KLE LAW ACADEMY BELAGAVI

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STUDY MATERIAL

for

PRINCIPLES AND PRACTICE OF AUDITING

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Auditing study material

CHAPTER – 1

Origin of Audit

- Audit may be traced to middle ages, but it can be seen during the industrial Revolution during 18th Century,
- There was an Italian, Luca Pacialo who first published his treatise on double entry system of book keeping for the first time in 1494. He mentioned and Described the duties and responsibilities of an Auditor. Since then there has been a lot of changes in Definition, meaning and responsibilities of an auditor.

Auditing an Introduction

- The primary purpose of the audit is to confirm the authenticity of books of accounts prepared by an accountant. It is well known saying that "where the function of accountant ends, audit begins to determine the true and fair picture of such accounts."
- The audit is an intelligent and critical examination of the books of accounts of the business.
- Auditing is done by the **independent person or body of persons** qualified for the job with the help of statements, papers, information and comments received from the authorities so that the examiner can confirm the authenticity of financial accounts prepared for a fixed term and report that:
- The balance sheet exhibits an accurate and **fair view** of the state of affairs of concern;
- The profit and loss accounts reveal the right and balanced view of the profit and loss for the financial period;

- The accounts have been prepared in conformity with the law.
- Thus, it will be seen that the duty of an auditor is much more than a mere comparison of the balance sheet and accounts with the books.
- But, apart from doing this, he has to satisfy himself according to his information and the explanations given to him.

Definition of Audit

- The word “audit” is derived from Latin word “audire” which means to “hear”. In the olden times, whenever the owners of a business suspected fraud, they appointed certain persons to check the accounts. It was in Italian Luca Pacialo, first published his treatise on double entry system of book keeping for the first time in 1494.
- Primary object of audit is to principally check whether to see accounting party has properly accounted for the receipts and payments of cash.

Spicer & Pegler

- Have defined audit as “ such an 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 true and fair view of the state of affairs of the business, and whether the Profit & Loss Account gives a true & fair view of the profit or loss for the financial period, according to the best of his information and the explanation given to him and as shown by the books; and if not, in what respect he is not satisfied.
- The book "an introduction to Indian Government accounts and audit" "issued by the **Comptroller and Auditor General of India,** defines audit “an instrument of financial control. It acts as a safeguard on behalf of the proprietor (whether an individual or group of persons) against extravagance, carelessness or fraud on the part of the proprietor's agents or servants in the realization and utilisation of the money or other assets and it ensures on the proprietor's behalf that the accounts maintained truly represent facts and that the expenditure has been incurred with due regularity and propriety. The agency employed for this purpose is called an auditor."

Why Audit ?

- Mushrooming of plethora of auxiliary and facilitator service like banking, financing agencies, warehousing, stock market, depositories, risk managers, dispute resolution agents, factors, intelligence providers, information technology system,, …These led to creation of monitoring authority to ensure review and correction mechanism, a system to effect, extract accountability from the managers of the business- **a sine quo non** for the trust reposed on them for allowing the custody of societal funds including investor money, bank's finance, and in general all what the societal environment allowed them for to operate ..

- AS a result, auditing as an independent and professional medium emerged, not a part of industrial and business service but as one separate , unique , independent , a class by itself, a par excellence, with robes of technical education, expertise, experience and self regulated discipline for ensuring standards of quality work befallen onto its shoulders.

Institute of Chartered Accountants of India

- **Definition of auditing**. **Auditing** and Assurance Standards (AAS) 1 by **ICAI**.
  "**Auditing** is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon".

The Comptroller and Auditor General (CAG) of India is an authority,

- Established by Article 148 of the Constitution of India,
  which audits all receipts and expenditure of the Government of India and the state governments, including those of bodies and authorities substantially financed by the government.

- The CAG is also the external auditor of Government-owned corporations and conducts supplementary audit of government companies, i.e., any non-banking/ non-insurance company in which Union Government has an equity share of at least 51 per cent or subsidiary companies of existing government companies.

- The reports of the CAG are taken into consideration by the Public Accounts Committees (PACs) and Committees on Public Undertakings (COPUs), which are special committees in the Parliament of India and the state legislatures.

- The CAG is also the head of the Indian Audit and Accounts Department, the affairs of which are managed by officers of Indian Audit and Accounts Service, and has over 58,000 employees across the country.

- The CAG is mentioned in the Constitution of India under Article 148 – 151.

Feature or aspects or Importance of auditing

- Audit is a systematic and scientific examination of the books of accounts of a business;

- Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

- Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

- The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts
- Audit of accounts in business is made throught the year or periodically.
- Auditing always provides true and fair report of financial statement.
- The scope of audit is not only limited to the business concern but also extended non business concerns such as educational institutions. Health department , charitable trust etc.
- Audit is a critical review of the system of accounting and internal control.
- Audit is done with the help of vouchers, documents, information and explanations received from the authorities.
- The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

ADVANTAGES OF AUDIT

- **Verification of Books and Statement:-**
- The main object of audit is the verification of the books and the financial statements of the company concerned**.**
- **Discover and Prevention of Error:-**
- While examining the books, auditors detect some errors. These are various kinds of errors. So audit is very useful in preventing and detecting the errors**.**
- **Discovery and Prevention of Fraud:-**
- Fraud means false representation made intentionally with a view to defraud somebody. It is the duty of the auditor that he should detect the fraud. So audit main object and advantage is that fraud may be detected and prevented. Auditor may also suggest various methods of internal check which will prevent fraud.
- **Moral Check:-**

- When each staff of the company knows that this financial transactions will be examined by the auditor then he fears to do that fraud. The fear of their detection acts as a moral check on the staff of the company**.**
- **Independent Opinion:-**
- Auditing is very useful to obtain the independent opinion of the auditor about the business condition.
- If the accounts are audited by the independent auditor, the report, of the auditor will be a true picture and it will be very important for the management. Keeping in view the report, owner of the business will be able to prevent frauds and errors in future.

- **Protects the Interest of Share Holder:-**

Audit protects the interest of shareholders in the case of Joint Stock Company. Through audit shareholders are assured that the accounts of the company are maintained properly and their interest will not suffer.

Check on Directors:-

Audit acts a check upon the directors and precaution against fraud on the part of the management**.**

- **Proper Supervision:-**
- Sometimes owner of the business can not look after the business personally. Audit acts as a check on employees and it saves the owner from losses**.**

- **Valuable Advice:-**
- The auditor has expert knowledge about the accounts and finance problems, so he may be consulted about these problems.
- In case of partnership, audit is very useful in settling the disputes among the partners. If any partner dies, or retires, the audited balance sheet will be very useful in estimating the value of goodwill.
- **Loan Facility:-**

- If accounts are audited, then true picture will be known to the financial institutions and they will never hesitate to lend the money.
- **Insurance Claim:-**
- In case of fire insurance and participation of fraud claims can be settled on the basis of audited accounts of the previous years**.**
- **Property Value Assessment:-**
- If the accounts have been audited, then it is easier to value property when the business is sold. In the eyes of law audited accounts are considered more reliable**.**
- **Correct Information about Business:-**
- Due to the fear of audit work accounting always remains upto date and correct information is given to the members in time.
- **Advantage for General Public:-**
- Audited financial statements present the real position of the company before the general public. Keeping in view the position of a company one can do the investment.
- **Useful For Tax Department:-**
- Assessment of tax becomes very easy job for the tax department. Keeping in view the audited accounts they impose the taxes.

Disadvantages of auditing:

- **It is true that auditing has many advantages, but it has some limitations as such**
- **Non-detection of errors/frauds: -** Auditor may not be able to detect certain frauds which are committed with malafide intentions.
- **Dependence on explanation by others**:- Auditor has to depend on the explanation and information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information proved to be false.
- **Dependence on opinions of others: -** Auditor has to rely on the views or opinions given by different experts viz Lawyers, Solicitors, Engineers, Architects etc. he can not be an expert in all the fields

- **Conflict with others:** - Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal judgment plays an important role. It differs from person to person.

- **Effect of inflation**: - Financial statements may not disclose true picture even after audit due to inflationary trends.

- **Corrupt practices to influence the auditors**: - The management may use corrupt practices to influence the auditors and get a favorable report about the state of affairs of the organization.

- **No assurance**: - Auditor cannot give any assurance about future profitability and prospects of the company.

- **Inherent limitations of the financial statements**: - Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgement of the owners. Certain non-monetary facts can not be measured. Audited statements due to these limitations can not exhibit true position.

- **Auditing is a postmortem examination**: auditing work begins where accounting ends then the auditor is fully depends upon the accounting transaction provided by the accountant in the throughout the year. So auditing work is not suitable for the current position of the business. But it is useful to the future business situation.

- **Detailed checking not possible**: - Auditor cannot check each and every transaction. He may be required to do test checking.

S.No	*SA*	*Title of Standard on Auditing*
1	SQC 1	Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements
2	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
3	SA 210	Agreeing the Terms of Audit Engagements
4	SA 220	Quality Control for Audit of Financial Statements
5	SA 230	Audit Documentation
6	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements
7	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements
8	SA 260 (Revised)	Communication with Those Charged with Governance
9	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
10	SA 299	Responsibility of Joint Auditors
11	SA 300	Planning an Audit of Financial Statements
12	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
13	SA 320	Materiality in Planning and Performing an Audit
14	SA 330	The Auditor's Responses to Assessed Risks
15	SA 402	Audit Considerations Relating to an Entity Using a Service Organization
16	SA 450	Evaluation of Misstatements Identified during the Audits
17	SA 500	Audit Evidence
18	SA 501	Audit Evidence - Specific Considerations for Selected Items
19	SA 505	External Confirmations
20	SA 510	Initial Audit Engagements-Opening Balances
21	SA 520	Analytical Procedures

22	SA 530	Audit Sampling
23	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
24	SA 550	Related Parties
25	SA 560	Subsequent Events
26	SA 570 (Revised)	Going Concern
27	SA 580	Written Representations
28	SA 600	Using the Work of Another Auditor
29	SA 610 (Revised)	Using the Work of Internal Auditors
30	SA 620	Using the Work of an Auditor's Expert
31	SA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements
32	SA 701 (New)	Communicating Key Audit Matters in the Independent Auditor's Report
33	SA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report
34	SA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
35	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
36	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

Objective of Auditing:

The objectives of an audit may broadly be classified as

- Primary Objectives
- Secondary objectives.
- Specific object

Primary Objectives:

- The main purpose of audit is to judge the **reliability** of the financial statements and the supporting accounting records for a particular financial period. The Companies Act, 1956 requires that the auditor of a company has to state whether in his opinion the accounts disclose a true and fair view of the state of company's affairs, profit and Loss Account and Balance Sheet of the state of affairs of a business, the auditor carries out a process of examination and verification of books of accounts and relevant documents. Such an examination will enable the auditor to report to his client on the financial condition and working results of the organization. While carrying out the examination of the various books of accounts, relevant documents and evidences, the auditor may came across certain errors and frauds. Despite such a possibility the detecting of errors and frauds is an incidental object.

Secondary Objectives:

- As stated above, an auditor has to examine the books of accounts and the relevant documents in order to report on the financial condition of the business. In the process of such an investigation of accounts certain errors and frauds may be detected. These are discussed under the following two heads:
- Detection of Errors
    - Detection of Frauds
    - Prevention errors and frauds

Detection of Errors: Various types of errors are mentioned

- **Clerical** Errors: Such an error arises on account of wrong posting. For example, an amount received from Thomas is credited to Sunny. Though there is wrong posting still the trial balance will agree. Clerical errors are of three types as follows:

- **Errors of Commission**: When the transaction is recorded but incorrectly we say that error of commission is committed.

(i). Wrong posting from original books to ledger. (ii). Incorrect entries in the original records.

Effect On Trial Balance :- (a). In the invoice if transaction is recorded incorrectly, the effect on the trial balance will be nil.

(b). If a part of transaction is recorded incorrectly then the trial balance will be not balanced.

- **Detection of Errors**: - Such errors can be detected by checking the arithmetical accuracy of the original books. It can also be discovered when somebody challenges the transaction.

- **Errors of Omission:** When any transaction is not recorded in the books of accounts, it is called an error of omission. So transaction is absolutely omitted from the record.

- **Effect on Trail Balance: -** Now this error will not be detected by the trial balance. The trial balance will agree even this error is committed. So the error willing to be disclosed by the trial balance. It will be very difficult to locate the error.

- **Example: -** Suppose some purchase was not recorded in the books. The total purchase recorded in the books will be less than actual purchase. This error will not be disclosed by the trial balance.

- **Detection of Error: -** An auditor may detect the error by comparing the data of previous with this item. We may say that critical analysis of the auditor locate such type of errors.

- **Compensating Errors:** When two or more errors are committed in such a way that the result of these errors on the debits and credits is nil, they are referred to as a compensating errors.

- **For example, Anil's account which was to be debited for Rs. 500 was credited for Rs. 500 and similarly, Sunil's account which was to be credited for Rs. 500 was debited for Rs.500. These two mistakes will nullify the effect of each other. Both the sides of the trial balance are equally affected. As such, these errors are difficult to locate unless detailed investigation is undertaken.**

- Errors of duplication: this errors occurs if the same transaction has been recorded twice in the books of original entry and also posted twice in the ledger a/c . it is very difficult to trace

Errors of Principle

- Such errors are committed when some fundamental principle of accounting is not properly observed in recording transaction. For example, if there is incorrect allocation of expenditure or receipt between capital and revenue or when closing stock is over-valued. Though trial balance will not disagree, the Profit and Loss Account may be very much affected. Sometimes, such errors are committed deliberately to falsify the accounts or unintentionally due to lack of knowledge or sound principles of accounting. Thus, a thorough examination is to be done to locate such errors.

Detection of fraud:

The fraud connected with the accounting in the following ways.

Misappropriation of cash :

In this types of errors take place by omission of receipt regarding to the payment, receipts of cash vouchers. it means misutilization of cash by without showing the cash book .

In this type of fraud may be done by an employee or cashier of the business concern. This method is called by the name of “teaming and lading or lapping”

Teaming and lading:

It is a method of committing fraud by an employee or cashier of the business concern.

Teeming means misappropriation or misuse of cash.

Lading means shortage of cash **by the cashier.** Totally it is a method of cheating to the business owner by the way of continuous cash shortage.

Misappropriation of goods :

It refers to fraudulent application of goods by those who handle them. It can be done by recording sales of larger quantities and misappropriating the balance or by recording purchase of large quantities receiving less quantity and then receiving the balance amount privately

Manipulation of accounts :

- Manipulation of accounts is said to be committed when a person makes a false entry in the books of accounts knowing it to be wrong, alters or destroys a true entry in the business records or prevents the making of a true entry in the business records. Normally it is done by people at the top management level. It is done to overstate or understate the profits and the financial conditions of the business so as to serve their purpose.

Manipulation may be done in any of the following ways:

- Overvaluation or undervaluation of assets
- Recording revenue expenditure as capital expenditure
- Showing expenses of the next year in the current year’s profit and loss account

- Not recording currents year's accrued expenses etc.

