulars about such contracts are given in the

The auditor should see that the Statement of Particulars is correct and transactions relating to such contracts have been properly recorded in the Books of Accounts.

4. Study of Previous Year's Balance Sheet and Auditor's Report:

When the auditor is appointed in place of retiring auditor, he should examine the Balance Sheet of the last year and also the Report of the auditor appointed last year to be familiar with any relevant matter raised by the previous auditor. He should ensure that the objections or qualifications raised in the previous Audit Report have been duly met by the company.

Besides this, he may also examine the Directors' Report to the members containing the recommendations of the Directors in respect of the appropriation of profits made last year. This is very important.

5. Obtaining a Schedule of Books and Persons handling them:

The auditor should, then, get a list of the persons employed to maintain accounts of the company and also of books maintained by them. This will help him in the successful conduct of the audit whenever he needs some information and explanations, and difficulties can, thus, be met easily.

6. Study of Internal Check System:

This is another significant part of an auditor's duty to obtain a detailed statement from the Directors of the Company about the system of the internal check in operation. This will enable him to note down the shortcomings of the accounting system and the procedure followed by the company.

7. Certificate of Incorporation and Commencement of Business:

A public limited company is not allowed to commence business unless a certificate entitling the company to commence business is granted. A private company is entitled to commence business and exercise borrowing powers immediately after incorporation. The auditor should examine the certificate and see that the company has commenced business after it is granted.

QUALIFICATION OF AN AUDITOR

Section 141 (1) & (2) of the Companies Act, 2013 prescribed the following eligibility and qualifications of auditor which are as follows:

1. A person, who is a chartered accountant and holds a certificate of practice, shall be qualified to be appointed as an auditor of a company.
2. The partners who are chartered accountants of a firm alone shall be authorized to act and sign on behalf of the firm.

DISQUALIFICATION OF AN AUDITOR

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

1. A body corporate, except Limited Liability Partnership.
2. An officer or employee of the company;
3. A person who is a partner of an officier or employee of the company.
4. A person who is a relative or his partner of a company or holding or subsidiary company or associate company is disqualified in the following circumstances:

a. When he is holding any security, or
b. When he is indebted in excess of Rs.5,00,000, or
c. When he is given a guarantee or provided any security in connection with indebtedness in excess of Rs.1,00,000.

5. A person or a firm has business relationship of such nature with a company or holding or subsidiary company or associate company.
6. A person whose relative is a director or is in employment of the company as director or key managerial personnel.
7. A person holding more than 20 company audit (20 company audit shall exclude one person company, small company, dormant company, private company with paid up capital less than Rs.100 Crore).
8. A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.
9. Any person who is engaged in consulting and specialized services.

APPOINTMENT OF AN AUDITOR

Appointment of Auditor in Government Company

CompaniesAct,2013definesaGovernment Company [Section 2 (45)], "as a company in which not less than 51% of the paid up share capital is held by the Central or State Government or Governments or partly by the Central government and partly by one or more State governments."

Appointment of First Auditor [Section 139 (7)] 1.

- The first auditor of Government company shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of registration of the company.
- In case the Comptroller and Auditor General of India does not appoint such auditor within 60 days, the Board of Directors of the company shall appoint first auditor within next 30 days.
- In case of failure of the Board to appoint the first auditor, it shall inform Members of the company who shall appoint first auditor within 60 days at an Extraordinary General Meeting.
- First Auditor shall hold office till the conclusion of the first Annual General Meeting.

Appointment of Subsequent Auditor [Section 139 (5)] 2.

The Comptroller and Auditor General of India shall appoint subsequent auditor of Government companies within 180 days from the commencement of the financial year and who shall hold office till the conclusion of the Annual General Meeting.

Appointment in case of Casual Vacancy [Section 139 (8)] 3.

Appointment of auditor due to casual vacancy in Government Company is filled by the Comptroller and Auditor General of India within 30 days. If he fails to do so, the Board of Directors shall fill within next 30 days.

Appointment of Auditor in Non-Government Company

Appointment of First Auditor 1. [Section 139 (6)]

The first auditor of a company other than a Government company, shall be appointed by the Board of Directors within 30 days from the Date of Registration of the company.

In case of failure of the Board to appoint the auditor, it shall inform the members of the company. The Members shall appoint the auditor within 90 days at an Extraordinary General Meeting.

Appointed First Auditor shall hold office till the conclusion of the first Annual General Meeting.

Appointment of Subsequent Auditor's [Section 139 (1)] 2.

Every company shall appoint an individual or a firm as auditor of the company at the first Annual General Meeting.

The appointed auditor shall hold the office till the conclusion of sixth Annual General Meeting and thereafter till the conclusion of every sixth meeting.
The Company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.
Before such appointment is made, the written consent of the auditor to such appointment and also a certificate from the auditor that he is eligible for appointment shall be obtained from the auditor.
The company shall inform the appointed auditor and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Appointment in case of Casual 3. Vacancy [Section 139 (8)]

Causal vacancy arise due to death or insanity or insolvency of an auditor. If an auditor is disqualified after his appointment, he shall vacate his office as auditor. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.
Appointment of auditor's in case of casual vacancy shall be done by the Board of Directors within a period of 30 days.
If vacancy is due to resignation of an auditor, such appointment shall also be approved by the company at a General Meeting convened within 3 months of the recommendation of the Board.
The auditor shall hold office till the conclusion of the next Annual General Meeting.

