AUDITING

Second Year : B.Com.

SEMESTER – IV

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2nd Year B.Com. Semester – IV

AUDITING

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining a 'A' Grade from the NAAC in the year 2014, the Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 285 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education with the aim to bring higher education within reach of all. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even housewives desirous of pursuing higher studies. With the goal of bringing education in the door step of all such people. Acharya Nagarjuna University has started offering B.A, and B, Com courses at the Degree level and M.A, M.Com., L.L.M., courses at the PG level from the academic year 2021-22 on the basis of Semester system.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers invited respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn facilitate the country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Coordinators, Editors and Lesson -writers of the Centre who have helped in these endeavours.

Prof. P.Rajasekhar
Vice –Chancellor,
Acharya Nagarjuna University

PROGRAMME: THREE-YEAR B COM

(General and Computer Applications)

Course Code:

Domain Subject: Commerce

Semester-wise Syllabus under CBCS

(w.e.f. 2020-21 Admitted Batch)

II Year B Com (Gen& CA)– Semester – IV

405BCO21- **Course 4E:Auditing**

Learning Outcomes:

At the end of the course, the student will able to;

- Understanding the meaning and necessity of audit in modern era
- Comprehend the role of auditor in avoiding the corporate frauds
- Identify the steps involved in performing audit process
- Determine the appropriate audit report for a given audit situation
- Apply auditing practices to different types of business entities
- Plan an audit by considering concepts of evidence, risk and materiality

SYLLABUS:

Unit-I: Introduction: Meaning – Objectives – Importance of Auditing – Characteristics - Book Keeping vs Auditing - Accounting vs Auditing – Role of Auditor in Checking Corporate Frauds.

Unit-II: Types of Audit: Based on Ownership,Time and Objective - Independent, Financial, Internal, Cost,Tax, Government, Secretarial Audits

Unit-III: Planning of Audit: Steps to be taken at the Commencement of a New Audit – Audit Programme - Audit Note Book– Audit Working Papers - Audit Evidence - Internal Check, Internal Audit and Internal Control.

Unit-IV: Vouching and Investigation: Definition and Importance of Vouching – Objectives of Vouching -Vouching of Cash and Trading Transactions – Investigation - Auditing vs. Investigation

Unit-V: Company Audit and Auditors Report: Auditor's Qualifications – Appointment andReappointment – Rights, Duties, Liabilities and Disqualifications - Audit Report: Contents –Preparation - Relevant Provisions of Companies Act, 2013.

References:

1. S.Vengadamani, "Practical Auditing", Margham Publications, Chennai.
2. Ghatalia, "Principles of Auditing", Allied Publishers Pvt. Ltd., New Delhi.
3. Pradeesh Kumar, BaldevSachdeva&Jagwant Singh, "Auditing Theory and Practice,Kalyani Publications
4. N.D. Kapoor, "Auditing", S Chand, New Delhi.
5. R.G. Saxena, "Principles and Practice of Auditing", Himalaya Publishing House New Delhi
6. JagadeshPrakesh, "Principles and Practices of Auditing", Kalyani Publications
7. Kamal Gupta and Ashok Gupta, "Fundamentals of Auditing", Tata McGraw Hill
8. B.N. Tondan, "Practical Auditing", S.Chand, New Delhi.
9. K J Vijaya Lakshmi & A S Roopa, Auditing, Seven Hills International Publishers, Hyderabad

Suggested Co-Curricular Activities:

- Seminars
- Visit the audit firms
- Visit an audit firm, write about the procedure followed by them in Auditing the books of accounts of a firm.
- Guest lecture by an auditor
- Collect the information about types of audit conducted in any one Organization
- Collection of audit reports
- Group Discussions
- Draft an audit program.