<u>Prevention of error and fraud:</u>

- Frauds are always committed deliberately and intentionally to defraud the proprietors of the organization. If the frauds remain undetected, they may affect the opinion of the auditor on the financial condition and the working results of the organization. It is, therefore, necessary that the auditor should exercise utmost care to detect such frauds.

Qualification of an auditor:

- An auditor should be a chartered accountant, without obtaining the certificate of chartered account any person cannot be appointed as an auditor of a public company. For this purpose the person is required to pass the examination conducted by the **institute of Chartered Accountants of India(ICAI)**

Quality of an auditor:

- Now a day an auditor must have some qualities for his efficient work. Some of the qualities for inherent, and rest of other quality acquired from other. The qualities of an auditor are mainly classified into two types. Namely
- Professional qualities
- General qualities

Professional qualities of an Auditor:-

- The important professional qualities of successful auditor are

- **Knowledge of accounting**: the auditor should have the accounting knowledge among various system of accounting and its function for the purpose of proper checking of a financial statement.
- **Knowledge of principles of accounting**: the auditor should be familiar with the various accounting concept and convention, income & expenditure, revenue and capital etc.
- **Knowledge of cost accounting:** the auditor should have a knowledge of cost accounting regarding direct and indirect cost, cost and budgetary control etc. because this knowledge will be helpful to conduct a cost audit.
- **Knowledge of management accounting**: the auditor should have knowledge of management accounting for the purpose of providing advices to the budgetary control & for the purpose of conducting management audit.
- **Knowledge Of management System: -** The auditor must have the knowledge of management information system. It helps him to understand the internal set up of the business concern and its operation.
- **Knowledge of Business Law:-**An auditor must possess a considerable knowledge of business law. He must be aware about his duties and rights given by law.
- **Knowledge of Taxation Law:-**Various types 'of taxes are imposed by the government on the business. For example in some countries Income tax, sales tax, gift tax is imposed. So if auditor has not a considerable knowledge about the taxation. He can not perform his services properly.
- **Knowledge of Auditing**:-An auditor's knowledge of auditing must be up to date. He must know the techniques of auditing. He must have the knowledge of other subjects relating to auditing.
- **Computer Expert**:-The auditor must be able to operate the computer. Today the business organizations are using computers. If auditor does not know to use computer, he cannot work efficiently.
- **Preparation of Budget**:-The auditor must know that how the organization prepares the budget. If he does not know then it will be not possible for him to audit the various heads of the budget.

General Qualities of an auditor

- In addition to the profession qualities the successful auditor should have some general qualities to the following ways.

- **Honest and integrity**:-It is also very important quality of an auditor. Justice Hindley says "An auditor must be honest. He must not certify what he does not believe to be true and he must take a reasonable care and skill before he believes that what he certifies is true.
- **Intelligent**:-It is also important quality of an auditor that he should be intelligent. He must be able to understand the technical details of any business.
- **Tactful**:-In a particular situation auditor should deal tactfully. He should ask the questions in such a manner that it does not show about his ignorance or weakness
- **Maintain Secrecy**:-The auditor’s nature of work is confidential. He should maintain secrecy from others about the affairs of his client.
- **Patience:-**There should be a quality of patience in the auditor. Before signing on any paper he should check the evidence and then sign it. He never checks the papers in hurry.
- **Critical Attitude** :-It is also very essential quality of the auditor. He should examine the statements critically. He should ask the various questions from the client and try to find contradictions.
- **Independent:-**The auditor should be impartial. He should not have such relations with the organization which may affect his independence. He should give his opinion independently
- **Common Sense**:-The auditor must have the quality of common sense and judgement. He may be able to assess the value of depreciation and bad debt.
- **Bold And Courageous**:-Auditor should be bold and courageous person. He should not be influenced by any authority. He should possess the courage to face the difference of opinion between him and client on any issue.
- **Communication**: the auditor should communicate the actual fact to his client through the audit report, if he fails to communicate the actual fact, the auditor is fully responsible for that remarks.

<u>Type or classification of audit:</u>

- The audit can be classified into different types such as
    - **From the point of organizational structure**
        - Statutory audit
        - Private audit

    - government audit
- **From the point of time and scope of auditing procedure**
    - continuous audit
    - internal audit
    - interim audit
    - final audit
- **From the point legality**
    - voluntary audit
    - compulsory audit
- **From the point of specific objectives**
    - cost auditing
    - special audit
    - tax audit
    - management audit
    - operational audit
    - cash auditing
    - marketing audit
    - environment audit
    - social audit
    - property audit

Let us discuss types of audit

Statutory audit :

The term statutory audit refers to the review or the record of the company of the government organization which is required by the law or the municipal authority of any particular region. This is done to monitor the performance of the firm or the government organization. The company here the auditors who provide the auditing report and submit those reports annually or semiannually to the law or the concerned authority. The statutory auditors become elected when the board of directors vote them, those auditor before being elected to this job must have some top position in the hierarchy level of that government organization. Its required for company, co-operative societies, trust , banking , insurance company etc.

- **Statutory Audit vs Internal Audit**
- ***Internal audit is limited to the governance of an organization, management controls over the operations of an organization and risk management. External audit is related to the reports on financial statements of the corporate entity.
- ***External audit is a legal requirement while internal audit is conducted based on the personal resolve of the business owners to measure the operation' efficiency as conducted by the business.
- ***External audit is performed by an external auditor or audit firm while the process of internal audit is performed by the firm's employees, nevertheless, an audit firm can also be selected and appointed to conduct the process of internal audit.

- *Internal auditor is selected or appointed by the company while the selection of the external auditor is at the shareholder's annual general meeting.
- *External audit is performed while maintaining in perspective the various requirements of any acceptable financial reporting standards while no such rules hold for internal audit.
- *Internal auditor by means of the internal audit process is responsible to report to the management or audit committee while statutory auditor as part of the statutory audit process reports to the company shareholders.

Private audit:

- When the audit is not a statutory requirement, but is conducted at the desire of owners , such an audit is private audit . The audit is conducted primarily for their own interest. At times the private audit may become a requirement under tax laws, if the turnover exceeds a specified limit. Private audit is of the following types:
- 1) audit of sole proprietorship
- 2) audit partnership firms
- 3) audit individuals' accounts
- 4) audit institutions not covered by statutory audit

Government audit :

- Audit forms an indispensable part of the financial administration and is one of the important organs necessary to ensure the sound functioning of a Parliamentary Democracy. It is the main instrument to secure accountability of the Executive to the Legislature. Audit assists Parliament/Legislature in exercising its financial control over the Executive, to ensure that funds voted by the Parliament/Legislature have been utilized for the purpose intended and the funds authorized to be raised through taxation and other measures have been assessed, collected and credited to the Government properly.

Continuous audit

- Continuous audit or a detailed audit is an audit which involves a detailed examination of books of account at regular intervals i.e. one month or three months.
- The auditor visits clients at **regular intervals** during the financial year and checks each and every transaction.
- At the end of the year auditor checks the profit and loss account and the balance sheet. A continuous audit is not of much use to small firm as its accounts can be audited at the end of the financial year without much loss of time.

Business where continuous audit is applicable:

- Where it is desired to present the account just after the close of the financial year, as in the case of a bank.
- Where the volume of the transactions is very large.
- Where the statements of accounts is required to be presented to the management after every month or quarter.
- Where no satisfactory system of internal check is in operation.

Advantages of Continuous Audit

- **Easy to quick discovery of errors**
- Errors and frauds can be discovered easily and quickly as the auditor checks the accounts at regular intervals and in detail. As an auditor visits the client after a month or two or so on, the number of transactions will be small and hence, the errors will be detected easily and quickly.
- **Knowledge of technical details**
- Since the auditor remains more in touch with the business, s/he is in a position to know its technical details and hence can be of great help to her/his clients by making valuable suggestions.
- **Quick presentation of accounts**
- As most of the checking works are already performed during the year, the final audited accounts can be presented to the shareholders soon after the close of the financial year at annual general meeting.
- **Keeps the client's staff alert**
- As the auditor visits the clients at regular intervals, the clerks are very regular in keeping the accounts up-to-date. They will see that there is no in accuracy or frauds as it would be detected by the auditor at the next visit.
- **Moral check on the client's staff**
- If the auditor pays surprise visit, it will have a considerable moral check on the clerks preparing the accounts as they do not know when the auditor may pay a visit to check. Moral check will be more valuable to make staff alert and careful.

Disadvantages of Continuous Audit

- In spite of the above-mentioned advantages of a continuous audit, there are certain drawbacks of such and audit which are as follows:
- **Alteration of figures**

Figures in the books of account which have already been checked by the auditor at previous visit, may be altered by a dishonest clerk and the frauds may be committed.

- **Disturbance of client's work**

The frequent visits by the auditor may disturb the work if the client and cause inconvenience to the latter.

- **Expensive**

Continuous audit is an expensive system of audit because an auditor devote more time. So, company needs to pay more amount as the remunerations of an auditor.

- **Queries may remain outstanding**

The audit clerk may lose the thread of work and the queries which s/he wanted to make may remain outstanding as there might be a long interval between two visits.

- **Extensive note taking**

Extensive note taking may be necessary in order to avoid any alteration in the figures after the audit.

Internal audit:

- Internal Auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist management and the Board in the effective discharge of their duties.
- It is the Board's responsibility to set policies and the auditor's role to independently and objectively analyze, review, and evaluate existing procedures and activities, to report on conditions, and to recommend changes for consideration.
- To this end, internal auditing furnishes analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed

Interim audit:

- An audit which conducted in between the two annual audits with a view to find out interim profits to enable the company to declare an interim dividend is known as Interim Audit. It is a kind of audit which is conducted between the two periodical or balance sheet audits
- **Objectives of Interim Audit**
  - To know profit or loss of interim period.
  - To distribute interim dividend.
  - To get loan on the basis of interim account.
  - To get information about the financial position of interim period.

FINAL AUDIT or COMPLETE AUDIT or BALANCE SHEET AUDIT

- Definition: - According to W.W.Bigg
- "Final audit is not commenced until after the end of the financial period and is then carried on until completed."
- An audit which is started at the end of financial year when financial statements are finalized and it is carried out until completion. In case of Joint Stock Company it is compulsory by law. It is also known as "Balance Sheet Audit."

Financial audit

Financial audit is an independent, objective evaluation of an organization's **financial** reports and **financial** reporting processes. The primary purpose for **financial audits** is to give regulators, investors, directors, and managers reasonable assurance that **financial** statements are accurate and complete.

Cost auditing

Cost Audit represents the verification of cost accounts and check on the adherence to cost accounting plan. Cost Audit ascertain the accuracy of cost accounting records to ensure that they are in conformity with Cost Accounting principles, plans, procedures and objective

Management Audit

A management audit is an analysis and assessment of the competencies and capabilities of a company's management in carrying out corporate objectives. The purpose of a management audit is not to appraise individual executive performance but to evaluate the management team in its effectiveness to work in the interests of shareholders, maintain good relations with employees, and uphold reputational standards.

Difference between Cost Audit and Management Audit

BASIS	COST AUDIT	MANAGEMENT AUDIT
Meaning	It is a verification of cost records to measure the internal efficiency of a business.	It is intended to develop the relationships with the outside world and internal efficiency of a business.
Objectives	The cost auditor checks the cost accounting records.	The management auditor investigates objectives and actions of the management.
Requisite Qualification	The cost auditor should be a person with the requisite qualification to conduct the cost audit.	The management auditor may be a person having good knowledge of the management control, production planning and control etc.
Statutory Obligation	The cost audit is made compulsory and statutory in many organizations.	The management audit is not a statutory obligation for any concern.
Tenure	It is a program of one year and the report is to be submitted every year.	It covers a wide area having its scope of all the management activities.
Auditor	Only independent Chartered Accountant or Cost Accountant can perform the work of cost audit.	It can be conducted by any independent person having good knowledge of management.
Report	To submit a report under cost audit, the time limit is fixed by the statute under which it is conducted.	No time limit can be fixed for submission of the report under management audit.

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Steps or procedure or method of pre plan audit:

- The audit of accounts of a business concern involves the sound planning for the purpose of conduct audit work efficiently & effectively.
- Because auditor has to face many problems at the time of preparing audit reports. Therefore an auditor determine future course of action and frame the policies, programs & procedures for the purpose of audit work.
- The audit work involves the consideration of the following steps.
  - arrangement with the client
  - audit of memorandum
  - instruction to client
  - audit program

    - audit notebook
    - division of work between the junior & senior clerk
    - audit report
- **Arrangement with the client**: an auditor should contact the client about the following aspect of audit of that concern before finalizing any agreement are as follows.
- The remuneration of the auditor
- The nature or type of the audit work
- The time period of audit report should be submitted to the client.
- **Audit of memorandum:** after having the proper arrangement with the client an auditor should prepare the memorandum containing all useful information about the business of the client. It contain following point
- ownership and control of the organization
- a details of the accounts related to business concern
- the important product of the company
- the nature of market
- the pricing condition of the product
- the source of the product
- the location of the business
- Overall asset and liability and financial records of a business

AUDIT PROGRAMME

- It is a written scheme of the exact details of the work done by the auditor and his staff in connection with the particular work. All the work which is assigned to each member of the audit team is written in the audit programme. Audit programme guides the audit personal in work to audit be done.
- While construction an audit programme, the Auditor should keep the following points in his mind-
- To operate within the scope and limitations of the assignment.

- To determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- To apply only those steps and procedures, which are useful in accomplishing the verification purpose in the specific situation.
- To consider all possibilities of error.
- To co-ordinate the procedures to be applied to related items.

METHODS OF AUDIT PROGRAMME

- **Complete Programme :-**
- Complete programme is on the file. Completed items are ticked off by the particular assistant. Assistant knows what he has to do. He also knows that by which date each item is to be completed.
- **Individual Programme :-**
- According to the nature of the business auditor prepares the programme for each assistant in such cases.
- **No Any Advance Programme:-**
- In this case auditor never prepares the programme in advance but according the progress of the work he allows to go.

ADVANTAGES OF AUDIT PROGRAMME

- **Supervision of Work:-**
- The auditor can judge the efficiency of his audit team by holding of an audit programme. He is in a position to know the progress of the work. He can see at any time that what part of the work has been completed and what remains to be done.
- **Distribution of Work:-**
- Audit programme is very useful in distributing the audit work properly among the members of the audit team according to their talent.
- **Uniformity of Work:-**

- Audit programme helps in settling all the things in advance, so the uniformity of work can be achieved.
- **Basic Instrument for Training:-**
- Audit programme is very useful for the new auditor. It provides training and guidance to him. So it is rightly called the basic instrument for training.
- **Legal Evidence:-**
- Audit programme is a legal evidence of work done by every assistant of the audit team. It can be presented in the court of law if any client is taken against the auditor for negligence.
- **Fixation of Responsibility:-**
- If any error or fraud remains undetected the responsibility of negligence will fall on the particular assistant who has performed that job.
- **Several Audits may be Controlled:-**
- The auditor controls the audit of various companies at the same time. In the absence of audit programme he can not supervise them effectively.
- **Easy Transfer:-**
- If one assistant is unable to continue the work given to him, it can be given to another person. Audit programme guides him that what is done and what is remaining.