Removal of Auditor [Sec.140 (1)]

- An auditor can be removed before the expiry of the term by obtaining the prior approval of the Central Government by filling an application.
- The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.
- The auditor concerned shall be given a reasonable opportunity of being heard.

Resignation of Auditor [Sec.140 & (3)]

- The auditor who has resigned from the Company shall file a statement in the prescribed form stating the reasons for his resignation to the Comptroller and Auditor General of India in case of a Government Company and to the Registrar of Companies in case of Non-Government Companies.
- While filing the statement, reasons for resignation and other facts as may be relevant with regard to his resignation shall also be indicated.
- In case of non-compliance, he shall be punishable with fine ranging from □.50,000 to □.5,00,000.

Powers (or) Rights of an Auditor [Sec.143]

The Companies Act has conferred certain rights on auditor's so as to enable them to discharge their duties smoothly.

1. Right to Access Books and Vouchers: Every auditor of a company has a right to access book of accounts and vouchers of the company at all times. Vouchers include all documents, correspondence, agreements, etc.
Books include financial, accounting, statutory and statistical books of the company. The term all times means only during the normal business hours.

2. **Right to Obtain Information and Explanation:**

An auditor has the right to seek information and explanation from the directors and officers of the company. That will enable him to perform his duties successfully. Every officer of the company must furnish the necessary information to the auditor. If the officer refuses to do so, the auditor may report to the members of the company.

3. Right to Sign Audit Report [Sec.145]:

The auditor has the right to sign the auditor's report. The auditor can also sign or authenticate any document which the law requires to furnish.

4. Right to receive Notices and attend General Meeting [Sec.146]:

The company must send all notices and communications to the auditor relating to any general meeting. The auditor shall attend the meeting either through himself or through his representative, who shall be an auditor. The auditor in general meeting must be given reasonable opportunity to speak on any part of the business, which concerns him as the auditor.

5. Right to visit Branches:

The auditor has the right to access all books and vouchers kept at the head office or at any branches of the company. In case the accounts of branches are audited by a person other than the company's auditor, he shall be entitled to visit the branch office. The company auditor can get copies of accounts certified by the branch auditor.

6. Right to get Remuneration:

The remuneration of the auditor of a company shall be fixed in its general meeting for auditing the books of accounts of the company. The auditor can claim remuneration from the appointing authority. At the time of winding up of the company, he can claim remuneration as creditor of the company.

7. Right to Report to Members:

The auditor has the right and duty to report to the members of the company regarding the accounts examined by him. He is also required to give his opinion about whether the financial statements give a true and fair picture of the state of affairs of the company.

8. Right to seek Legal and Technical Advice:

The auditor has the right to seek expert advice in respect of legal or technical matters at the expense of the company.

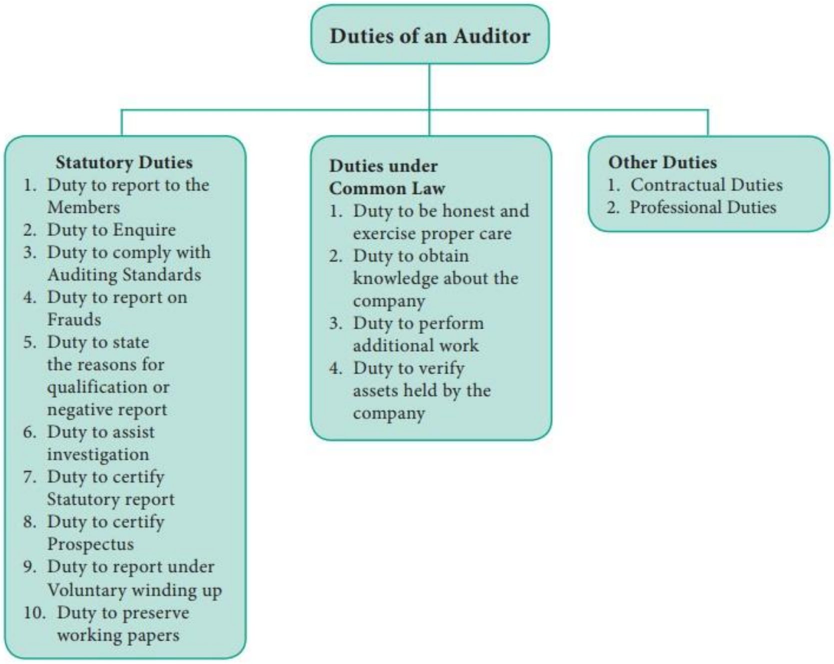
9. Right to give Suggestions to the Board: The auditor has the right to suggest some modifications in the books of accounts to the Board. The Board should comply with the suggestions made by the company auditor. If not, the auditor should report the same to the members. But the auditor cannot make changes in the books of accounts of his own.

10. **Right to Correct Wrong Statements:** The auditor has the right to correct wrong statements made by the directors relating to the accounts. But it should be remembered that any statement by him to this effect will not relieve himself for any omission or incompleteness in his report.

11. Right to be Indemnified:

The auditor has the right to be indemnified out of the assets of the company against any liability incurred by him in defending himself against the civil or criminal proceedings by the company if it is proved that the auditor has acted honestly.

Duties of an Auditor [Sec.143]



Statutory Duties

1. **Duty to report to the Members [Sec.143 (3)]:**

The auditor shall make a report to the members of the company on accounts and financial statements examined by him.

The report shall state:

a. Whether he has sought and obtained all necessary information and explanations.

b. Whether proper books of accounts has been kept.

c. Whether company's Balance Sheet and Profit and Loss account are in agreement with books of accounts and returns.