MODEL QUESTION PAPER (405BCO21)

B. Com.(General / Comp. Appl.s) Degree Examination

Second Year – Fourth Semester

Part – II : Commerce

Paper – IV : AUDITING

Time : Three hours **Maximum Marks : 70**

Section – A

Answer any FIVE of the following questions. (5 × 4 = 20 Marks)

1) Importance of Auditing.
ఆడిటింగ్ యొక్క ప్రాముఖ్యత.

2) Book keeping.
బుక్ కీపింగ్.

3) Internal Audit.
అంతర్గత (తనిఖీ) ఆడిట్.

4) Audit note book.
ఆడిట్ నోట్ బుక్.

5) Internal check.
అంతర్గత తనిఖీ.

6) Vouching.
వోచింగ్.

7) Duties of auditor.
ఆడిటర్ యొక్క విధులు.

8) Investigation.
దర్యాప్తు.

Section – B

Answer the following questions. (5 x 10 = 50 Marks)

9) (a) What is auditing? Explain the characteristic of auditing.

ఆడిటింగ్ అంటే ఏమిటి? దాని యొక్క లక్షణాలను వివరించండి.

Or

(b) Discuss the role of auditor in checking corporate frauds.

కార్పొరేట్ మోసాలు తనిఖీ చేయటంలో ఆడిటర్ యొక్క పాత్ర చర్చించండి.

10) (a) Explain Independent and Financial audit.

స్వతంత్ర మరియు ఆర్థిక ఆడిట్ ల గురించి వివరించండి.

Or

(b) Discuss Government audit and secretarial audit.

గవర్నమెంట్ (ప్రభుత్వ) మరియు సెక్రటేరియల్ ఆడిట్ గురించి చర్చించండి.

11) (a) What are the steps to be taken at the commencement of new audit?

క్రొత్త ఆడిట్ ప్రారంభానికి కావాల్సిన ప్రాథమిక దశలను వ్రాయండి.

Or

(b) Explain internal Audit and Internal control.

అంతర్గత ఆడిట్ మరియు అంతర్గత నియంత్రణను వివరించండి.

12) (a) Define Vouching. Explain the objectives of Vouching.

వోచింగ్ నిర్వచించి, దాని యొక్క లక్ష్యాలను వివరించండి.

Or

(b) Auditing vs. Investigation.

ఆడిటింగ్ vs. దర్యాప్తు.

13) (a) Explain qualification and disqualification of auditor.

ఆడిటర్ యొక్క అర్హతలు మరియు అనర్హతలు గురించి వివరించండి.

Or

(b) What is audit report? Explain preparation of audit report.

ఆడిట్ రిపోర్ట్ అంటే ఏమిటి? ఆడిట్ రిపోర్ట్ ఏ విధంగా తయారు చేస్తారు.

CONTENTS

LESSON - 1

INTRODUCTION

1.0. Objectives : After going through this lesson the student can know what is auditing ? What are the objects and advantages of Auditing ?

Structure :

1.1. Introduction :

The practice of auditing accounts may be traced back to the early stages of civilisation. In those days audit was undertaken mainly for state or public accounts. The historical records of auditing show that ancient Egyptians, Greeks and the Romans used to get their public accounts audited. Audit of accounts of Private business houses was rare as the size of the business houses was small and management and ownership were joint.

The system of accounting and auditing is believed to have existed in our country under the Mauryas, Chandra Gupta and other Hindu Kings. Kautilya, in his Arthashastra had mentioned about the accounting and auditing of state finance. He also listed various kinds of frauds and prescribed punishments to deal with them. However, the growth of the Accounting Profession in India is of a recent origin.

Auditing as it exists today can be associated with the introduction of large scale production as a result of Industrial revolution during the 18th century.

The introduction of joint stock form of organisation widened the scope of investment and business activities. Business community started raising money from public and also borrowed capital from various private and state financial institutions. Under company form of organisation the investors called as shareholders delegate the management of the undertaking in which they have invested their money to a Board of Directors but they would be keenly interested in the safety of their investment. As the shareholders are drawn from far off places and are not at the helm of the affairs of the company. In these circumstances need for getting the accounts audited arose.