- **Final Review:-**
- Before signing the report, final review is made and for this purpose also auditing programme is very useful.

- **Useful for Future as a reference:-**
- On completion of an audit, it serves the purpose of audit record which may be useful for future reference.

DISADVANTAGES OF AUDIT PROGRAMME

- **Not Comprehensive:-**
- Auditors may have covered the whole field but it can not be said with certainty that all the necessary work have been done.

Rigidness:-

- Audit programme looses its flexibility. While each business has separate problems. So audit programme can not be laid down for each type of business.

No Initiative:-

- It kills the initiative of capable persons assistant can not suggest any improvement in the plan.

Too Mechanical:-

- Such audit programme is mechanical that it ignores many other aspects like internal control.

Not Suitable For Small Audit:-

- It has been proved that audit programme is not suitable for small audits.

New Problems Over Looked:-

- With the passage of time new problems arise which may be over looked.

Audit Note Book

- A note book which is prepared by the audit staff to note down all the uncleared queries which s/he may find in the course of audit and requires further clarification and explanation is known as audit note book. Audit note book contains information regarding day-to-day work performed by the audit staff on any particular date. Notes about all types of errors, difficulties and uncleared queries or points to be discussed with the auditor or clients and the points which are to be incorporate in the report are noted down.

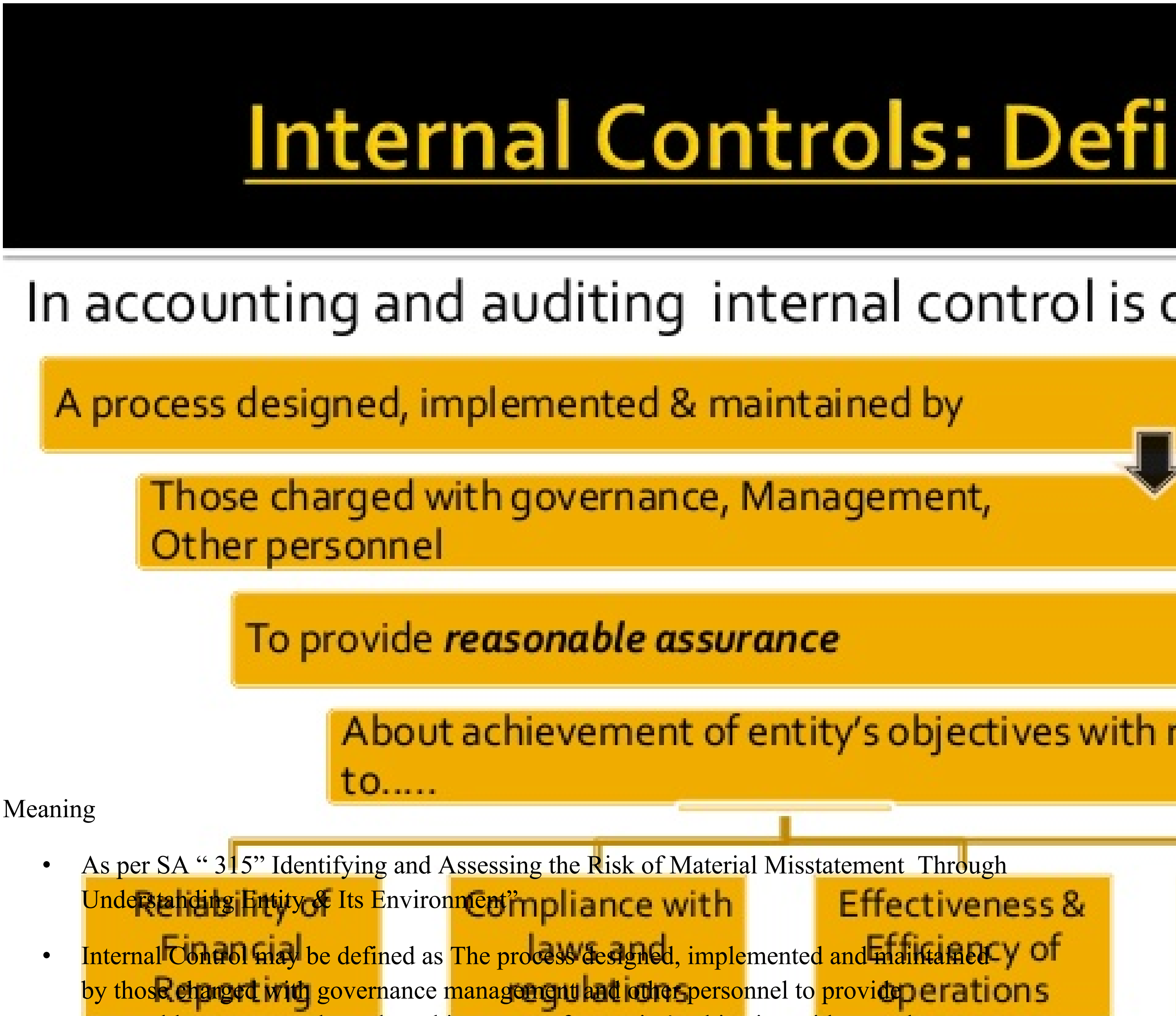
Contents of Audit Note Book:

- A copy of audit program.
- The nature of business and important documents relating to the business.
- The name of the clients and audit year.
- A list of books of accounts.
- Name of principal officers, their duties and responsibilities.
- Accounting and financial policies followed by the business.

Special Matters to Be Recorded In the Audit Note Book

- Routine queries not cleared, i.e., missing receipts and vouchers etc.
- Details of mistakes and errors discovered.
- The points raised during the course of audit, to which the attention of the auditor must be drawn, i.e. failure of the company to comply with the provisions of the Companies Act or of the Memorandum of Association and other legal requirements.
- Extracts from minutes books and contracts and other correspondence with various government agencies, financial institutions, debtors, creditors etc.
- The points to be incorporate in the audit report.
- The points which needs further explanation and clarification e.g., a change in the basis of valuation of finished stocks or in the computation of depreciation, etc.
- Date of commencement and completion of the audit

CHAPTER – 2



Meaning

- As per SA " 315" Identifying and Assessing the Risk of Material Misstatement Through Understanding Entity & Its Environment"
- Internal Control may be defined as The process designed, implemented and maintained by those charged with governance management and other personnel to provide reasonable assurance about the achievement of an entity's objective with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulation. The term "controls" refers to any aspects of one or more of the components of internal control.

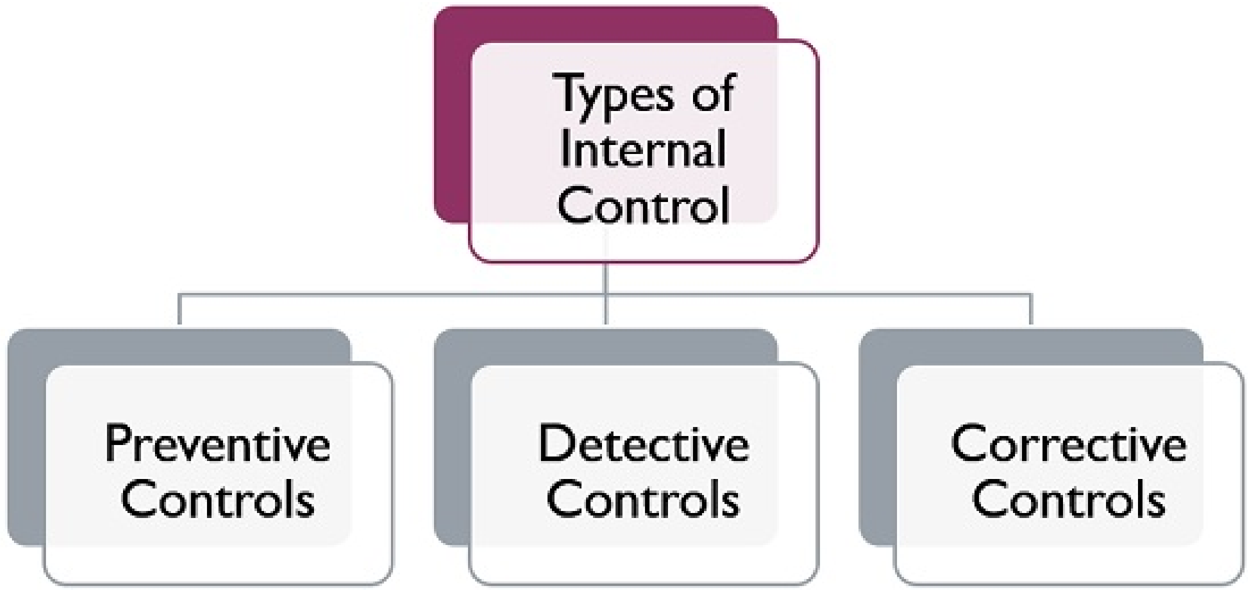
Objectives

- To ensure that the **business transactions take place as per the general and specific authorization** of the management.

- All Transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets.
- To make sure that there is a **sequential and systematic recording** of every transaction, with the accurate amount in their respective account and in the accounting period in which they take place. It confirms that the financial statement fulfils the relevant statutory requirements.
- To provide **security to the company's assets from unauthorized use**. For this purpose, physical security systems are used to provide protection such as security guards, anti-theft devices, surveillance cameras, etc.
- To **compare the assets in the record with that of the existing ones** at regular intervals and report to the those charged with governance (TCWG), in case any difference is found.
- To evaluate the **system of accounting for complete authorization** of the transactions.
- To review the **working of the organization and the loopholes in the operations** and take necessary steps for its correction.
- To ensure there is the **optimum utilization of the firm's resources**, i.e. men, material, machine and money.
- To find out **whether the financial statements are in alignment with the accounting concepts and principles**.

Factors of Internal Control Relevant to Audit

- Materiality
- Significance of the related risk
- Size of Entity
- Nature of the entity's business, including its organization and ownership characteristics
- The Diversity and Complexity of the entity's operations.
- Applicable Legal and regulatory requirements.



Types of Internal Control System

- **Preventive Controls**: These controls are introduced in the firm to stop errors and irregularities from taking place.
- **Detective Controls**: These controls are implemented to reveal errors and irregularities, once they take place.
- **Corrective Controls**: These controls are designed to take corrective action for removing errors and irregularities after they are detected.
- The type of internal control system implemented in the organization will be based on the company's nature and requirements.
- Internal Control System is important for every organization, for efficient management as well as it also assist in the company's audit. It includes all the processes and methods to help the company in reaching its ultimate objective.

Internal Check- Meaning

- An internal check is a part of internal control. Internal check is the process of arrangement of duties of various staffs of a business in such way that work is automatically checked by the next staff while performing their duties. Frauds which are committed by a staff are automatically detected and corrected by the another staff. So, it helps a lot in the work of final audit.
- For example, a staff records the expenditure in a book and another staff posts them into ledger, another staff checks and verifies the ledger and payment is made by another staff. So, the work of one staff is checked by the another staff while performing their works so

that errors and frauds committed by one staff are detected and prevented by the another staff.

Definition

- **Ronald A. Irish** says that It refers to the organization of office duties in such a way as to prevent or disclose both errors and frauds.
  L.R. Dicksee says that It is an arrangement of book that error and frauds are likely to be prevented by the operation of the bookkeeping itself.
  De Paula says that It means practically a continues internal audit carried on by the staff itself by means of which the work of each individual is independently checked by other members of the staff.

OBJECTIVES OF INTERNAL CHECK

- **FRAUD PREVENTION:** The purpose of the internal check is to prevent frauds. The management can achieve this objective through the distribution of duties. One employee is allowed to perform one part of the others complete*the other parts. In this way, many hands complete the work
  2. ASSETS PROTECTION: The purpose of the internal check is to **protect the assets**. The management can take steps to safeguard the resources, One person maintains the record and the custody are given to another officer. Top-level management makes the purchase and disposal. The assets are used for business purpose The periodical inspection of resources is necessary to avoid misuse of the resource.
  3. ERROR PREVENTION: The purpose of the internal check is to prevent errors. The management can devise such a system of internal that mistakes are prevented altogether. If there is negligence on the part of one employee, it is pointed out by another employee who can check the person of the first person.

- **4. FIXING RESPONSIBILITY**: The purpose of the internal check is to fix the responsibility of employees. The division of duties helps the management to locate the inefficient employees.' The pending work provides chances of errors and frauds. The management can replace employees who are negligent in their duties,
  5. MORAL CHECK: The purpose of the internal check is to develop high moral values. The work of one employee is supervised and checked by another employee. All employees feel the sense of responsibility, They complete their work on daily basis. Thus the efficiency of workers increases.

- **RECORDING FACTS:** The purpose of the internal check is to record facts and figures in the books of accounts. The work of recording facts is divided among many employees, In this way, it is possible to prepare books of accounts, which can reflect the true and fair view of business work.
  7. ACCOUNTING SYSTEM: The purpose of the internal check is to devise proper accounting system, It consists of personnel, procedure, records, form used by an organization in developing and communicating accounting information.

Principles

- **SUFFICIENT STAFF:** The principle of internal check is sufficient staff, The employees can be appointed according to workload, The management can determine the amount of ‘work, which distributed among the departments. The persons are hired to perform their duties The overloading can create trouble for management.
  2. DIVISION OF WORK: Division of work is a principle of internal check. The management can determine the total amount of work. The whole work is divided among departments. The heads of such departments are responsible for completion of work according to a timetable.
  3. CO-ORDINATION: Co-ordination is a principle of internal check. All departmental managers are bound to coordinate with each other in order to achieve the objectives of the organization. When there is a fault in one department, the work of other departments suffers and the objectives cannot be achieved. It determines the degree of coordination among the managers.

- **4. ROTATION OF DUTIES:** Rotation of duties is a principle of internal check/ The workers bored by doing the same work from year to year. There is a need for rotation of duties. It is in the interest of the concern as well as the employee. The efficiency improves due to change in duties.
  5. RECREATION LEAVE: The recreation leave is a principle of internal check. The employee can enjoy the recreation leave, It is necessary for the mental health of the employee, He cannot commit frauds as the new employee in his place can disclose the matter. The internal check system can work in the interest of the business, The weaknesses of one person are disclosed due to leave.
  6. AUTOMATIC MACHINES: The principle of internal check is that machines must be used to do accounting work if permissible. The machines Can do a lot of work without delay, The chances of frauds and errors are reduced to a minimum. The working of machines improves the efficiency of the accounting staff,
  7. CHECKING: The principle of an internal check to check the work of other employees. Many’ persons perform the work. The officer can put his Signature to verify the work done by his subordinate. In this way one Work passes many hands, The chances of errors and frauds are minimized due to checking and counter-checking.

- **SIMPLE:** The principle of internal check is simple working: The employee can understand the working of the internal check system. A person can work under the supervision of other employees. The line of authority moves from top to bottom level. Alt workers can understand their duties in the organization.