2. **Duty to Enquire [Sec.143 (1)]:**

It is the duty to inquire into the following matters:

- Whether loans and advances made by the company based on security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members.
- Whether transactions of the company, which are represented merely by book entries, are prejudicial to the interests of the company.
- Whether loans and advances made by the company have been shown as deposits.
- Whether personal expenses have been charged to revenue account.
- Whether it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

3. **Duty to comply with Auditing Standards [Sec.143 (9)]:**

- Every auditor shall comply with the auditing standards.
- The Central Government shall notify standards in consultation with National Financial Reporting Authority, (NFRA).
- The government shall also notify that auditor's report shall include a statement on such matters as notified.

4. **Duty to report on Frauds [Sec. 143 (12)]:**

When an auditor suspects an offence involving fraud is being committed by officers or employees of the company, he shall immediately report the matter to the Central Government in such manner as may be prescribed.

5. **Duty to state the reasons for qualified or negative report [Sec.143 (4)]:**

In case of negative or qualified report, the reasons must be stated in the report.

6. **Duty to assist investigation:**

It is the important duty of the auditor to assist the investigator to investigate the affairs of the company. Further, it is the duty of the auditor,

- To provide and preserve the necessary documents which are in his custody to the investigator, and
- To assist the investigator by providing all assistance in connection with the investigation.

7. **Duty to certify Statutory Report:** The auditor has to certify statutory report as correct to the extent of –

- Shares allotted by the company,
- Cash received in respect of such shares, and
- An abstract of receipts and payments of the company.

8. **Duty to certify Prospectus:**

It is the duty of auditor to certify a report showing statement of profits or losses and assets and liabilities of the company and its subsidiaries. The report shall also include rates of dividend paid by the company for each of five financial years preceding the issue of prospectus.

9. **Duty to report under Voluntary winding up:**

When the company proposes for voluntary winding up, directors of the company have to make a declaration of solvency. The auditor has to certify a report upon the solvency based on the Profit and Loss Account and Balance Sheet.

10. Duty to preserve Working Papers: It is the duty of an auditor to preserve and produce all books and papers relating to the company which are in his custody and to assist the inspector appointed by the government for investigation.

Duties under Common Law

1. Duty to be honest and exercise proper care:

The auditor should be straightforward, honest and tactful and must not be influenced by others in discharge of his duties. He should be careful and cautious in performing his duties.

2. Duty to obtain knowledge about the company:

He should obtain detailed knowledge about the activities and affairs of the company.

3. Duty to perform additional work: The auditor besides performing the statutory duties is bound to perform additional work by passing a resolution in the general meeting or making a provision in the Articles of Association of the company.

4. Duty to verify assets held by the company:

It is the duty of the auditor to verify assets of the company.

Other Duties

1. Contractual Duties:

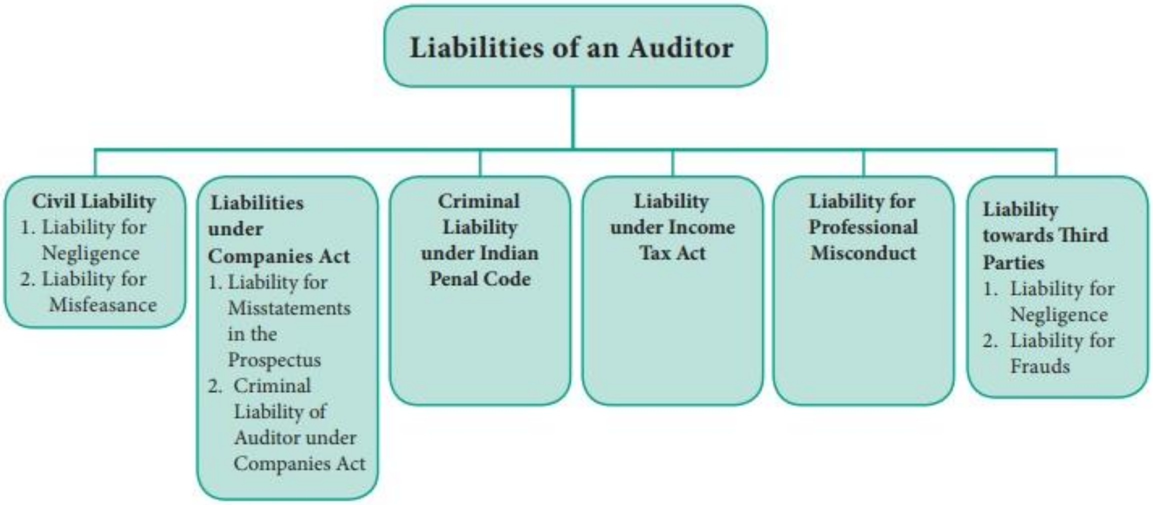
The auditor's duty will depend upon the terms and conditions of his appointment between him and the party who appointed him.

1. **Professional Duties:**

The auditor has to observe the ethics given by the Institute of Chartered Accountants of India. He should correspond with the previous auditor before accepting the assignment.

Liabilities of an Auditor:

A Chartered Accountant is associated with the valuable profession. His primary duty is to present a report on the accounts and statements submitted by him to members of the company. He is responsible not only to the members of the company but also to the third parties of the company, i.e., creditors, bankers etc.