The Indian companies Act had made it compulsory for all the corporate bodies to get their accounts audited by qualified professional accountants.

1.2. Definition:

The word audit is derived from the Latin word 'Audire' which means " 'to hear'. In olden days whenever the owners of the business suspected fraud they appointed certain persons to check the accounts. The auditor use to hear the accounts of the parties relating to financial transactions. It was in fact a cash audit. But Now-a-days the auditor verifies the accounts to find out their accuracy. Thus the modern audit is not merely a cash audit but also an audit of final accounts.

'Auditing' means an examination of the accounts books and the relative documentary evidence by an independent qualified person in order to ascertain the accuracy of the figures appearing there in.

Some of the definitions given by different writers are given below :

Montgomery a leading American accountant and auditor, has define auditing as "a systematic examination of the books and records of a business or other organisation in order to ascertain or verify and the report upon the facts regarding the financial operations and the results thereof".

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

According to Dickse "auditing can be understood as an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they purport to relate. But this is not the end of the matter, in addition the auditor also expresses his opinion on the character of the statements of accounts prepared from the accounting records so examined whether they portray a true and fair picture".

Mautz defines auditing as being "concerned with the verification of accounting data, with determining the accuracy and reliability of accounting statements and reports".

After going through the above definitions in simple words we may say that auditing is a critical and intelligent examination of the books of accounts with relevant vouchers and documents to ascertain whether the profit or loss shown by the profit & loss account and financial position as shown by the balance sheet are fair and true.

1.3. Objects of an Audit :

The main object of an audit is to find out after going through the books of accounts whether the Balance sheet and profit and loss account are properly drawn up according to the companies Act and whether they represent a true and fair view of the state of affairs of the concern. Detection and prevention of errors is the subsidiary object of modern audit.

Thus in general auditing may be defined as "Science of verifying the records and reports which reflect the financial condition and operating results of the business."

1.3.a. Verification of Accounts and statements :

The primary object of an audit is to establish, by an examination of books, vouchers and other appropriate records that the balance sheet, at a given date, is properly drawn up so as to exhibit a true and fair view of the state of affairs of the business and the profit and loss account discloses the correct profit or loss for the period. His primary object always is the establishment of the degree of reliability of the annual statements of accounts.

An audit is also intended to disclose how far the system of accounting which is being followed has been successful in correctly recording the transactions as well as the weaknesses that there may be in its organisation. The companies Act requires an auditor to report whether books of accounts are kept in accordance with the Act and whether they show a true and fair view of the state of affairs of the company.

1.3.b. Detection and prevention of Errors :

A) Error may be defined as "Mistake of negligence or misjudgment without an intention to fraud."

Audit aims at finding out errors if any in the accounts. Errors may arise at various stages in Book-keeping records. The errors may arise because of the carelessness of the clerks or their ignorance of the principles of accounts. The former are called clerical errors and the later are called errors of principles, clerical errors are of four kinds.

1) Errors of Ommission

2) Errors of Commission

3) Errors of Duplication

4) Compensating errors

1) Errors of Ommission :

These errors arise when any transactions are not recorded in the books either wholly or partially. Complete omission will not effect the Trail Balance. So the auditor has to take special care to detect such ommission. Ommission to enter purchases in the purchases book, omission to enter sales in the sales book and non Provision for outstanding expenses are some of the examples of complete ommission . Partial ommission will effect the trail balance. So the auditor can detect them easily. These errors affect the accounts and profit and loss account materially. They may even effect Balance sheet.

2) Errors of commission :

These are most common. These errors arise when any transaction is incorrectly recorded or posted. They consists of wrong entries postings, castings and calculations and carry forwards. Most of these errors will affect the agreement of trail balance. So they can be detected by a cautious routine checking. But errors in calculations will not affect the agreement of the trail balance. So detection of such errors is not easy.