- **9. DOCUMENTS CLASSIFICATION:** The classification of documents the principle of internal check. the business documents are prepared, collected recorded and placed in proper files. The index is prepared to compile data. The filing system as useful to place letters. In case of need, the documents can be traced quickly.

- **10. DEPENDENT WORK:** Dependent work is a principle of internal check. The work of one employee is dependent upon the others. One work passes through the hand of two or three persons till it is completed. The senior person checks the work of junior person, No person is, all In all, to start and complete the transaction,

- **11. HARMONY:** The principle of internal check is harmony among the employees and departments, The understanding is essential for business goals. The management is to achieve other social and national objectives. The harmony is the basis for the successful internal check.

The systems of internal check in respect of wages and wage payments

- In businesses where the number of workers is large, the work connected with the maintenance of **wage** records and payment of wages is of much importance. There are many possibilities of misappropriation of cash under this item.
- Unless there is an efficient system of internal check in operation as regards wages, the auditor should at the first instance satisfy himself with the arrangement for the preparation of Wage Sheets. If there are some shortcomings, he must disown his liability. The following may be the chances of errors or fraud:
- (1) The time records may be incorrect and incomplete and as a result, workers get wages for the period for which they have not worked
- (2) Similarly, the piece-wage records may be incomplete and incorrect and workers may get wages for the work which they have not done.
- (3) Chances of clerical errors in the preparation of Wage Sheets.
- (4) Inclusion of fictitious names of ‘dummy’ or ‘ghost’ workers in the Wage Sheets.

Payment of wages

- The Wage Sheets should be passed over to the cashier who has not been associated with their preparation. The cashier should withdraw the necessary sum as shown by the Wage Sheets under the column, ‘Net Wages’. After the amount has been withdrawn, the following procedure may be adopted to avoid a fraud or irregularity in payment:
- (1) The clerks, who were associated with the preparation of Wage Sheets, should not take part in the payment of wages to avoid collusion between two or more persons.
- (2) The use of envelopes (i. e., pay packets) indicating the names of workers and amounts contained therein can be a suitable device for making payments.
- (3) All workers who are to receive wages should be present at the time of payment.

- 4) The foreman of each department should be present at the time of payment to prevent any sort of impersonation for workers who are absent.
- (5) Proper precaution should be taken to make payments to workers who become absent at this time. In such cases, payment may be made on the basis of a letter of authority brought by a worker who is present.
- (6) Generally, it is not possible to obtain the signature of each worker on the Wage Sheets. Hence, the payment should be attested by that present, e. g., the foreman, the works manager and the cashier.
- (7) The payment of wages to casual labour present problems. A separate list of such workers should be prepared and the payment should be made in the presence of a responsible officer. To avoid fraud, the officer employing casual labour should not be connected with the payment of wages.

Cash Receipt			
Date: ____________			Receipt No: ______
Received From:			
For Payment Of:			
Payment Amount:			$
Payment Method		Previous Balance:	
Check	☐	Amount Paid:	
Cash	☐	New Balance:	
Money Order	☐	Received By:	
Credit Card	☐	Memo:	

Cash Receipt – Internal Check

- **1. Writing of ledger:**

The cashier doesn't write the ledger it should be written by other person cashier should not have control over the ledger.

- **2. Presence of Officer:**

All the new letters should be opened under the supervision of a responsible officer.

- **3. Cheque's should be crossed:**

All the cheques and drafts in the mail must be crossed and noted in the daily cash book and then delivered to the cashier.

- **4. Comparison:**

The cash book must be compared with the daily cash book and pass book entries should be reconciled

- **5. Issue of receipts:**

A printed sequential numbered receipt should be issued for the amount record.

- **6. Counterfoil:**

Receipt of money should be in double or its counterfoil must be prepared and kept for reference, unused receipt books must be kept safety.

- **7. Daily Deposit:**

All the receipt of cash and cheque must be deposited on the same day or next morning.

- **8. Use of Cheque :**

Sometime payment received cash may not be used always, cheque should be used for payment.

- **9. Sound system to cash sale:**
- There should be a sound system of cash sales recording method of cash sales should be cash well organized.
- **10. Collection of cash by agent:**
- Three copies of cash receipts should be prepared by the agent. One should be given to party, second should be sent to office and third should be kept by the agent agents should also be paid by the cheque.

Chapter – 3

VOUCHING

Introduction to Vouching

- Vouching, widely recognized as "the backbone of auditing," is a component of an audit seeking to authenticate the transactions recorded in a firm's book of accounts. When an accounting transaction is vouched, it is tested and verified by presenting relevant documentary evidence.
- **What is the definition of vouching?** Seeking to establish the accuracy of recorded transactions, vouching ensures that all the entries in the books of accounts come with the relevant evidence, including invoices, receipts, and others. Vouching does not take into account the non-business transactions, thus helping auditors to ensure that all transactions in a firm's book of accounts are business-related. Auditors confirm that the amounts mentioned in each transaction are truthful, disclosing the nature of a transaction, and its authorization.
- **Example**
- A manufacturing company submits its financial statements and book of accounts to a leading auditing firm for vouching. The auditor who undertakes the project seeks to verify that the company's transactions are valid, business-related and properly authorized.
- In the company's cash book, the auditor identifies entries of cash sales, receipts from creditors, interest income, dividend income, mortgage payments, fixed asset sales and accounts receivable. By using this technique, the auditor reviews all the entries and seeks for the relevant documentary evidence that supports and verifies each transaction.
- The auditor finds documentation of receipts, capital expenses, and others that pertain to the recorded transactions in the book of accounts. With the proof of being vouched, the auditor ensures that the claims provided in the book of accounts are justified, and the company does not engage in any type of fraud.
- If the auditor didn't vouch, he might have incurred control risk by neglecting some important information and failing to display appropriate due diligence in reviewing the company's books. Often, auditors are guilty of fraud by presenting a company's financial statements as valid. With the use of technique, the auditing process is accurate and transparent.
- **Summary Definition**
- **To vouch means to search for evidence and verify a claim asserted.**

Meaning

- The act of **examining documentary evidence** in order to **ascertain the accuracy and authenticity of entries** in the books of accounts is called Vouching.
- Vouching means a **careful examination of all original evidences** that is invoices, statements, receipts, correspondence, minutes, contracts etc, with a view **to ascertain the accuracy of the entries in the books of accounts** and also to find out, as far as possible that **no entries have been omitted in the books of accounts.**

Definition

- Vouching means **testing the truth of items appearing in the books of original entry.**
- Vouching is an **act of comparing entries in the books of accounts with documentary evidence** in support thereof.
- Vouching is the **examination of the evidence offered in substantiation of entries in the books,** including in such examination the proof, so far as possible, that **no entries have been omitted from the books.**

Importance of Vouching

- **Backbone of Auditing –** Vouching is the **only way of detecting all sorts of errors and planned frauds**. Hence it is the backbone of auditing.
- **Essence of Auditing –** Auditing checks **if transactions are related to business or not.** It checks for **fictitious transactions created for committing frauds**. All these facts can be found with the help of vouching. So, **vouching is essential** for auditing.
- **To check whether evidences are correct or not –** Frauds may be committed presenting duplicate vouchers. **Evidential documents or records are to be checked carefully** which is the scope of vouching.

Importance of Vouching

- **Proper evidence –** It acts as an **evidence for the entries recorded in the books of accounts**. It is the work of vouching to **ensure that proper evidence is available for every entry**.
- **Proper authority –** To **verify proper authority behind every transaction**. Transaction is **not accepted without signature** of concerned manager.
- **Cash balance –** It is conducted to **check if the cash in hand is correct**. To

count cash and compare it with cash book.

- **Helps to detect frauds –** Success of an audit will depend on the efficiency with which vouching has been applied during the process of auditing. Various **frauds can be detected only if vouching is conducted** in a proper manner.
- **Arithmetical accuracy –** To **maintain arithmetical accuracy** of books of accounts.

Differences between Routine Checking & Vouching

Routine Checking

1. It is the checking of costing, carry forwards, postings and balancing.
2. Concerned with checking of arithmetical accuracy of books of original entry.
3. Narrow concept which involves merely checking of books of accounts.
4. It is a simple & mechanical checking of books of entries.
5. It does not include vouching.
6. Arithmetical accuracy of the entries in the books of accounts is ascertained.
7. It reveals only minor frauds.
8. Reveals only clerical errors and not errors of principle.

VOUCHING

1. It is checking of the validity, authenticity and accuracy of the entries in the books of accounts.
2. Concerned with an examination of documentary evidences /vouchers with entries in books of accounts.
3. Broader concept which involves not only checking books of accounts but also verifying source of transaction with the entries made.
4. An intelligent checking of books of entries with scrutiny of documentary evidences.
5. Includes routine checking.
6. Genuineness of entries, real accuracy of entries in books of accounts is ascertained.
7. Reveals both minor as well as clever and well designed frauds.
8. Reveals both clerical errors and errors of principle.

Types of Vouchers

- **Primary Vouchers –** When **written evidence is available in original**, it is known as primary vouchers. (Purchase invoices & Cash receipts)
- **Collateral Vouchers –** When **evidence in original is not available**. **Copies of such evidences are made available** for the purpose of audit. These documents are known as collateral vouchers. (copy of demand draft)
- **Internal Vouchers – Vouchers originating within the organization** are known as internal vouchers. (Sales invoices & material requisition slip)
- **External Vouchers – Vouchers originating from outside sources** are known as external vouchers. (Mortgage deed & bank statement)

Vouching of Receipts

- Vouching of Receipts means **vouching of the cash receipt transactions**, verifying the **vouchers of the receipts side or debit side** of the cash book.
- Usually it is **difficult to vouch** the receipt of cash than to vouch payments as **some entries might have been omitted altogether** and therefore only an indirect evidence like counterfoils of receipts issued, carbon copies of receipts, contracts and letter from debtors are available.
- Auditor should **check a few items at random** and if he finds them to be in order, he may assume that the others will be correct but **he must not forget to compare the rough cash book or the diary with the cash book.**
- If he finds that there is a **time gap between the two dates**, he should go deeper into the matter as it is possible that **money might have been received in between the two dates and misappropriated.**

Vouching of Cash Sales

- **Cash Sales –** Auditor should **evaluate the Internal Check System** and if it is proper then he should rely on it. He has to **check the cash sales memos** and **compare it with the daily summaries** of salesman and cashier. Also check the **figures of the salesman and cashier summaries** in the cash book.
- **Documents to be checked by the Auditor –** Sales Invoices, Cash Sales Summary and Copies of Cash Memo.

Methods in Vouching of Cash Sales

- **Internal Check –** Auditor should **evaluate the Internal Check System** and if it is proper then he should rely on it. He should examine the system of internal checks **pertaining to proceeds from cash sales** to ensure **no loop holes on omission of cash sales are existing** and **prompt banking into the bank.**
- **Checking of Memos –** Auditor should **check the cash sales memos** and **compare it with the daily summaries** of salesman and cashier. **Verify cash sales with carbon copies of cash memos.**
- **Entry in Cash Book –** Auditor should **check the figures of the salesman and cashier summaries entry in the cash book.** Ensure that the **dates of cash memos/cash sales bills tally** with those of their entry in the cash book.
- **Checking of Cash Book –** Auditor should **compare the cash book with the general ledger.** The **dates on the cash memos should tally** with those on which **cash collected** in respect thereof has been entered in the cash book.
- **Checking of Price Lists –** Auditor should **obtain and verify the price lists** and **compare the price list with cash sale memo**. If a cash memo has been cancelled, its original copy should be inspected because there could be a **possibility of misappropriation** of the amount thereof.
- **Checking the practice –** Auditor has to **ascertain the practice followed in the matter of issuing cash memos of cash sales bills.** Cash sales memo/cash bills must be in number and in sequence.
- **Guidance to client –** If internal check system is not effective then auditor should **inform the client about the dangers of frauds**. He may **suggest some measures.**
- **Checking of Cash Register –** Auditor should **check the total daily rolls with the entries in the cash book**. If **cash collections are made through automatic cash registers**, the daily totals entered in the cash book should be checked with the current rolls.

Steps in Vouching Receipts from Debtors

- **Receipts issued –** Auditor can **vouch the receipt issued to debtors for collection of money.** Counter foil or carbon copies to be compared with entries made in cash book.
- **Receipt date –** Auditor to **make note of the date of receipt and compare with date in the cash book.** There should be no difference in date on receipt and cash book.
- **Daily list –** Auditor can **vouch the daily list of cash collected from debtors in case of large scale business.** Receipt and amount to be recorded in it. Total must be shifted to the cash book on daily basis.

- **Salesmen collection –** Salesmen **may collect cash through sale of goods**. They **must not be allowed to keep cash.** It must be **collected and deposited** with the cashier.
- **Sales returns –** Sales returns **must be deducted from debtors** but in case of cash sales the amount of cash should be given to them.
- **Discount allowed –** It is a **deduction from debtors account**. Must be deducted in order **to find out the net amount receivable from debtors**. Should be seen that the **discount allowed to customers is authorized** by responsible officer. The **terms and conditions of discount** should be properly ascertained and **discount rates should be compared with prevailing rates in market.**
- **Salesmen commission –** It is **deducted from cash collected** by them. Commission on **monthly basis should be paid** to the salesmen. But total amount of cash sales should be collected from them.
- **Bad debts recovered –** Special attention to be given to the amount shown as bad debts written off as **cash can be misappropriated by writing off the whole or a part of the debt balance as bad.** He has to ascertain as to **who is responsible for writing off debts** as bad. With the permission of the client, **he can directly contact the debtors to receive confirmation or verification of slips** if required.
- **Teeming and lading –** Teeming and lading is a **bookkeeping fraud** also known as **short banking**, delayed accounting and lapping. **It involves the allocation of one customer's payment to another in order to make the books balance and often in order to hide a shortfall or theft.** With regard to receipts from debtors, fraud may be committed by the process of teeming and lading. That is **not entering cash in the cash book** received from a debtor and **entering it only when a similar amount is received from another debtor** and so on. No misappropriation is committed but the practice should be checked because there is the **loss of interest for the period money** is misappropriated and the cashier may be tempted to commit such a fraud of bigger amount and **may not be able to replace the same.**

Proceeds from Sale of Investments

- **Broker's sold notes –** Investments are **usually sold through brokers**. The **brokers sold notes or contract notes** which contains the details about the actual amounts received from the sale of investments and the **commission paid to brokers**, should be examined to vouch the amounts received from the sale of investment.
- **Bank advice –** If the sale of investment **has been affected through bank,** then the **bank advice should be examined** to vouch the amount received from the sale of investments.