Normally the liability of auditor based on the work done by him as professional accountant and carry out his work due care, caution and diligence. The nature of liabilities of an auditor is discussed below:

1. Civil Liability:

1. Liability for Negligence:

Negligence means breach of duty. An auditor is an agent of the shareholders. He has to perform his professional duties. He should take reasonable care and skill in the performance of his duties. If he fails to do so, liability for negligence arises. An auditor will be held liable if the client has suffered loss due to his negligence. It should be noted that an auditor will not be liable to compensate the loss or damage if his negligence is not proved.

2. Liability for Misfeasance:

Misfeasance means breach of trust. If an auditor does something wrongfully in the performance of his duties resulting in a financial loss to the company, he is guilty of misfeasance. In such a case, the company can recover damages from the auditor or from any officer for breach of trust or misfeasance of the company. Misfeasance proceedings can be initiated against the auditor for any untrue statement in the prospectus or in the event of winding up of the company.

2. Liabilities under Companies Act

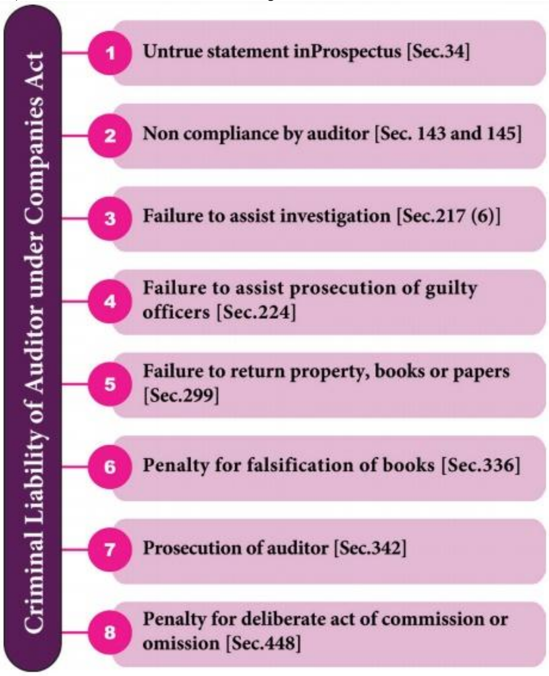
The following are the liabilities of an auditor under the provisions of the Companies Act.

(1) Liability for Misstatements in the Prospectus [Sec.35]:

An auditor shall be held liable to compensate every person who subscribes for any shares or debentures of a company on the faith of the prospectus containing an untrue statement made by him as an expert. The auditor shall be liable to compensate him for any loss or damages sustained by him by reason of any untrue statement included therein. The auditor may escape from liability if he proves that:

- The prospectus is issued without his knowledge or consent.
- He withdrew his consent, in writing before delivery of the prospectus for registration.
- He should have withdrawn his consent after issue of prospectus but before allotment of shares and reasonable public notice has given by him regarding this.

(ii) Criminal Liability of Auditor under Companies Act:



1. Untrue statement in Prospectus [Sec.34]

The auditor is liable when he authorizes a false or untrue prospectus. When a prospectus includes any untrue statement, every person who authorizes the issue of prospectus shall be imprisoned for a period of six months to ten years or with a fine, which may be three times the amount involved in the fraud or with both.

2. Non compliance by auditor [Sec. 143 and 145]:

If the auditor does not comply regarding making his report or signing or authorization of any document and makes willful neglect on his part he shall be punishable with imprisonment upto one year or with fine not less than □. 25,000 extendable to □. 5,00,000.

3. Failure to assist investigation [Sec.217 (6)]:

WhenCentral Government appoints an Inspector to investigate the affairs of the company, it is the duty of the auditor to produce all books, documents and to provide assistance to the inspectors. If the auditor fails to do so he shall be punishable with imprisonment upto one year and with fine up to □.1,00,000.

4. Failure to assist prosecution of guilty officers [Sec.224]:

An auditor is required to assist prosecution when Central Government takes any action against the report submitted by the Inspector. If he fails to do so, he is found guilty and is punishable.

5. Failure to return property, books or papers [Sec.299]:

When a company is wound up the auditor is supposed to be present and subject himself to a private examination by the court and is also liable to return to the court any property, books or papers relating to the company. If the auditor does not comply, he may be imprisoned.

6. Penalty for falsification of books [Sec.336]:

An auditor when destroys, mutilates, alters or falsifies or secrets any books of account or document belonging to the company. He shall be punishable with imprisonment and also be liable to fine.

7. Prosecution of auditor [Sec.342]:

In the course of winding up of a company by the Tribunal, if it appears to the Tribunal that an auditor of the company has been guilty of an offence, it shall be the duty of the auditor to give all assistance in connection with the prosecution. If he fails to give assistance he shall be liable to fine not less than □ 25,000 extendable upto □.1,00,000.

8. Penalty for deliberate act of commission or omission [Sec.448]: If an auditor deliberately make a statement in any report, certificate, balance sheet, prospectus, etc which is false or which contains omission of material facts, he shall be punishable with imprisonment for a period of six months to ten years and fine not less than amount involved in fraud extendable to three times of such amount.

Criminal Liability under Indian Penal Code

If any person issues or signs any certificate relating to any fact which such certificate is false, he is punishable as if he gave false evidence. According to Sec.197 of the Indian Penal Code, the auditor is similarly liable for falsification of any books, materials, papers that belongs to the company.