3) Errors of Duplication :

These errors arise when any transaction is entered twice in the books of original entry and posted twice in the ledger. They will not cause the disagreement of trail balance. So detection is not easy.

4) Compensating Errors :

A compensating error may arise when errors counter act each other. It is a dangerous type of error. It may or may not affect the profit and loss account of the business. It will not affect the agreement of trail balance so detection is not easy. For example X account was credited by Rs.200 instead of Rs.800. There was a short credit of Rs.600, while Z account is debited by Rs.200 instead of Rs.800. Thus there is a short debit of Rs.600. It means that there was a short credit and short debit of Rs.600 each. Here one error was exactly counter balancing an other error. These errors are also known as off setting errors because the effects are off-set.

Errors of principle :

These errors arise when transactions are not recorded in the books of accounts according to the accepted principles of accountancy. These errors may be committed purposely or accidentally. They will not affect the trail balance but they will affect the profit and loss account and balance sheet to a great extent. The auditor must always be on the look out for such errors. These can be detected by searching enquiry and independent checking.

Wrong valuation of assets,wrong distribution of expenditure between capital and revenue, incorrect provision for depreciation or bad and doubtful debts are some of the examples of errors of principle.

Location of Errors :

The question is how to locate an error if the trail balance does not agree and the auditor is called upon to locate the error although it is not his duty to do so. The following steps will ease the work.

1) Check the totals of the trail balance.
2) Compare the names of the accounts in the ledger with the names of the accounts as have been recorded in the trail balance.
3) Total the lists of debtors and creditors and compare them with the trail balance.
4) If the books are maintained on the self balancing system, see that the total of different accounts agrees with the total of these accounts with the balance of accounts as recorded in the trail balance.
5) Compare the items of the trail balance, halve it and see if there is any item of this value. This is done to avoid the putting of the debit balance on the credit side of the trail balance or vice Versa.
6) Compare the items of the trail balance with the items of the trial balance of the previous year to see if any item has bee ommitted.
7) It is possible that the totals of some subsidiary books e.g : cash book, purchases book, sales book etc; might not have been transferred to the trail balance. Re-check the totals of these books.
8) If an error is divisible by 9 may be due to misplacement e.g. writing 32 as 23.

Detection of Frauds :

Frauds are planned and intentional errors with a view to defraud. Detection of fruad is more difficult than the detection of errors. Detection of fraud depends upon the efficiency of the internal check in operation. As a rule, frauds can be detected easily in the early stages. But it is difficult to detect them if they assume complications. The scope for committing fraud depends upon the supervision of the proprietor division of work and the system of internal check in operation.

Frauds may be committed mainly to three ways.

1) By misappropriation of money.

2) By misappropriation of goods

3) Manipulation of accounts.

Cash can be misappropriated in two ways, 1) By ommission of receipts by acknowledging a lesser amount than what actually received. 2) By inclussion of fictitious payments or recording more payments than actual payments. Ommission of receipts can be detected by checking the debit side of the cash book and sales mans dairy, counterfoil of receipt book etc.

Goods which are less bulky but more valuable can be easily misappropriated. Detection of such misappropriation is not easy. The success of detection depends upon the accuracy of stock records.

Accounts are manipulated to conceal the real position of the concern. It is usually committed by directors of managers or other responsible officials with the object of showing more profit than what actually they are to sell the shares at high prices by declaring high dividends to obtain further credit by showing the financial position of the business better than what actually it is or to attract more subscribers for the sale of shares of the company etc.

Prevention of errors and frauds is possible only by application of sound system of internal check and suitable management of the concern. The auditor must suggest methods to the management for preventing the recurrences of errors and frauds in future.

1.4. Advantages of an Audit :

On account of the following advantages people get their accounts audited.