- **Profit or loss –** Auditor should see that the **profit or loss on the sale of investments is properly adjusted.**
- **Stock market quotations –** Sale proceeds of the investments **should also be checked with the related investment accounts and also with the stock market quotations.**
- **Sold-cum dividend –** If the investment has been sold cum-dividend, the auditor should see that the sale proceeds thereof are properly apportioned between capital receipt and revenue receipt. **Cum dividend, which means "with dividend," is when a buyer of a security is entitled to receive a dividend that has been declared, but not paid.**
- **Sold-ex dividend –** If the investment has been sold-ex dividend, the auditor should see that the dividend is received and recorded subsequently. **Ex-dividend is a classification of trading shares when a declared dividend belongs to the seller rather than the buyer.** A stock will be given ex-dividend status if a person has been confirmed by the company to receive the dividend payment.
- **Ear-marked funds –** If the **investments pertain to some ear-marked funds**, the auditor should see that the profit or loss on the sale of investments **is transferred to the ear-marked fund account.** An earmark **is a legislative (especially congressional) provision that directs approved funds to be spent on specific projects,** or that directs specific exemptions from taxes or mandated fees.

Vouching of Payments

- Cash Payment is defined as a **form of liquid funds given by a consumer to a provider of goods or services** as compensation for receiving those products.
- In most **domestic business transactions,** a cash payment will typically be made in the **currency of the country** where the transaction takes place, either in **paper currency, in coins or in an appropriate combination**.
- **Terms used in Vouching of Payments –** Cheque, Cash in hand, Wages, Vouchers, Voucher Numbers, Bank Reconciliation, Blank Cheques, Monthly accounts, Discounts, Payment authorities.

Vouching of Cash Purchases

<u>Documents to be checked in Cash Purchases:</u>

1. Cash (cash collections)

2. Cash Memo
3. Cash Bill
4. Goods inward book
5. Payment Order
6. Original receipts from the payee

Auditor's Steps in Vouching the Cash Purchases

- **Proper Authorization –** Cash purchase is an important area where the misappropriation of cash is made possible. Hence Auditor should **examine if proper authorization is there for such purchase from appropriate authority.**
- **Situation of Purchase –** In case of emergency, **cash purchase of goods may be made.** So, the auditor should **evaluate the situation** under which cash purchase is made **to ascertain the emergence of such purchase.**
- **Internal Control System –** Usually purchase of stores and stationary items are **made on cash basis.** So the Auditor should **ensure that there is adequate ICS, which will help in controlling manipulation of cash purchases.**
- **Cash Memo –** It should be seen that the goods purchased are actually received by the storekeeper. Cash memos can be **compared with the entries in goods/purchase inward book to verify the actual goods received.**
- **Discount Facilities –** Auditor can check the discount facilities **provided by the suppliers and ensure that only net amount after deducting discount** availed have been entered in the books.
- **Net Amount –** Auditor has **to see that only net amounts,** that is, **purchases minus trade discount,** has been **carried to the books of account.**

Payments of Creditors

- **Goods purchased on credit** are entered in the purchase book.
- The objective of vouching credit purchase is **to see that the auditor's client pays for only those goods which have been actually received in the business and that goods are not misappropriated.**
- The auditor should **exercise great care** and **effectively check the purchase book and related ledger accounts.**

Auditor’s Steps in Vouching Payments of Creditors

- **Purchases –** Book on **issue of receipts for collection of money** is to be maintained. The receipts must be compared with cash book entry.
- **Invoices –** Auditor should check the **amounts due to the creditors** with the **accounts of the creditors** and the **goods received with the invoices**. The sellers may issue duplicate vouchers. The auditor should see that **only one copy is paid**. The **duplicate copy may not be accepted** at all.
- **Cash receipts –** Receipts are **issued for payment** of cash. The auditor can accept **receipt duly signed by the seller** and approved by the buyer. The vouching of such receipts is necessary for **accuracy of record.**
- **Purchase book –** Entries in the **goods inward book or stock ledger** should also be verified to see whether the goods have actually been received.
- **Statement of sales –** Auditor can ask the sellers to **provide statement of sales. Amount paid and payable can be examined.** Vouching of entries with the **account sales statement** is essential.
- **Suppliers account –** Sometimes, **payments made to suppliers are misappropriated** and to cover up the fraud, forged receipts might be produced. To ensure that the payees have actually received the amounts, auditor should **compare the supplier’s account with the statement of account submitted by them.**
- **Missing vouchers –** Vouchers may be missing for certain entries. Auditor can ask the **sellers to confirm the balance.** Responsible officer must **sign duplicate vouchers** before vouching.
- **Purpose of payments –** To ascertain whether the payments made to the suppliers relate to the business, the auditor should **examine the original invoices to find out whether the goods were purchased for the business or for the personal use of any of the officers**. If the goods are purchased for the personal use, it should be seen that the payment is debited to the personal account only.

Vouching of Cash Payments (Credit Side)

- **Bills Payable –** Should be honored on the **date of maturity** and are returned by the payee after receiving the payment. These **bills should be cancelled after being paid**. Bills payable paid can be vouched with bills book. If payment is made by bank, **bank statement or pass book can be examined** to verify the payment of bill.
- **Purchase of land and building –** Land may be **purchased either on leasehold or freehold basis**. In case of leasehold, Auditor to consider t**erms and conditions of lease**

agreement. In case of freehold, Auditor to consider **conveyance deed and receipt issued by seller** for amount paid.

- **Plant and machinery –** Auditor can vouch the **purchase of machinery with invoice** received from the supplier. In case of **imported machinery any import duty and clearing charges** should also be debited to the asset account.

- **Copyrights and patent rights –** If acquired, it should be vouched with receipt issued by seller, **agent's note, agreement, the purchase of patents and copyrights.** If developed through R&D, then all expenses incurred on R&D to be shown as cost.

Vouching of Deferred Revenue Expenditure

- **Deferred Revenue Expenditure** is an expenditure of revenue nature whose benefit is not completely exhausted in the year in which it is incurred, but extends over a number of years.

- In other words, it is a **revenue expenditure** which is **not completely written off in the year in which it is incurred**, but it will be **spread over the years** during which its benefit is available.

- **Examples –** (a) Preliminary expenses, (b) Research expenditure, (c) Development expenses, (d) Underwriting Commission for the issue of shares and debentures.

- **Nature of Treatment –** Auditor has to see that only **right revenue expenditures are treated as Deferred Revenue Expenditures.** That is, he should see that only exceptional revenue expenditures are treated as DRE and **normal revenue expenditures are not treated as DRE to inflate the profit of the business.**

- **Client Policies –** Auditor has to **discuss with the clients and understand clearly the policies of the client** in respect of the amortization (writing off) of the DRE.

- **Estimated Time –** Auditor should see that the **estimate of the number of years over which the DRE is required to be written off has been correctly made.** He should also see that the estimate so made is supported **by adequate and reliable evidences.**

- **Correct Calculation –** Auditor should **check the calculations of writing off** of DRE with relative vouchers are properly made.

- **Accuracy of Transaction –** Auditor should **examine whether the DRE and the DRE written off are treated correctly in the books** i.e. he should see that the written off portion of the DRE is charged or debited to the profit and loss account and the unwritten off portion of the DRE is carried forward as an asset.

- **Reasonable Amount –** Auditor should verify whether the **amount of DRE written off** and charged to the profit and loss account is reasonable.
- **Proper Distinction –** Auditor should see that a **proper distinction has been made between exceptional losses due to fire, floods, earthquake etc. and DRE.** He should see that **exceptional losses are not treated as DRE.**
- **Arithmetical Accuracy –** Auditor should see that the **amount of unwritten off portion of the DRE is correct.** He should see that the unwritten portion of the DRE is shown as an asset on the asset side of the balance sheet until it is completely written off.

Vouching of Preliminary Expenses

- These are the **expenses incurred at the time of floating** the joint stock company. Also known as **Promotion Expenses**.
- It includes (a) Investigation charges (b) Cost of issue of shares and debentures (c) Underwriting commission (d) Fees paid for the preparation of documents like Memorandum and Articles (e) Fees paid for Registration (f) Expenses on Prospectus
- Auditor should ascertain whether these **expenses are authorized by the appropriate authority** and whether these **expenses are incurred within the sanctioned limit.**
- **Cash vouchers and bank pass book** are to be examined for having paid these expenses.

Vouching of Cost of Issue of Shares and Debentures

- It includes the **marketing expenses of shares**.
- Marketing of fresh issues (Initial Public Offer-IPO) involves **direct selling or selling through under writers.**
- In case of direct selling, **Bankers to the Company** play a major role, as the initial deposits and subsequent calls will have to be paid to the company's bankers.
- **Cost of marketing, commission payable to bankers** for collecting money and other service charges have to be vouched.
- Auditor should examine the **Pass Book of the Bank** with which IPO accounts are maintained and the **Agreement Copy** between Banker and the Company.

Vouching of Under Writing Commission

- It refers to the Commission paid to the Underwriters.

- Auditor should look into the Agreement between the Company and the Underwriters regarding the Commission Payable.
- He has to find out whether the commission is paid only on marked applications.
- If the issue is not fully subscribed, he must check whether the underwriter has discharged his liability before the commission is paid.
- It is essential as sometimes the commission is paid even before the full subscription has been met with.
- He should ascertain whether the commission calculation has been properly made.

CHAPTER – 4

VERIFICATION AND VALUATION OF ASSETS AND LIABILITIES

Meaning and Objectives of verification and valuation

Verification means ‘ proving the truth’ or confirmation. Students should not get confused with vouching the expenditure in connection with acquisition of an asset. One of the most important duties of an auditor in connection with the audit of accounts of a concern is to verify that the assets and liabilities appearing in the balance sheet.

Verification Introduction

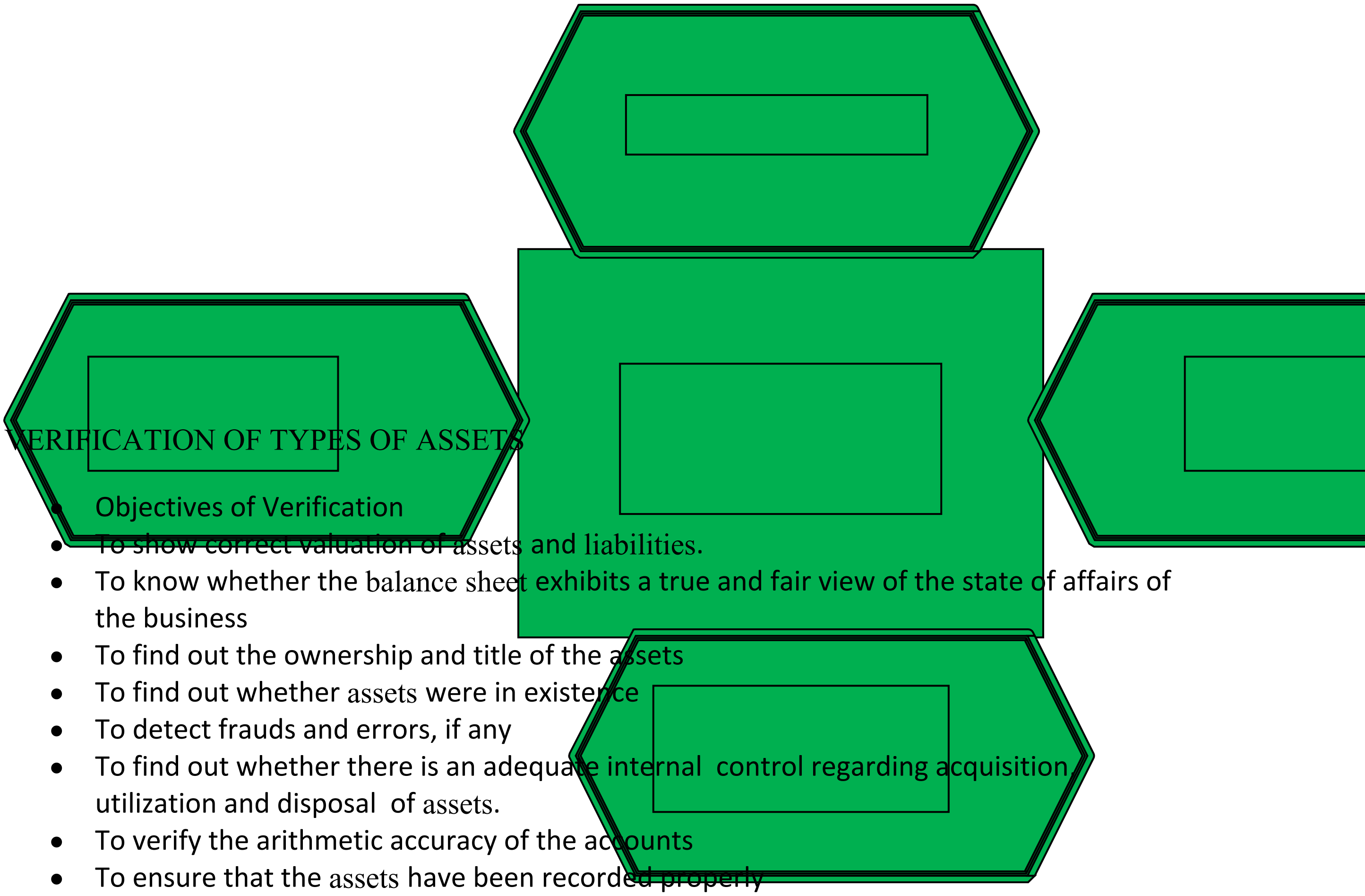
- It is not only to verify the transaction and arithmetical accuracy of the transaction in books of accounts but also to see that the assets recorded in the balance sheet actually exists.
- It is possible that asset might have been disposed or mortgage or pledge or no entry has been made at all.
- It was held in London Oil Storage Co ltd vs Sear Hasluck Co (1904) when Alverstone C J said “ It is duty of the auditor to verify existence of asset stated in the balancesheet and he will be liable for any damage suffered by the client if he fails in his duty.

Verification of assets involves

- 1) Comparing the ledger accounts with the balance sheet.
- 2) Verifying the existence of the assets on the date of the balance sheet
- 3) Satisfying that they are free from any charge or mortgage.
- 4) Verifying their proper value
- 5) Assets were acquired for the business.

McKesson & Robins case in 1939

But in light of decision in McKesson & Robins case in 1939, it would appear that the auditor must physically inspect some of the assets. Wherever possible, the documents of title such as negotiable instruments, shares and securities, debentures etc should be examined on the last day of the financial period.



VERIFICATION OF TYPES OF ASSETS

- Objectives of Verification
- To show correct valuation of assets and liabilities.
- To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business
- To find out the ownership and title of the assets
- To find out whether assets were in existence
- To detect frauds and errors, if any
- To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.
- To verify the arithmetic accuracy of the accounts
- To ensure that the assets have been recorded properly

Valuation

Valuation is the process of **valuing** a company's assets and liabilities for financial reporting purposes. Several accounting- **valuation** methods are used while preparing financial statements in order to value assets.