Liability under Income Tax Act [Sec.278]

- For tax evasion exceeds □.1,00,000, rigorous imprisonment of six months to seven years.
- A person who induces another person to make and deliver to the Income Tax authorities a false account, statement or declaration relating to any income chargeable to tax which he knows to be false, he shall be liable to fine and imprisonment of three months to three years. An auditor may also be charged in case of wrong certification of account.
- A Chartered Accountant can represent his clients before the Income Tax Authorities. However, if he is guilty of misconduct he can be disqualified from practicing.
    - An auditor can face imprisonment upto two years for furnishing false information.

Liability for Professional Misconduct

The Chartered Accountant Act, 1949 mentions number of acts and omissions that comprise professional misconduct in relation to audit practice. The council of ICAI may remove the auditor's name for five years or more, if he finds guilty of professional misconduct.

Liability towards Third Parties

There are number of persons who rely upon the financial statements audited by the auditor and enter into transactions with the company without further enquiry viz. creditors, bankers, tax authorities, prospective shareholders, etc.

1. Liability for Negligence:

It has been held in the court that auditor is not liable to third parties, as there is no contract between auditor and third parties. He owes no duty towards them.

2. Liability for Frauds:

The third parties can hold the auditor liable, if there is fraud on the part of auditor even if there is no contractual relationship between auditor and third parties. In certain cases negligence of auditor may amount to fraud for which he may be held liable to third parties. But it must be proved that auditor did not act honestly and he knew about it.

Audit Report

Audit report is the final stage of audit process. The results of the audit are communicated through audit report. Audit report is the written opinion of an auditor regarding companies financial statements. Audit report is a document prepared by an auditor to certify the financial position and accounting records of a firm.

Meaning of Audit Report

Audit report is the statement included in the financial statements. It contains the opinion of the auditor in financial statements. The auditor reports to the shareholders who have appointed him. He has to provide his opinion on the truth and fairness of financial statements. Thus, the auditor protects the interest of shareholders through audit report.

Definition of Audit Report

Lancaster has defined a report as "a report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of subject matter of the report."

According to Cambridge Business English Dictionary, Audit report is defined as a formal document that states an auditor's judgment of a company's accounts.

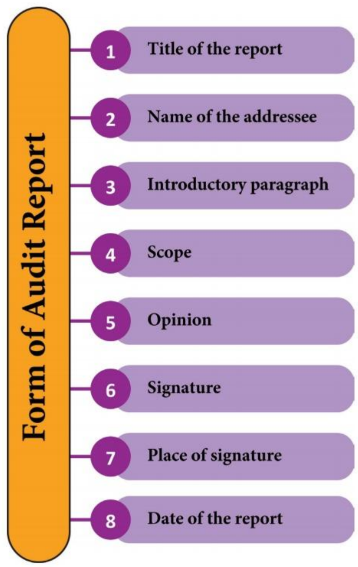
Under Sec. 143(3), auditor of a company must report to its members.

(a) The accounts examined by him;

(b) Balance Sheet, Profit and Loss Account, and Cash Flow statement, which are laid in general meeting of a company during his tenure of office; and

(c) The document declared to be attached to the Balance Sheet and Profit and Loss Account.

Form of Audit Report



1. Title of the report

The title of audit report should help the reader to identify the report. It should disclose the name of the client. The title distinguishes the audit report from other reports.

2. Name of the Addressee

The addressee normally refers to the person who appoints the auditor. If a company appoints the auditor, the addressee should be shareholders. As per law, the complete address of the addressee is required. Addressee for the statutory audit shall be shareholders and in case of Special Audit, it is Central Government.

3. Introductory Paragraph

The introductory paragraph should specify that it is the auditor's opinion on financial statements audited by him. The period covered by financial statements should be stated with exact dates.

4. Scope

This part should include the matter-of-fact relating to the manner in which audit examination was made. The audit examination should cover company's accounts, Profit and Loss Account, Balance Sheet and Cash Flow Statements. The examination should be as per the relevant law. The auditor should not curtail or limit any examination task.

5. Opinion

The auditor's opinion on the books of account and financial statements examined by him is based on the information and free from bias. The auditor has to give his opinion as follows:

- Whether the financial statements are arithmetically correct and correspond to the figures recorded in the books of accounts.

 In case of unqualified opinion, whether the financial statements represent a true and fair view of the state of affairs and the results of operations.
 In case of qualified opinion, if the Balance Sheet and Profit and Loss account do not present a true and fair view, the reasons for what and where is wrong.

6. Signature

The signature part should include the manual signature of the auditor.The personal name and signature of the auditor should be given. If the auditor is a firm, the signature in the personal name and firm name should be given.

7. Place of Signature

This should include the location of the auditor or the auditor firm, which is ordinarily their city.

8. Date of the Report

The date of completion of the audit work should be mentioned in this section.

Contents of Audit Report

As per Sec. 143 of the Companies Act, the auditor's report shall also state—

a. whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

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

c. whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report;

d. whether the company's Balance Sheet and Profit and Loss account dealt with in the report are in agreement with the books of account and returns;

e. whether, in his opinion, the financial statements comply with the Accounting Standards;

f. the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

g. whether any director is disqualified from being appointed as a director under sub-section (*2*) of section 164;