1. Errors and frauds are located at an early date and in future no attempt is made to commit such frauds.
2. The auditing of accounts keeps the accounts clerks regular and vigilant in their work.
3. In case of fire the insurance companies may settle the claim on the basis of audited accounts of the previous years.
4. Money can be borrowed easily on the basis of previous audited Balance Sheet.
5. If the business is to be sold as a going concern there will not be much difficulty regarding the valuation of assets and goodwill as the accounts have already been subject to audit by an independent person.
6. Income tax authorities generally accept the profit and loss account which has been prepared by a qualified auditor and they do not go into the details of accounts.
7. The management may consult the auditor and seek his advice on certain technical points although it is not the duty of an auditor to give advice.
8. Accounts of one year can be compared with other years and if there is any discrepency the causes may be enquired into.

9. The audited accounts are considered more or less correct by the sales tax authorities.

10. It would facilitate the settlement of the accounts of a deceased partner.

11. An auditor acts as trustee of the shareholders and safeguard their financial interest in the case of a joint stock company. Shareholders are assured that the accounts have been properly maintained and the directors and managers of the company have not taken any undue advantages of their position.

12. Audit safeguards the interest of the workers because audited accounts are useful for settling trade dispute for higher wages or for payment of bonus to the workers.

1.5. Qualities of an Auditor :

The person who conduct audit is known as the auditor. He makes a report to his appointing authority after careful examination of the accounting records and the accounting statements. In this report he expresses his opinion whether the statements of account are true and fair or not. For this purpose the auditor need the following qualities.

1) It is very important for an auditor to be well versed in the fundamental principles and theory of all branches of accounting; ex : Financial Accounting, cost accounting; Income tax etc. It is not possible for a person to audit the accounts unless he himself knows how to prepare them. He should not pass a transaction unless he himself knows that it is correct. This is possible only when one knows thoroughly well the principles of accounting.

2) He should be able to grasp quickly the technical details of the business whose accounts he is auditing. If possible he should pay a visit to the works of his client before he commences his work.

3) He should be prepared to seek elucidiaton technical questions rather than show a false pride or fear of displaying his own ignorance.

4) He should quite familiar with the company and mercantile laws and must be complete master of the principles of auditing.

5) He must be tactful and honest as Lord Justice Lindley has said "An auditor must be honest i.e. he must not certify what he does not believe to be true and he must take reasonable care and skill before he believes what he certifies is true”. (In London & General Bank).

6) He must not be influenced directly or indirectly by others in discharging his duties.

7) Sometimes he is put in a very ackword position when his duties to his client is opposed to his own interest in which case he must have the courage to carry out his duty faithfully, and honestly even if such a step harms him.

8) He must be prepared to resign rather than sign a Balance Sheet which he knows does not exhibit a true and fair view of the state of affairs of a concern and thus gives a false report.

9) He should not disclose the secrets of his client.

10) He must have the tact to put some intelligent questions to extract full information.
11) He must be prepared to hear the arguments and must be reasonable.
12) He must be vigilant, cautious, methodical and accurate.
13) He should have an understanding of the general principles of Economics.
14) He should have thorough training in business organisation, management and finance.
15) He should have common sense and the ability to write the report clearly, correctly, concisely and forcefully.
16) An auditor need not be unduly suspicious. As Lord justice Lopes said, "An auditor is not bound to be a detective or to approach his work with suspicion or with foregone conclusion that there is something wrong.” (In Kingston Cotton Mills Co. case)

1.6. Distinction between accountancy and auditing :

Accountancy may be defined as the science as well as the art of recording business transactions in the financial books. The person who is concerned with the recording of business transactions in the financial books is known as an accountant. He maintains accounts and prepares the profit and loss account and Balance Sheet but he will not give guarantee of the correctness of the accounts which he prepares. He will not certify the Balance Sheet as true and fair, he can only say that the Balance Sheet is in accordance with the books. He will not certify the Balance Sheet as true and fair, he can only say that the balance sheet is in accordance with the books.

Accountancy is quite distinct from auditing. The following are the main differences between accountancy and auditing.