Difference between Vouching & Verification

1. Vouching is based only on documentary evidence

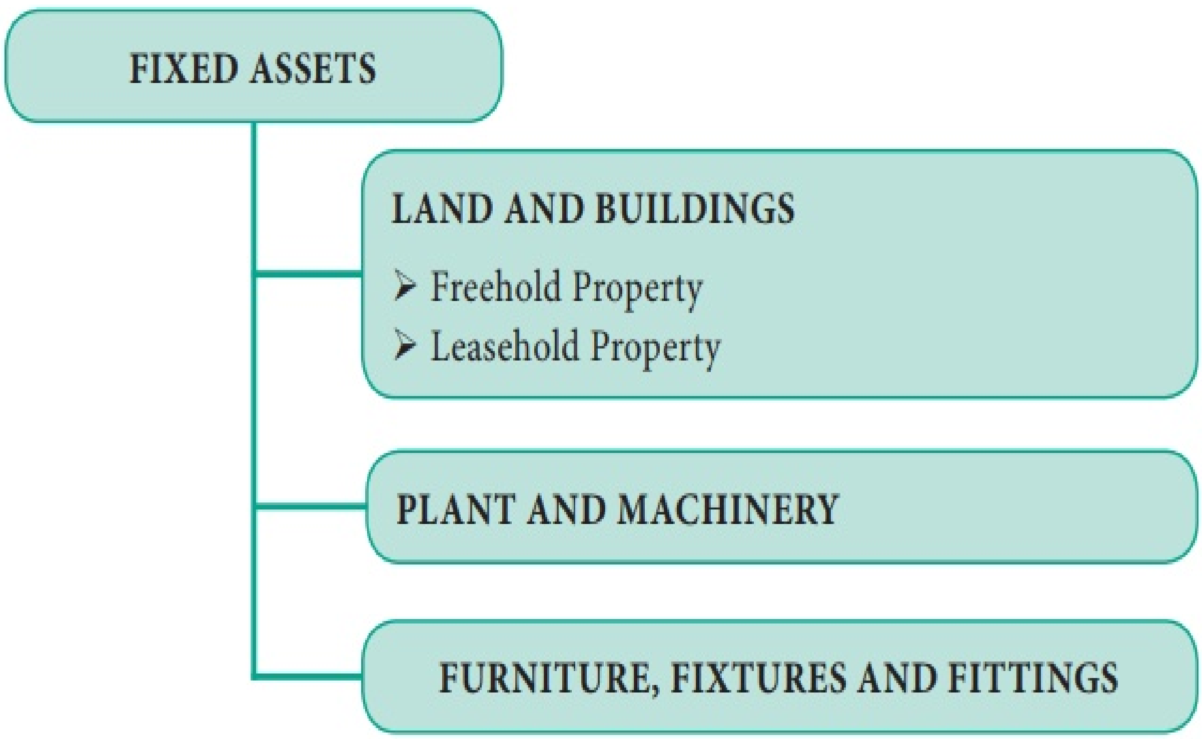
whereas verification is based on physical inspection as well as documentary examination.

1. Vouching examines the entries relating to the transaction recorded in the books of account whereas verification examines the assets and liabilities appearing in the balance sheet.
2. Vouching of books of account is done for the transactions for the whole year. Verification, on the other hand is done at the end of the year when the balance sheet has been prepared.

3. Vouching indicates though a particular asset must be in possession of the concern whereas verification certifies the existence of the asset.

Problems in the valuation of assets

- Replacement Value, Realizable Value, Scrap Value or Breakup Value.
- It must be remembered assets to be valued as per going concern, therefore assets are valued at 1) Original Cost 2) Probable working life of an asset 3) wear and tear of these assets 4) break-up value of these assets 5) chances of asset becoming obselete
- There should be no manipulation of asset value so in valuation , these things should be considered,
- 1)Fixed Assets
- 2) Floating Assets
- 3) Fictitious assets



Fixed Assets

- Fixed assets of are a permanent nature with which the business is carried on and which are held for earning income and not for re-sale in the ordinary course of the business. It is a long-term tangible property that a firm owns and uses in its operations to generate income. Fixed assets are not converted into cash or consumed within a year. They are also called as Capital Assets. Example: land and buildings, plant and machinery, furniture etc. These assets are to be valued at cost price less total depreciation in their value by constant use. Additions by way of purchase and deletions by way of sales should be taken into account.

1. **Land and Buildings**

Land means a long -term asset that refers to the cost of real property exclusive of the cost of any constructed assets on the property. The value of land has an appreciated value and is not subject to depreciation. A building is a noncurrent or long-term asset which shows the cost of a building (excluding the cost of the land) . Buildings will be depreciated over their useful life of the asset.

Classified into two types

- Land and Buildings can further be classified as –
- **A Freehold property.**
- **B Leasehold property**

Freehold Property

- A property which is free from hold (Possession/Rights) is called as freehold property. This means that the property is free from the hold of anybody besides the owner who enjoys complete ownership.
- **Auditor's Duty**

  1. Where Freehold property has been purchased, the auditor should examine the title deeds e.g., purchase deed, certificate of registration, the broker's note and auctioneer's account etc., to verify the correct position.

2. When the property has been mortgaged, the auditor should obtain a certificate from the mortgagee regarding the possession of title deed and outstanding amount of loan.

3. When the property has been acquired in the current year, then the cost may be verified with the help of the bank passbook. He should vouch all the payments made in this connection.

4. He should see that the property account should be shown in the Balance Sheet at cost price including the legal and registration charges less depreciation up-to-date.

5. He should also see that a separate account for building and land on which it is constructed is maintained. It is necessary because depreciation is provided for building and not for the land.

(B) Leasehold Property

- Leasehold is an accounting term for an asset being leased. The asset is typically property such as a building or space in a building.
- The property which is on lease (rent).
- The property (plot/flat/villa/mall/ factories) which is leased by the landlord for a certain period of time to the lessee (tenant /leaseholder/renter/ occupant/dweller).
- The (tenants) have been given the right to use during that specified time by the landlord.
- The ownership of the property returns to the landlord when the lease comes to an end.

Comparison between Leasehold and Freehold property

Leasehold Property	Freehold Property
Land belongs to the state, leased to owner for a certain number of years	Land belongs to the owner
At the end of the lease period, owners must pay to extend the lease	Ownership is indefinite
Requires state consent (obtained at the land office) to transfer ownership	Does not require state consent to transfer ownership (except in certain specially earmarked properties)

Auditor's Duty

- 1. The auditor should verify this by inspecting the lease agreement or contract to find out value and duration. He should see that the terms and conditions of lease are properly complied with.
- 2. In case property has been mortgaged, the auditor should obtain a certificate from the mortgagee regarding the possession of title deed.
- 3. Where the leasehold property has been sub-let, the counter part of the tenant's agreement should also be examined.
- 4. The auditor should physically inspect the properties.
- 5. The auditor should also note that proper provision has been made for depreciation of lease problem and for any possible claims arising there under.

Plant and Machinery

- A plant is an asset with a useful life of more than one year that is used in producing revenues in a business's operations. Plant is recorded at cost and depreciation is reported during their useful life.
- **Auditor's Duty**
- 1. When the machines are purchased in the current accounting period, the invoices and the agreement with the vendors should be verified.

- 2. The auditor should ` examine the plant register in which particulars about the cost, records about sales, provision for depreciation, etc., are available.
- 3. He should prepare a list of each machine from the plant register and should get the list certified by the works manager as he is not a technical person and therefore he has to depend upon the advice of the works manager regarding their valuation, etc.
- 4. He should see that plant and machinery account is shown in the Balance Sheet at cost less depreciation after making proper adjustment for purchases and sales during the year under audit.
- 5. In case any plant and machinery has been scrapped, destroyed or sold, he should ascertain that the profit or loss arising thereon has been correctly determined.

Name of the plant/asset ______					Location ______				
Description					Method of Depreciation				
Original Cost					Rate of Depreciation				
Estimated Life									
Date	Particulars	Opening value	Additions during the year	Gross value	Disposal or sale during the year	Net value	Depreciation for the year	WDV as on the close of the year	Repairs during the year

Goodwill

Goodwill should be shown as an asset in the balance sheet only if it has been purchased. In such a case goodwill should be shown at cost. But if the price paid for goodwill has not been fixed specifically in the contract of sale, the amount of goodwill will be the difference between the total purchase price and the other assets at agreed valuations, less any liabilities taken over from the vendors.

6.12 VERIFICATION AND VALUATION OF INTANGIBLE ASSETS

6.12.1 GOODWILL

Goodwill is considered as an intangible fixed asset. The value that is shown in the Balance Sheet does not appear to be its present value, because the present value of goodwill depends upon a number of factors like financial position of the business, earning capacity at present and its future trend etc. But in actual practice, it is not valued at cost.

Valuation of Goodwill

There are several methods of valuation of goodwill. However, goodwill should not be recognised in the accounts unless it is purchased. Regarding valuation of goodwill, an appropriate method is to be adopted to write the cost down out of the available profits and in this way, it should be ensured that the capital of the business is represented by tangible assets only.

Auditor's Duty Regarding Valuation

i. The auditor should confirm himself that goodwill appearing in the Balance Sheet has not been shown in excess of its cost price.

ii. The auditor should see that the goodwill is never appreciated in the books of a company.

Excerpt from ICAI

Verification of Goodwill

Goodwill is the excess of the price paid for a business as a whole over the book value or the computed value or the agreed value of all tangible assets purchased. It is not possible to be verified physically; hence verification of goodwill means proper checking of accounting entries passed for goodwill.

Auditor's Duty Regarding Verification

i. The goodwill as recorded in the books of account should be properly examined and the same is to be verified with the Balance Sheet.

ii. If goodwill is created on account of purchasing a running business, the auditor should verify it with the contract made between the client and the vendor.

iii. Sometimes, management intends to capitalise the current expenditure, which is usually high. The auditor should raise objection to this practice.

iv. In case of goodwill once written off, but later on brought back in order to write off the debit balance of profit and loss account or any capital loss, the auditor should investigate the reasons for this and may refer to the resolutions adopted at the Directors Meeting and the approval of the shareholders.

Verification and Valuation of Investments

An investment is a monetary asset purchased with the idea that the asset will provide income in the future or will later be sold at a higher price for a profit. Investments include Government securities, shares, debentures, etc. When the number of investments is very large, the auditor should ask for a schedule of investments held by the client containing various particulars like name of the securities, date of purchase, nominal value, cost price, market price, etc., and examine the same. He should ensure that the investment asset has been shown separately in the Balance Sheet.

The auditor should verify the existence of investments **by personal inspection**. At the same time, he should also ensure that the investments are **registered in the name of the client** and they are free from any charge. He should rely on the relevant vouchers and certificates to do so.

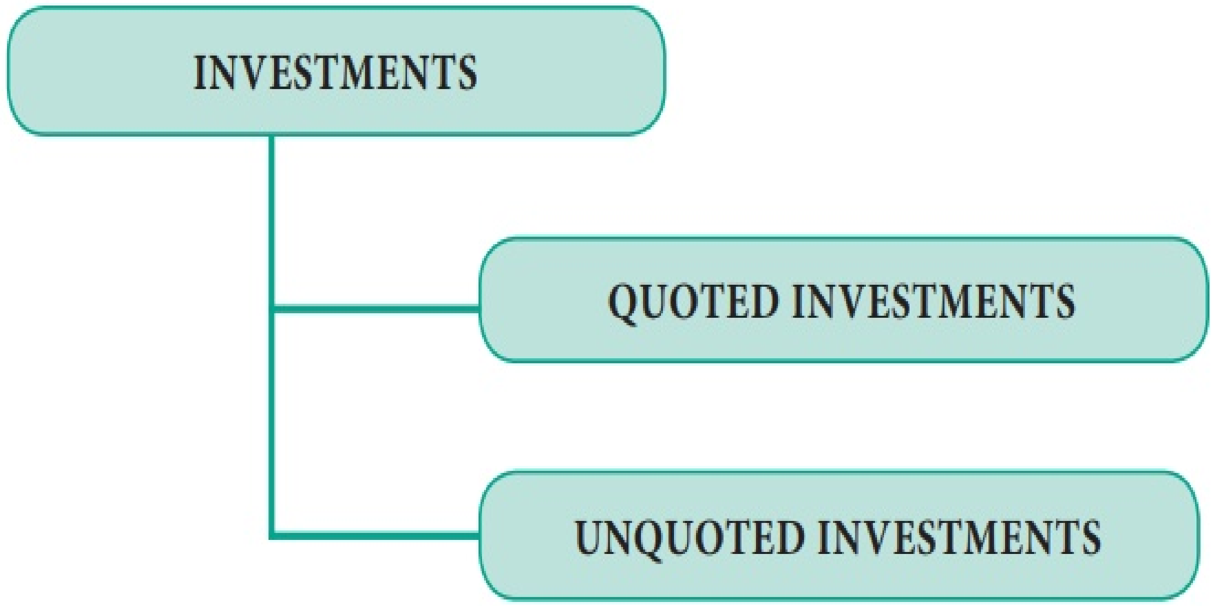
If the securities are with the trustees on behalf of the concern the auditor should examine the **trust deed**. In case they are under the safe custody of the banker then he should obtain the certificate from the banker and examine the same.

If they are with the broker, he should examine the certificate received from the broker.

Having verified the securities, the auditor has to find out that the investments are properly valued. Generally, investments are valued at cost price or market price whichever is lower.

In case there is a temporary fall in the price of the shares, it should be ignored. But where such a fall is permanent,.

Actually, the basis of valuations of investment will depend upon the purpose for which they are held. For instance, in case of trust company, the sole purpose of which is to earn interest and dividend, then such investment must be treated as fixed asset. In such cases, even the permanent fall in their value should be ignored.



Quoted Investment

A company’s share is said to be “lists”, or “Quoted” if its share can be traded on a stock exchange, i.e., Public Limited Companies.

Auditor's Duty in Verification

1. Verify the authorization for purchase of investment. Auditor should review **board minute book** (book which record the conclusion of meeting) for authorization.

2. Vouch the entries **in brokers contract note**, share certificate and cash book.

3. Examine the share certificate to ensure that the type of security and number of share agrees with investment account and that the share held in the company with its name.

4. Verify that the investments are properly classified and disclosed as stated in Companies Act.

Auditor's Duty in Valuation

1. The auditor should satisfy himself that the investment has been valued in the financial statement in accordance with recognized accounting policies and practices and relevant statutory requirements.

2. The auditor should examine whether in computing the cost of investment, expenditure incurred on account of transfer fees, stamp duty, brokerage etc., is included in the cost of investment.

Unquoted Investments

A company share is said to be “unlisted” or “unquoted” if its stocks that are not listed on a stock exchange and so have no publicly stated price. Here, Investments are difficult to value, for example, shares that have no stock exchange listing i.e. Private Company etc.

Auditor's Duty in Verification

1. Auditor should verify the Memorandum of Association to ensure authority for purchase such investment.

2. Where investments are in large numbers, the auditor should obtain the schedule of securities certified by a senior officer of the company.

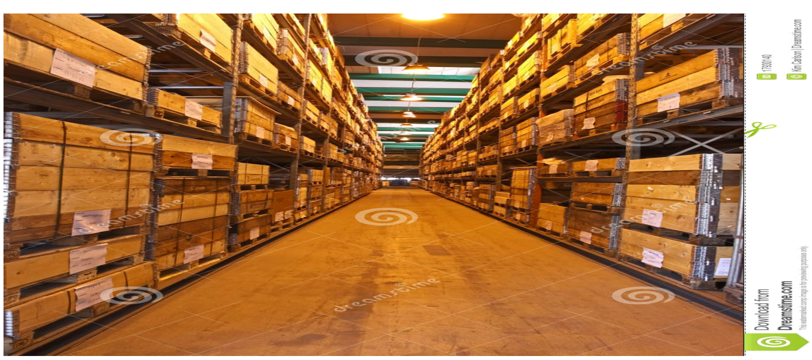
3. Obtain the schedule of investment comprises for information about the name of the securities / investment, date of their acquisition, nominal/ face value, cost price, book value, paid up value market value, rate of interest applicable, dates of interest due, tax deduction, etc., at the date of Balance Sheet.