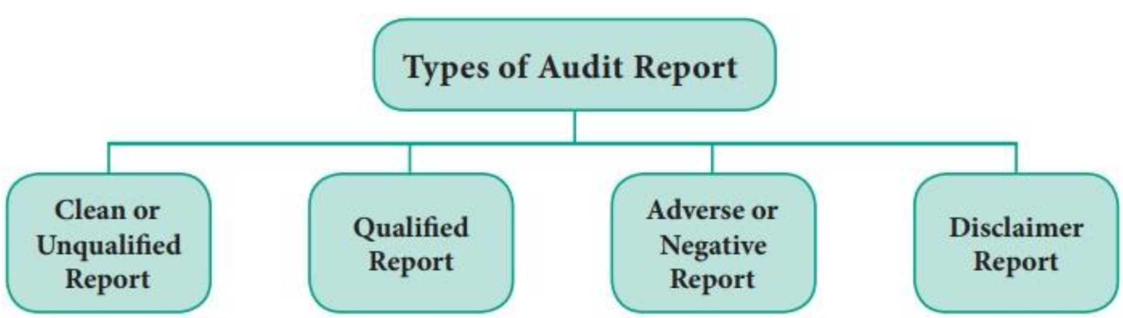
h. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

i. whether the company has adequate internal financial control system in place and the operating effectiveness of such controls;

j. such other matters as may be prescribed.

Types of Audit Report

The audit report may be of the following types:



1. Clean or Unqualified Report

Clean or Unqualified report will be given by the auditor if the auditor is satisfied that the accounts, Balance Sheet, Profit and Loss Account and Cash Flow statement do represent a true and fair view and they are prepared in conformity with the accounting principles and statutory requirements.

2. Qualified Report

In qualified report the auditor believes that overall financial statements are not fairly stated. The reasons for giving Qualified Report are be as follows:

i. The books of accounts, Profit and Loss Account and the Balance Sheet do not represent the true and fair view of the state of affairs and results of the operations, due to lack of conformity with the accounting principles and statutory requirements,

ii. The auditor is not able to verify the value and existence of certain assets,

iii. The information requested by the auditor is not furnished,

iv. Proper books of account are not maintained as required by law,

v. Part of audit examination done by other auditors.

3. Adverse or Negative Report

When there is sufficient basis for the auditor to form an opinion that the whole accounts and financial statements, do not present a true and fair view of the financial condition and results of operation, the adverse or negative opinion will be given. The adverse or negative report will be given on the following grounds:

- When the auditor is not satisfied with the truth and fairness of financial statements,
- Non conformity with the Generally Accepted Accounting Principles,
- Mistakes, discrepancies and material misstatement in the financial statements,
- Omission of a material disclosure.

4. Disclaimer Report

The auditor may disclaim or refuse opinion on the accounts, Profit and Loss Account and the Balance Sheet, when he does not have sufficient information to base his opinion. In the scope and opinion paragraph, the auditor should give disclaimer information. This may happen on the following grounds:

- The auditor has not been able to obtain sufficient information to form his opinion,
- The audit examination is not adequate to form an opinion,
- There are some material un-determined item in audit examination.

Differences between Unqualified, Qualified Differences between Unqualified, Qualified

Basis	Unqualified Audit Report	Qualified Audit Report	Adverse Audit Report
Meaning	Auditor issues a unqualified report where the auditor is fully satisfied with the work of client.	Auditor issues a qualified report where the auditor is not fully satisfied with the work of client.	Auditor issues an adverse report when he does not agree with the affirmation made in the financial statements i.e., accounts disclose a serious distortion.
True and Fair View	The auditor is satisfied that the accounts, Balance Sheet, Profit and Loss Account and Cash Flow statement do represent a true and fair view.	The books of account, Profit and Loss Account and the Balance Sheet do not represent the true and fair view of the state of affairs.	When there is sufficient basis for the auditor to form an opinion that the whole accounts and financial statements, do not present a true and fair view of the financial condition.
Opinion	The auditor gives clean opinion without any reservation.	The auditor gives an opinion subject to certain reservation.	The auditor concludes that based on his examination, he is not satisfied with the affirmation made in the financial statements.

SHARE TRANSFER AUDIT

A share transfer is the process of transferring existing shares from one person to another; either by sale or gift.

OBJECTIVES OF SHARE TRANSFER AUDIT

The main objectives of the share transfer audit are as below:

1. Checking or preventing clerical errors.
2. Preventing the improper issue of duplicate share certificates or certified transfers.
3. Enabling the dealing of securities in stock exchanges as per the stock exchange rules and regulations.

AUDITOR'S DUTY / GUIDELINES REGARDING SHARE TRANSFER AUDIT

While auditing the transfer of shares, the auditor should give consideration to the following aspects:

1. The auditor should examine the Articles of Association of the company to find out the procedure to be followed in case of share transfer and see whether they have been duly followed.
2. Every instrument of transfer shall be in the prescribed form and duly stamped and executed and signed by both the transferor and transferee is delivered to the company along with the share certificate. The auditor should see whether these have been duly fulfilled.
3. Auditor should verify the signature of the transferor by comparing it with the specimen signatures on application forms or from the earlier transfer deeds. This step is important because in case a forged transfer is registered, the company will be liable to the true owner.
4. If the shares are in the joint names of two or more persons, he should see whether they all signed in the transfer deed.
5. He should see whether the company has created any charge on shares transferred.
6. The auditor should inspect the Directors Minute Book to verify whether all the transfers have been duly authorized by the Board.
7. He should vouch the entries passed relating to share transfer in Journal proper.