Accouantancy	Auditing
1) Accountancy is concerned with the writing of books or the prepration of accounts.	1) Auditing is concerned with the examination of such books or accounts to ascertain their accuracy.
2) Accountancy is primarily constructive and concerned with recording of business facts	2) Auditing is analytical and essentially retrospective in nature.
3) Accoutancy is the original work.	3) Auditing presupposes the existence of accounts. It gives finishing touch to accounts. An audit commences after the accounting are ready. It is said that audit really begins where accountancy ends.
4) Accountancy involves the preparation of final accounts.	4) An auditor verifies their accuracy and certifies that they represent a true and fair view of the state of affairs of the concern. Thus the auditor verifies what the accountants have done.
5) No qualification is prescribed for the accountants of a joint stock company. Any person having specialised knowledge of the principles of accountancy is eligible for appointment as an accountant of a joint stock company.	5) But only persons who satisfy the qualifications prescribed by the Indian Companies Act are eligible for appointment as auditor of joint stock companies.

Distinction between Accountancy and Auditing is of great importance. An auditor must clearly know as to whether he is working in the capacity of an auditor or accountant.

In the case of Apfel Vs Anna Dexter & Co (1929), it was sought to prove that the auditor had acted in the capacity of auditors and therefore, they were liable for negligence in detection of a fraud.

The auditors contention was that they were employed to prepare the books of accounts for Income tax purpose and not to do the work of an audit. The certificate given by the auditors was prepared from the books of "Mrs. Adele Apfel and in accordance there with". But they had sent the bill for costs which was worded as "for services in connection with the preparation and audit of your accounts".

From the certificates given by the auditors it is clear that the work done by them was of a purely accountancy nature while the bill sent by them was both of accountancy and auditing. Austbury J. gave the judgement in favour of the auditors taking into consideration the object and the purpose for which the auditors were employed.

In the case of commissioner of Income tax Madras Vs G.M. Dandekar 1956. It was held by the Madras High court that the auditor was employed to prepare incometax returns and did not act in the capacity of the auditor of his employer.

1.7. Summary :

Auditing is a critical and intelligent examination of the books of accounts with relevant vouchers and document to ascertain whether the profit or loss shown by the profit and loss account and financial position as shown by the balance sheet are fair and true. Detection and prevention of errors is the subsidiary object of modern audit. Errors are of two types clerical errors and principle errors. Error may be defined as a mistake or misjudgement without an intention to defraud the concern. A Fraud may be defined as intentional errors with the object to defraud the concern. It is compulsory to audit the account of a joint stock company. The auditor must distinguish his duties whether he has been appointed as an accountant or an auditor.

1.8.Self Assessment Questions :

1. Define an "Audit" and state the various objects of an audit.
2. What are the different types of frauds in connection with accounts ?
3. Distinguish accountancy and auditing ?
4. What are the essential qualities required of an auditor apart from the statutory qualifications.
5. Write short notes on the following :

a) Location of errors

b) Detection and prevention of errors.

c) Detection and prevention of frauds.

6. What are the advantages of an audit ? Briefly state the qualities of an auditor.

7. What are the main objects of an audit ?

1.9. Recommended books

Principles of Auditing	**:**	**R.G. Saxene**
Principles & Practices of Auditing	**:**	**B.N. Tandon**
Principles & Practices of Auditing	**:**	**Jegadish Prakash**
Contemporary Auditing	**:**	**Kamal Gupta**

-Dr. Ch. Suravinda

LESSON - 2

TYPES AND CONDUCT OF AUDIT

2.0. Objectives : After going through this Lesson the student can know the various types of Audit and How it is conducted ?

Structure :

2.1. Introduction :

It is not obligatory to the sole traders or partnerships, under law, to get their accounts audited but because of the advantages derived they generally have their accounts audited.