Auditor’s Duty in Valuation

1. The Auditor should examine the method adopted by the organization for determining the market value of such securities.

2. The Auditor should examine whether the method of valuation of securities by entity is one of the recognized methods of valuation viz., breakup value method, capitalization of yield method, yield to maturity method etc.

VERIFICATION OF STOCK IN TRADE



In every business, stock is taken at the close and if the Stock Accounts are maintained properly and there is an effective system of internal check in operation, the possibility of fraud and errors is minimized.

The following points should be kept in mind while verifying the stock-in-trade:

(1) The method of stock-taking should be examined so that possibilities of fraud and errors may be found out. It should also be seen whether proper control is exercised over the receipt and the issue of goods in stock.

(2) The auditor should obtain a list of instructions issued in connection with the stock-taking.

(3) A few items should be checked in the rough stock sheets.

(4) The totals and balances of Stock Sheets should be thoroughly checked.

(5) The value of different items of stock should be examined with the help of Valuation Sheets, Invoices, etc.

(6) The principles and bases followed in the valuation of stock should be examined to ensure that they are those followed in previous years. To verify the work-in-progress and the closing stock, the accounts relating to costs should be checked.

(7) It should be seen that the valuation of stock is done on the basis of cost price or market price whichever is less, as stock is a floating asset and is meant for resale. The actual loss has been provided for and the stock is properly valued.

(8) The Goods Inward Register should be examined and it should be seen that the goods received on the closing day or earlier have been included in the stock.

(9) Similarly, the goods sold on or prior to the closing day, have not been included in the stock.

(10) It should also be ensured that the goods not related to the business have not been recorded in the stock.

(11) The percentage of gross profit to sale of the current year should be compared with that of the previous years. If there is some difference, that matter should be enquired into.

VERIFICATION OF TRADE CREDITORS

1. The correctness of liabilities depends upon the correctness of purchases. Hence, the auditor should compare the percentage of gross profits to purchase with that of the previous years to verify the correctness of purchases.

2. The auditor should obtain a Schedule of creditors and verify them with the balances of ledger accounts and statements of account received from creditors. (VERIFY CREDITOR, AMOUNT PAYABLE IS CORRECT)

3. He should check the **Purchases Book and Purchases Returns Book with the help of invoices**, credit notes, etc. He should also check the postings into the Ledger.

4. He should examine the Goods Inward Book to ensure that the goods purchased have been actually received.

5. He should see that all the purchases made during the year have been accounted for especially at the end of the year.

6. He should examine the **discount allowed by creditors** during the period and see that these substantiate the credit balances. (There is scope for manipulation)

7. In case of hire purchases, the auditor should see that the conditions of Hire Purchase agreements are properly complied with.

8. He should examine the entries made at the beginning as well as at the end of year to check the **employees have passed any fictitious entries** in this regard.

9. **If any debt is found unpaid for a long time, an enquiry should be made** since it is possible that instead of paying to the creditor, the amount might have been **misappropriated.**

VERIFICATION OF BILLS PAYABLE

1. The auditor should obtain a Schedule of bills payable and its totals should be compared with the Bills Payable Book and Bills Payable Account.

2. The bills paid after the Balance Sheet date should be examined with the entries passed in the Cash book

3. The auditor should obtain confirmatory statements from the drawers directly with the permission of his client.

4. He should pay special attention to the bills that have been paid between the date of the Balance Sheet and the date of his audit have been duly written in the books.

VERIFICATION & VALUATION OF LOANS

1. The auditor should verify the existence of loans, if any. In case of a company he should examine the correspondence, contracts, and Directors' Minute Book.

2. The auditor should ascertain the terms of loan, amount of loan, period and nature of loan, etc. by referring to the loan agreement.

3. He should confirm the balances of the unpaid loans directly from the creditors of the company with the permission of his client.

4. In case of loans or overdrafts taken from a bank, an agreement with the bank and a certificate to that effect should be obtained and examined.

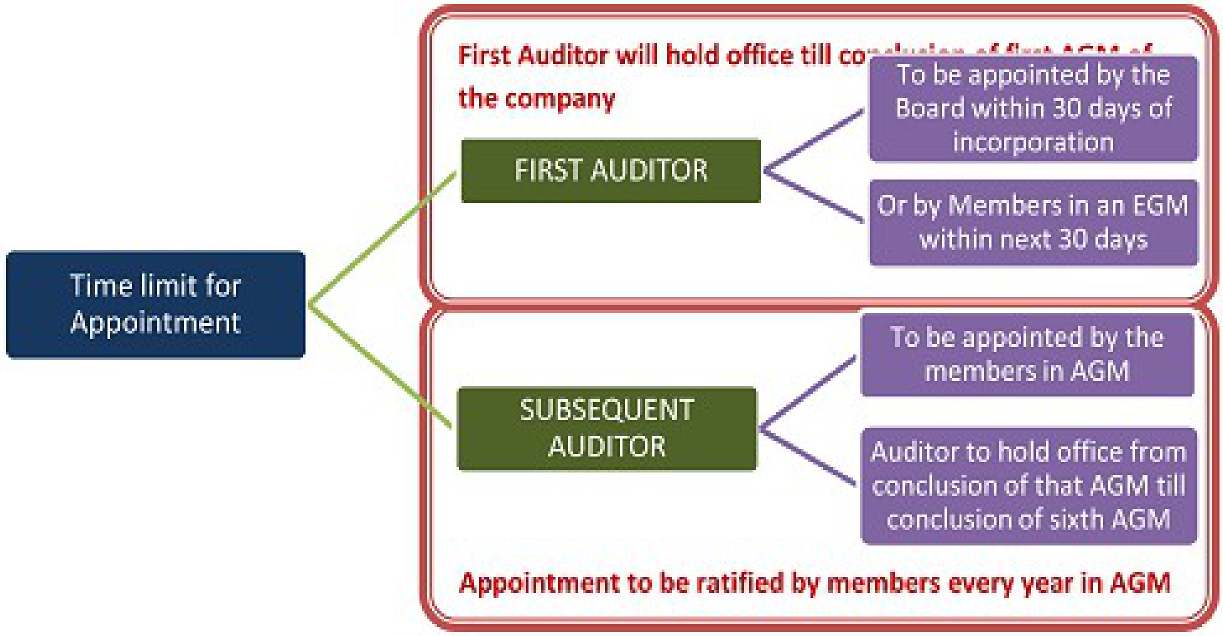
5. The auditor should see whether the interest due has been paid or not. If the interest is due but not paid till the date of the Balance Sheet, he should see whether the same has been clearly shown as liability therein.

6. In case of a Joint Stock Company, the auditor should examine the borrowing powers of the company. He should also examine the Register of Charges, and should see that a charge created has been registered with the Registrar.

7. It should be seen that the interest on loans has been paid up to date. If not he should see whether the amount due is recorded as unpaid in the books of accounts.

CHAPTER – 5

AUDIT OF LIMITED COMPANIES AND OTHERS , APPOINTMENT OF AUDITORS AND POWERS & DUTIES



APPOINTMENT OF FIRST AUDITORS

- Within one month from the date of registration of the company, the first auditor or auditors may be appointed by the Board of Directors.
- The First auditors may remain in office until the conclusion of the First Annual General Meeting.
- Companies (Amendment) Bill, 2003, extends the time to 3 months.
- **2. Appointment by company at a General Meeting**
- In case, the first auditors are not appointed by the Board of Directors, the company may appoint the first auditors at a general meeting.
- **Procedure for the appointment of First Auditors**
- For the appointment of first auditors, a company may adopt the following procedure.
- 1. Any member of the company may nominate a person, to be appointed as First Auditor.
- 2. At least 14 days' notice should be given to the members before the scheduled date of the meeting.

- 3. Some companies name their first auditors in their Articles of Association. Such appointment is invalid since provisions of Companies Act are not complied with.

APPOINTMENT OF AUDITORS OTHER THAN FIRST AUDITORS

- **1. Appointment of auditors by Share Holders**
- 1. At each Annual General Body meeting of the company, the shareholders may appoint an auditor for the company.
- 2. The auditor so appointed shall hold office until the conclusion of the subsequent annual general body meeting.
- The company should intimate the auditor about the appointment within 7 days of such appointment.
- 4. The acceptance or refusal of such appointment should be intimated by the auditor to the Registrar of Companies within 30 days of the receipt of the intimation of such appointment.
- 5. Such acceptance / refusal should be made in a prescribed form.
- 6. The intimation to the Registrar about the acceptance / refusal of appointment is necessary only if the auditor / auditors are appointed in an annual general body meeting.

Powers

- **Right to access :**Every auditor of a company shall have right to access at all time to book of accounts and vouchers of the company.
- The Auditor shall be entitled to require from officers of the company such information and explanation as he may consider necessary for performance of his duties. There is an inclusive list of matter for which auditor shall seek information and explanation. The list includes issues related to: (a) Proper security for Loan and advances,(b) Transaction by book entries,(c) Sale of assets in securities in loss,(d) Loan and advances made shown as deposits,(e) Personal expenses charged to revenue account,(f) Cash received for share allotted for cash. The auditor of holding company also has same rights.
- **Auditor to sign audit reports :**The auditor of the company shall sign the auditor’s report or sign or certify any other document of the company and financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor’s report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

- **Auditor in general meeting: It** is a prime requirement under section 146, that the company must send all notices and communication to the auditor, relating to any general meeting, and he shall attend the meeting either through himself or through his representative, who shall also be an auditor. Such auditor must be given reasonable opportunity to speak at the meeting on any part of the business which concerns him as the auditor.
- **Right to remuneration: The** remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. It must include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.
- **Consent of auditor: As** per section 26, the company must mention in their prospectus the name, address and consent of the auditors of the company.

DUTIES

- **Make report:**The auditor shall make a report to the members of the company on accounts examined by him on every financial statement and shall state:(a) Whether he has sought and obtained all the necessary information and explanations,(b) Whether proper books of account have been kept,(c) Whether company's balance sheet and profit and loss account are in agreement with books of accounts and returns.
- **Audit report of Government Company :**The auditor of the government company will be appointed by the Comptroller and Auditor-General of India and such auditor shall act according to the directions given by them. He must submit a report to them which should include the action taken by him and impact on accounts and financial statement of the company.The Comptroller and Audit – General of India shall within 60 days of receipt of the report have right to (a) conduct a supplementary audit and (b) comment upon or supplement such audit report.The Comptroller and Audit – General of India may cause test audit to be conducted of the accounts of such company.
- **Liable to pay damages:**As per section 245, the depository and members of the company have right to file an application before the tribunal if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company. They also have right to claim damages or compensation from the auditor for any improper or misleading statement made in his audit report or for any fraudulent or unlawful conduct.
- **Branch Audit :**Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company, or by any other person qualified

for appointment as an auditor of the company. The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

- **Auditing Standards :**Every auditor shall comply with the auditing standards. The Central Government shall notify these standards in consultation with National Financial reporting Authority. The government may also notify that auditors' report shall include a statement on such matters as notified.
- **Fraud Reporting :**If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.
- **Winding up:**As per section 305, at the time of voluntary winding up of a company it is a mandatory requirement that auditor should attach the copy of the audits of the company prepared by him.
- The company makes loans and advances against proper security and the terms of these are prejudicial to the interests of the company.
- Transactions that merely represent a book entry are prejudicial to the interests of the company.
- In the case of a company which is not an investment or banking company, it sells the assets. They are in the form of shares, debentures, and other securities at a price less than their purchase price.
- The company shows the loans and advances that it makes as deposits.
- It charges the personal expenses to revenue account.
- It states in the books and documents that where it has allotted the shares in cash, it has received the cash or not. Also, whether the position in the books and Balance Sheet is correct and not misleading.

<u>Qualification of Company Auditor</u>:-

- As per section 226 of companies act, a person should not be qualified for appointment as an auditor or a public or private company unless he is a chartered accountant within the meaning of the Chartered Accountant Act,1949.
- According to section 226(2), a person holding a certificate under Restricted Auditors Certificate (Part – B states) Rules,1956, is also qualified t act as an auditor of a company.

- However, the Central Government may grant, renew, suspend or cancel and make other rules for such certificates by notification in the official Gazette.

<u>Disqualification of Company Auditor</u>

Following are the disqualification of a company auditor:-

- An auditor can not be a body corporate.
- An auditor can not be an employee of officer of the company.
- A person who is a partner or who is in the employment of an officer of the company, can not be the auditor of the company.
- A person who is indebted to the company for an amount exceeding one thousand rupees, can not be the auditor of the company.
- A person who is a member or a director of a private company or partner in a firm which is the managing agent or the secretaries and treasurers of the company, can not be the auditor of the company.
- A person who is a director or holder of shares of more than 5% in nominal value of the subscribed share capital of any body corporate which is the managing agent or the secretaries and treasures of the company, can no be the auditor of the company.

Audit of Educational Institutions, Cooperative Societies and Insurance Companies

- Maintenance of Accounts of Educational Institutions
- A large number of educational institutions are registered under the India Society Registration Act, 1860. The purpose behind the formation of educational institutions is to spread education and not just earn profits. The following table lists out the sources for collection of amount and also the different types of expenses incurred by the educational institutions −

Main Source of Collection

- Admission fees, tuition fees, examination fees, fines, etc.
- Securities from students.
- Donations from public
- Grants from Government for building, prizes, maintenance, etc.

Preliminary Audit of Educational Institutions

- Following points need to be considered by an Auditor while conducting audit of educational institutions −
- It is to be confirmed whether the letter of his appointment (the Auditor's) is in order.
- The Auditor should obtain a list of books, documents, register and other records as maintained by the educational institutions.
- He should examine the audit report of last year and should note down the observation and qualification, if any.
- He should note down the important provisions regarding to accounts and audit from the Trust Deed, Charter of Regulations.
- He should examine the Minutes of Meetings of the Board of Trustee or the Governing Body for important decisions regarding the sale or purchase of fixed assets, investments or delegation of finance power.
- In case of colleges and university, the Grants Commission provides Grants to them subject to certain conditions. The Auditor should study all the conditions concerning grants.
- The Auditor should examine the Code of State regarding grant-in-aid.

- He should be aware of all the provisions and rules of related laws concerning books of account and audit.