8. He should examine the Share Transfer Journal, and should ascertain that the entries as to the names of transferor and transferee and the distinctive numbers of shares transferred, have been made in the Register of members.
9. He should see whether share transfer fees have been collected and the same have been transferred to the Profit & Loss Account.
10. He should examine the share transfer form, and see whether the transferor's share certificate is duly cancelled so that it may not be presented in support of another transfer. If the transfer relates to only a part of the shares from out of those mentioned in the share certificate, the auditor should see that correct Balance Certificates have been issued to the transferors.
11. Auditor should make sure that the duplicate certificates, in particular, are issued with the consent of Board of Directors. The fact has to be entered in the duplicate certificate that it is so issued.
12. He should confirm that if the registration of the transfers has been refused, due notices are issued to both parties within 2 months which is essential as per section 111 of the Companies Act.
13. When the transfer of shares are registered on the death or insolvency of shareholders, the auditor should see if the provisions of the Articles have been duly followed and that for transmissions on death to any executor, the following documents have to be examined:

a. Succession Certificate granted by the Court.
b. Certificate issued by the Controller of Estate Duty to ensure the Estate Duty has been paid.
c. Request from the executor that the shares be entered in his name.
d. Order of the Court of Insolvency.
e. Minutes book, regarding the resolution of Board of Directors for approving the transmission.

AUDIT OF SHARE CAPITAL

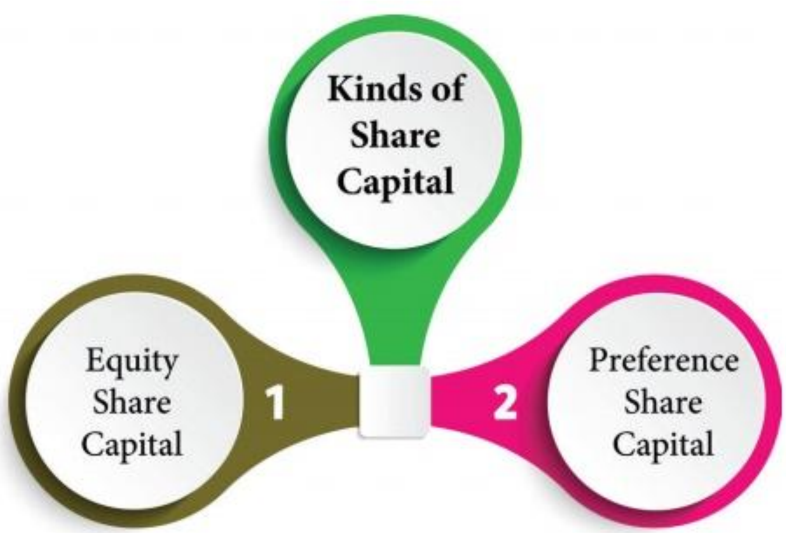
Share capital means capital raised by the company by issue of shares. This issue of share capital should be audited to verify the compliance of requirements and provisions of Companies Act.

MEANING OF SHARE CAPITAL

A company may meet its fund requirements either through raising share capital or through borrowings. The company does a proper financial analysis before taking such a decision. The funds raised through issue of shares is termed as share capital.

KINDS OF SHARE CAPITAL

The share capital of the company is of two kinds, namely, Equity share capital and Preference share capital.



1. Equity Share Capital

Equity share capital means all share capital, which is not preference share capital and called as the ordinary share capital of the company.

2. Preference Share Capital

Preference share capital means that part of the issued share capital of the company which either carries or would carry a preferential right with respect to payment of dividend and a preferential right of repayment in case of winding up or repayment of capital. Apart from these two preferential rights, preference shares can be of participating or non-participating type depending upon their right to participate in dividend payment with capital.

UNIT-V

MEANING

Investigation is a detailed examination of accounts and enquiry into the state of affairs of the business or for a specific purpose. It involves the process of analyzing, collecting and presenting facts in a manner which enables the parties to know the essential facts regarding the matter under enquiry. Investigation covers more than one financial period and the program depends on each type of investigation.

DEFINITION

According to **Spicer and Pegler,** "The term investigation implies an examination of records for some special purpose".

Taylor and Perry, "Investigation involves and enquriy into the fact beyond the books of accounts into the technical, financial and economic position of the organisation".

OBJECTIVES OF INVESTIGATION

I. To ascertain the financial position and the earning capacity of the concern.
II. To investigate when fraud is suspected by the proprietor.
III. To investigate on behalf of Income Tax authorities for tax liability.
IV. To investigate for the purpose of lending money to a concern.
V. To investigate for claims under insurance policy covering losses.

AUDIT OF COMPUTERISED ACCOUNTS

Computerised accounting system is a software that helps businesses to manage the big financial transactions, data, reports, and statements with high efficiency, speed, and better accuracy. Better quality work, lower operating costs, better efficiency, greater accuracy, minimum errors are some of the advantages of Computerized Accounting.

NEED FOR COMPUTERIZED ACCOUNTING

Its need arises from the benefits of speed, accuracy and lower cost of handling the business transactions. Also, it has the capability to record a large number of transactions with speed and accuracy. It allows quick and quality reporting because of its speed and accuracy. Manual accounting system requires large storage to keep accounting records, and vouchers. The requirement of books and stationery and books of accounts along with vouchers and documents is dependent on the volume of transactions.

There is a need to reduce the paperwork and dispense with a large volume of books of account. This can be achieved working with the help of computerized accounting system.

FEATURES OF COMPUTERISED ACCOUNTING ENVIRONMENT

This Accounting System and its awareness among entities have become a necessity in the present environment. Businesses of whatever field and size are shifting from the practice of maintaining accounts manually. The manual process is more time-consuming and exposed to human error.

Storage and retrieval of data and generation of a report cannot be ensured in real time in the traditional system. There is a need to shift to computerized accounting systems. They have empowered business to project accurate information of financial performance.