Internal Control System

- The Auditor should independently check the internal control system regarding authorization procedures, record maintenance, safeguarding of assets, rotation and division of staff duty, etc. Following are some of the important aspects that need to be considered by an Auditor to keep a check on the internal control system −
- Whether internal control and internal check system is working, if yes, how effectively.
- Is there is any system to physically verify the fixed assets, stores and consumables at regular interval.
- An Auditor should verify the control system concerning proper authorization, obtaining quotations, proper maintenance of accounts and record regarding purchase of fixed assets, purchase of material, investment, etc.
- Whether bank reconciliation statement is prepared at regular intervals and what kind of action is taken for un cleared cheque which were pending since long.
- Whether waiver of fees is properly sanctioned by appropriate authorities.
- The person who is collecting fees and the cashier should not be the same person.
- Class wise fees receivable and the actual fees received reconcile or not.
- Whether collected fees is deposited in bank on a daily basis.
- Fees collection register should be maintained on a daily basis.
- Whether approved list of supplier of sports material, stationery, lab items are readily available.
- Whether control system for payment is adequate or not.
- The system of letting out conference hall and class rooms, etc. for seminars and conventions.
- Whether fees structure is properly authorized along with change in fee structure if any.

Audit of Assets and Liabilities

☐ The following points need to be considered while conducting an audit of Assets and Liabilities −

☐ Verification of Assets register should be done considering grants on purchase of assets, if any received from State Government/ University Grant Commission (UGC).

☐ Verification of depreciation is very important; it should be according to useful life of assets or as per the Companies Act, whichever is applicable.

☐ If educational institution is running under Indian Public Trust Act, it is must for an Auditor to check, where investments have been made, because as per the Indian Public Trust Act, investment can be made in specific securities only.

☐ If donation is received in the form of investment, an Auditor has to check all related correspondence with the donor.

☐ All the applicable requirements of law should be fulfilled for the purchase of investments and fixed assets.

☐ An Auditor should read and note down the state code and provisions relating to the conditions and procedures of Grants. He should also verify the requirements of State/UGC which are to be fulfilled by educational institutions for receiving Grants and also for continuations of Grants.

Audit of Income of Educational Institutions

☐ The following points need to be considered by an Auditor while conducting audit of the Income of Educational Institutions −

☐ Fees and charges received on account of admission fees, tuition fees, sports fees, examination fees etc. should be verified based on the approved fees structure.

☐ Verification of counterfoil copies of fees receipt with fees received register should be done.

☐ Prescribed conditions by the State Government and the University Grants Commission should be verified whether fulfilled or not.

☐ Cash book should be verified with counterfoil of receipt book and fees register.

☐ Fees receivable and actual fees received should be reconciled.

☐ Charges and fees received and receivable should be examined on account of hostel accommodation, mess, housekeeping and clothing, etc.

☐ Cash book should be verified with the donation received register.

- Donation received should be accounted for according to the nature of donation means careful distinction should be there for revenue nature donation and capital nature donations; the same procedure is to be followed for Grants received.
- The purpose and utilization of grant should be same.
- Investment register and cash book should be verified for income received on account of interest on investment and dividends, etc.

Audit of Expenses of Educational Institutions

- The following points need to be considered by an Auditor while conducting audit of Expenses of Educational Institutions −
- Electricity expenses, telephone expenses, water charges, stationery and printing, purchase of sports items should be properly verified with quotation, purchase bills, inward register and Bills received from service providers, etc. All purchases should be authorized by appropriate person.
- In case where hostels purchase food items, provisions, clothing, etc. should be properly verified.
- Verification of Tax Deducted at Source, Employee State Insurance and Provident Fund should be checked. It is also very important that all deducted amount should be deposited in appropriate Government accounts well within time without any default. These can be verified from relevant bank challans.
- Payment made on account of salary should be verified from terms of appointment and increment policy. Auditor should verify the computation of salary and check whether all required deductions are made out of it or not like advance salary, loan installment, absence from duty, ESI (Employee State Insurance), PF (Provident Fund), etc. The Net Salary Payable amount will be verified from cash book and bank pass book for salary paid.
- Terms and conditions, cash book, voucher and receipts should be the basis for the verification of scholarship paid.
- Appropriate provision should be made on account of outstanding payments.

Audit of Insurance Companies

- The Insurance auditors shall examine policy and liability procedures, risk valuation, tax documents, and various other financial records of insurance. It is to ensure that proper insurance rates and premiums are implemented and regulators laws are being followed by insurance companies. Claims and commissions are also the core areas to verify during the course of insurance audits. In addition to these responsibilities, insurance auditors might be expected to maintain quality control between insurance companies and policyholders.

- An Indian insurance company is formed and registered under the Companies Act, 2013 and the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six per cent of the paid-up equity capital of such Indian insurance company. The sole objects of the Indian Insurance Company shall be to carry on life insurance business or general insurance business or re-insurance business. The said definition is according to section 2 of Insurance Act 1938.

Appointment provisions of Auditor to Insurance Companies

- As per Section 12 of the **Insurance Act, 1938**, the financial statements of every insurer are required to be audited annually by an auditor. According to IRDA Act, 1999, every insurer, in respect of insurance business transacted by him and in respect of his shareholders 'funds, should prepare, a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments and a Revenue Account in accordance with the regulations made by the IRDA at the end of each financial year.

- The central and branch auditors of an insurance company are appointed at the annual general meeting of the company and the approval of the C & AG required before the appointment is made. With the latest amendment to the Insurance Act, 1938 and the Companies Act, 2013, Authority (IRDAI) has issued the revised guidelines that Insurers shall comply with the provisions relating to appointment of Auditors as contained in the Companies Act, 2013. Additionally, insurers shall also comply with the provisions contained in such guidelines. Further the recommendation of the Audit Committee, the Board shall appoint the statutory auditors, subject to the shareholders' approval at the general meeting of an Indian insurance company. The branch auditors is appointed to conduct the audit of the divisions have the same rights and obligations under the statute as those of the, statutory auditors to whom they are expected to submit their report. However the branch auditors at division level certified the Trial balance of the division duly incorporated the financial statements of the branches under divisions.

- An insurer cannot remove its statutory auditor without the prior approval of the Authority.

Four Important Audit Points in Insurance Company Profit & Loss Account

- **<u>1. VERIFICATION OF PREMIUM</u>**

- The premium collections are credited to a separate bank account and no withdrawals are normally permitted from that account for meeting the general expenditure. As per the policy of the insurance company, the collections are transferred to the Regional Office or Head Office.

- No Risk shall be assumed by the insurer without receipt of premium according to section 64VB of the Insurance Act, 1938. Verification of premium is of utmost importance to an auditor because Insurance premium is collected upon issuing policies. It is the consideration for bearing the risk by the insurance company. The auditor should apply the following procedures: – • Before commencing verification of premium income, the auditor should look into the internal controls and compliance which are laid down for collection and recording of the premiums. • Cover notes should be serially numbered • The auditor should check whether Premium Registers have been maintained chronologically, giving full particulars including GST charged as per acceptance advice on a day -to-day basis. • The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger. • The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit.

2. VERIFICATION OF CLAIMS

The auditor should obtain from the divisions/branches, the information for each class of business. The auditor should determine the total number of documents to be checked giving due importance to claim provisions of higher value. The claims under policies comprise the claims paid for losses incurred, and those estimated or anticipated claims pending settlements under the policies. Settlement cost of claims includes surveyor fee, legal expenses, etc. The Claim Account is debited with all the payments including repair charges, fire fighting expenses, police report fees, survey fees, amount decreed by the Courts, travel expenses, photograph charges, etc. The auditor should-

Check whether provision has been made for all unsettled claim

VERIFICATION OF COMMISSION

- The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured and is debited to Commission on Direct Business Account. An insurance business is solicited by insurance agents. The auditor should verify-

- Voucher disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.

- Check whether the vouchers are authorized by the officers- in –charge as per rules and income tax is deducted at source, as applicable.

- Test check correctness of amounts of commission allowed.
- To check whether commission outgo for the period under audit been duly accounted or not.

4. VERIFICATION OF OPERATING EXPENSES

- All the administrative expenses in an insurance company are broadly classified under 13 heads as mentioned in Schedule IV. The auditor should check-
- • Expenses in excess of Rs.5 Lakhs or 1% of net premium, whichever is higher, should be shown separately; and
- • Expenses not directly relating to insurance business should be shown separately for example, expenses relating to investment department, bank charges etc.

Three Important Audit Points in Insurance Company Balance Sheet

- **1. INVESTMENTS**
- The auditor should keep in mind the following provisions related to Investments of the Insurance Act, 1938 while examining the investments-of an insurance company-
- a. An insurance company can only invest in approved securities. However, it can invest otherwise than in approved securities if the following conditions are satisfied.
- The auditor should keep in mind the following provisions related to Investments of the Insurance Act, 1938 while examining the investments-of an insurance company-
- a. An insurance company can only invest in approved securities. However, it can invest otherwise than in approved securities if the following conditions are satisfied.
- • Such investments should not exceed 25% of the total investments; and
- • Such investments are made with the consent of board of directors.
- b. An insurer should not invest in shares or debentures of insurance or Investment Company in excess of least of the following:
- • 10% of its own total assets;
- • 2% of the investee's subscribed share capital or debentures.
- c. An insurer company should not invest in shares or debentures of a company other than insurance or investment company in excess of least of the following
- 10% of its own total assets;

- ☐ 10% of investee's subscribed share capital or debentures.
- ☐ d. An insurance company cannot invest in shares and debentures of a private company.
- ☐ e. The insurance companies cannot invest the funds of its policy holders outside India.

CASH AND BANK BALANCES

• Bank reconciliation statements shall be prepared.

• The auditor should obtain confirmation of Bank Balances for all operative and inoperative accounts.

• The auditor should physically verify Term Deposit Receipts issued by bankers. Generally all cash at year end deposited as term deposit with the bank

• The auditor should verify the deposits and withdrawals transactions at random and check whether the Account is operated by authorized persons only.

• In case of funds, in -transit, he should verify that the same are properly reflected in a reconciliation statement.

3. OUTSTANDING PREMIUM AND AGENTS' BALANCE

- ☐ The audit procedures, which may be followed with regards to agent's balance, are as follows: a. Verify whether agent's balances and outstanding balances in outstanding premium account have been listed, analyzed and reconciled for the purposes of audit. b. Verify whether recoveries of large outstanding have been made in post audit period. c. Verify whether there is any old outstanding debit or credit balances as at the yearend which require adjustment. A written explanation may be obtained from the management is to their nature. d. Verify that agent's balances do not include employees' balances and balances of other insurance companies. e. Verify that no credit of commission is given to agents for businesses directly procured by it.

Audit of Cooperative Societies

- ☐ Any ten persons who are competent to enter into contract may make an application to the Registrar of Co-operative Societies as per section 6 of the Co-operative Societies Act, 1912. By-laws may be framed by each society and should be registered with Co-operative Societies. Effectiveness of change in by-laws of societies is applicable only when changes are approved by Registrar of Societies. There are two types of society's, limited liabilities and un-limited liabilities societies. Any member is not liable to pay more than the nominal value of share held by them and no member can own more than 20% of shares of societies.

- ☐ Government is encouraging co-operative societies to help society. Co-operative societies are operative in various sections like consumer, industrial, service, marketing, etc.
- ☐ Under accounting system of Co-operative societies, the terms receipt and payment are used for two-fold aspect of double entry system.
- ☐ Members are elected at the annual general meeting of the society. Day-to-day work of cooperative society is managed by the managing committee.
- ☐ Audit of Co-operative Society
- ☐ Let us now discuss the provisions for Audit as Per Section 17 of the Co-operative Society Act, 1912 −
- ☐ The Registrar shall audit or cause to be audited by some person authorized by him by general or special order in writing on his behalf, the accounts of every registered society once at least every year.
- ☐ The Audit under sub-section (1) shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.
- ☐ The Registrar, the Collector or any person authorized by general or special order in writing on his behalf by the Registrar, shall at all-time have access to all the books, accounts, papers and securities of a society, and every officer of the society shall furnish such information concerning the transactions and working of the society as the person making such inspection may require.

Books, Accounts and Other Records of the Society

- ☐ Under Section 43(h) of the Co-operative Society Act, 1912, the Government of a state can frame rules prescribing the books of accounts to be kept by a Co-operative society. Following books and accounts are prescribed by the Maharashtra Government.
- ☐ Cash Book
- ☐ General Ledger
- ☐ Stock register
- ☐ Personal Ledger
- ☐ Register of Members

- Register of Shares and debentures
- Minutes books of general body meeting and committee meetings
- Property Register
- Register recording loan applications
- Maintenance of register of audit objections and their rectifications
- Special Features of Co-Operative Audit
- The checking of posting, arithmetical accuracy, vouching, verification of assets and liabilities and scrutiny of balance sheet are same as Auditor do in any other case. We will now discuss a few important aspects related to the Audit of Co-operative societies.
- Examination of Overdue Debts
- An Auditor has to examine and classify overdue debts
- from six months to five years and,
- overdue above five years in two categories and shall have to report it in his audit report.
- Overdue Interest
- While calculating the profit of Co-operative society overdue amount of interest outstanding should be excluded.
- Valuation of Assets and Liabilities
- General principles of accounting and auditing conventions and standard are adopted at the time of valuation of assets and liabilities. No specific provisions or instructions under the Act and Rules are provided.
- Adherence to Co-operative principles
- Special Report to the Registrar
- During audit if any irregularities are found by the Auditor that should be reported to the Registrar and an appropriate action may be taken by the Registrar against the society.
- Audit Classification of Society
- After assessing the overall performance, an Auditor has to award a class to the society. Judgement of Auditor should be based on the criteria fixed by the Registrar. The Auditor should be very careful when making decisions related to the classes in the society; if

management is not satisfied by the award he may file an appeal to the Registrar and the Registrar may direct to review the audit classification.

- ☐ Discussion on Audit Draft
- ☐ After completion of audit, minor irregularities may be settled and rectified; matters concerning policies should be discussed in detail. The audit report can never be finalized without discussing with the managing committee.
- ☐ By-laws
- ☐ Each registered society is required to frame its own by-laws which have to be registered with the Registrar of Co-operative societies. According to Section 11 of the Act, the amendment of the by-laws of a registered society shall not be valid until the same has been approved by the Registrar of the Co-operative societies.
- ☐ An Auditor should ascertain how far the objectives, for which the Co-operative society is set up, have been achieved in course of its working. It is not necessarily in terms of profit, but in terms of extending of benefits to members who have formed the Society.
- ☐ Certification of Bad-debts
- ☐ As per Rule No.49 of the Maharashtra State Co-operative Rules, 1961, it is very interesting to note that no bad debts can be written off unless they are certified as bad debts by the Auditor. Where no such requirement of law exists, the managing committee of the society must authorize the write-off.
- ☐ Observation of the Provisions of the Act and Rules
- ☐ An Auditor should be well versed with the Provisions of the Act and Rules of the Cooperative Society and the by-laws thereof. If the Auditor finds any irregularity, it should be immediately assessed and reported to the next level.
- ☐ Verification of Members Register and Examination of their Pass Books
- ☐ This is essential especially in rural and agricultural credit society where members are illiterate, the Auditor should verify the pass book and members register to verify the amount of loan granted and their repayments. It will help to ensure that the books of accounts are free from any manipulation.