1. **Simple and Integrated:** It helps all businesses by automating and integrating all the business activities. Such activities may be sales, finance, purchase, inventory, and manufacturing etc. It also facilitates the arrangement of accurate and up-to-date business information in a readily usable form.
2. **Accuracy & Speed:** Computerised accounting has customized templates for users which allows fast and accurate data entry. Thus, after recording the transactions it generates the information and reports automatically.
3. **Scalability:** It has the flexibility to record the transactions with the changing volume of business.
4. **Instant Reporting:** It can generate a quality report in real time because of high speed and accuracy.
5. **Security:** Secured data and information can be kept confidential as compared to the traditional accounting system.
6. **Quick Decision Making:** This system Generates real-time, comprehensive MIS reports and ensures access to complete and critical information, instantly.
7. **Reliability:** It generates the report with consistency and accuracy. Minimization of errors makes the system more reliable.

ADVANTAGES OF COMPUTERISED ACCOUNTING

1. Better Quality Work: The accounts prepared with the use of computerized accounting system are usually uniform, neat, accurate, and more legible than a manual job.

2. **Lower Operating Costs:** Computer is a reliable and time-saving device. The volume of job handled with the help of computerized system results in economy and lower operating costs. The overall operating cost of this system is low in comparison to the traditional system.
3. **Improves Efficiency:** This system is more efficient in comparison to the traditional system. The computer makes sure speed and accuracy in preparing the records and accounts and thus, increases the efficiency of employees.
4. **Facilitates Better Control:** From the management point of view, there is greater control possible and more information may be available with the use of the computer in accounting. It ensures efficient performance in accounting records.
5. **Greater Accuracy:** Computerized accounting make sure accuracy in accounting records and statements. It prevents clerical errors and omissions in records.
6. **Relieve Monotony:** Computerized accounting reduces the monotony of doing repetitive accounting jobs. Which are tiresome and time-consuming.
7. **Facilitates Standardization:** Computerised accounting provides standardization of accounting routines and procedures. Therefore, it ensures standardization in the accounting records.
8. **Minimizes Mathematical Errors:** While doing mathematical work with computers, errors are virtually eliminated unless the data is entered improperly in the system.

AUDITING IN COMPUTERIZED ENVIRONMENT:

Specific aspects of **auditing** in a **computer based environment. Information technology (IT)** is the integral to **modern accounting and management information system.** Application control, comprising input, processing, output and master file controls established by an audit client over its computer bases accounting system.

DIVISIONS OF AUDITING IN EDP ENVIRONMENT

Auditing around the computer by matching **input to output data** would not be sufficient for an **electronic data processing environment**, the auditor needs audit the process through which the computer process the information are derived.

ONLINE COMPUTER SYSTEM

The exposure drafts defines online computer system as **computer systems** that enable users to access data and programs directly through terminals

DOCUMENTATION UNDER CAAT

The auditing in an EDP environment may be carried out by auditing around the computer or auditing through the computer. Auditing around the computer means **carrying out of audit in a traditional manner by comparing the printouts generated in the system.** The auditing through the computer makes use of **computer in auditing**. It also involves auditing systems and programs used in the entity by the auditors. Techniques which use the computer itself for audit purpose are known as **computer assisted auditing techniques (CAAT)**

DOCUMENTATION UNDER CAAT

According to SA 230, The auditor documents refers to record of audit performance and procedure relevant audit evidence obtained and conclusions the auditor reached (terms such as working papers are also used. The objective of audit documentation is to record and **demonstrate the audit work from one year to another**. The standard of working paper and retention procedures for a CAAT should be **consistent** with that of the audit as a whole. The auditor is expected to keep the following documents relating to the stages enumerated below and his audit **working papers** should contain sufficient documentation to describe the CAAT applications such as

- **A. Planning**
- **B. Execution and**
- C. **Audit evidence**

USING CAAT IN SMALL BUSINESS ENVIRONMENT

The use of CAAT in auditing is of immense help to auditor. The following are the benefits derived by this CAAT.

1. **Preparing** detailed audit programming
2. **Preparing audit planning,** scheduling and assignment of available manpower to different assignments in hand
3. **Retaining** required key information from files for making comparison with the set of standard information
4. **Doing arithmetical computations** and checking the arithmetical computations
5. **Doing analytical review** of the data by way of comparison, ratio analysis, trend analysis, test of reasonableness and so on
6 Checking of **validity, consistency and reasonableness of entries**
7. Reviewing **internal control system**
8. **Selecting representatives** for vouching, verification of debtors accounts may be planned to be tested if they comply certain predetermined criteria
9. **Flowcharting**
10. Preparation of audit **reports, documenting, working papers, writing other communication etc**.

LIMITATIONS OF EDP ENVIRONMENT

1. An auditor cannot physically observe the process of accounting in computerized system i.e. visual observation of the **processing is denied**

2. An auditor cannot ensure that the procedure followed in **processing is proper**

3. The procedure may be changed by the **intervention or by malicious codes.** This may not come to the knowledge of the auditor

4. The actual procedure followed may quite different from the **standard procedure** to be followed.

5. The source documents intermediate document and reports are eliminated and reports are **eliminated completely or partially**. Therefore the auditor may not be able to trace the data from the source.

6. The **source code** given and the **object code** used may not agree with each other. It creates a major problem for the auditor.

7. **To ensure efficiency** in operation many books have introduced real time processing wherein every transaction of the branches is processed immediately by the head office through the computers.

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