2.2. Various Types of Audit :

Audit may be of different classes but the principal classes of audit are :

1) Audit under statute (Law);

2) Audit of the accounts of private individuals;

3) Audit of the accounts of private firms;

4) Audit of the accounts of trustees and executors etc.

2.3. Audit under statute :

Audits are compulsory in the case of undertakings mentioned below, under the different laws that govern them

a) Joint stock companies incorporated under the companies Act, 1956.

b) Banking companies governed by the Banking companies Regulation Act, 1949.

c) Insurance companies governed by the Insurance Act, 1938.

d) Co-operative societies registered under the co-operative societies Act.

e) Public and charitable Trusts registered under various religious and other endowment Acts.

f) Local authorities and govt. undertakings.

Audit is of two types it may be a statutory audit or general audit. It is not compulsory to any partnership firm or sole trading concern to get their accounts audited, but it is optional, such an audit is known as general audit. When an auditor is asked to audit the accounts of a firm he must get clear instructions in writing from his client to know the scope of his work.

Audit is compulsory in case of joint stock company according to the company Act. The audit of accounts of a joint stock company is known as statutory audit.

Advantages :

1) The share holders of a company have no access to the books of accounts and therefore if the accounts are audited by an auditor who is an independent professional accountant, they are assured that they have not been defrauded.

2) An audit act as a check upon the dishonest employees whose number may be very large.

Distinction between the audit of a joint stock company and a firm :

Joint Stock Company	Firm
1) The audit of Joint stock company is compulsory under the companies Act.	1) Audit is not compulsory in case of partnership firm.
2) The duties, powers, rights etc, of an auditor of a joint stock company are defined by the Companies Act.	2) They depend upon the agreement between the auditor and firm.
3) He must be a qualified person as laid down under (Sec.226)	3) He need not be a qualified person.

Here the student must also know the difference between audit of government offices, and commercial undertakings. The book keeping system as is adopted by the commercial concerns is not followed in government offices although their objectives may be the same. The audit system in government offices is therefore not similar to that of the commercial concerns. First of all we will discuss the objectives of the government Audit.

Objectives of government Audit :

The objectives of government Audit are as follows :

1) To see whether there is a provision of fund for the expenditure and whether such a fund has been duly authorised by competent authority.
2) To see that the expenditure has been properly sanctioned according to the rules and regulations.
3) To see whether the sanctioned expenditure has been incurred by an officer competent to incur such an expenditure.
4) To see that the amount has been paid to the proper person and the relative receipt has been obtained.
5) To see that the payment has been properly and correctly classified.
6) To see whether the payment is to be debited to the personal account of a contractor or an employee.
7) To see while auditing the receipts that money due from others is regularly recovered and checked against payment already made and the amount received is duly credited to the account concerned.
8) To see while auditing the stores and stocks, whether they are properly and accurately valued.
9) To see that the stock taking of the stores is periodically done or such stores may be verified with the balance as shown in the stock Register.
10) To see that the expenditure confirms to the general principles like, that the expenditure is not more than what is necessary and that every Government servant has exercised reasonable care to spend the money; and the public money is not utilised for the benefit of a person or section.
11) To see that the allowances should not become a source of profit to the receipient.

Distinction between the Audit of Government Accounts and Commercial Concern :

The following are some of the important distinctions between government audit and commercial audit.

Government Audit	Commercial Audit
1) The audit of government transactions, whether in or outside India is entrusted to the Audit and Accounts department which is quite independent of the spending department. It compiles of the major portion of the accounts which it audits.	1) In the case of commercial firms the auditor never prepares the accounts which he has to audit.
2) The spending department in case of Government offices, itself performs a part of the work incidental to audit as the audit officer has no knowledge of the quantity or quality of work done by a contractor or goods supplied by the supplier etc.	2) In the case of commercial concerns the audit work is not performed by the spending department.

3) Treasury officer who is not a member of the Accounts and Audit Department, makes the preliminary examination of the bills while making the payment on Government accounts.	3) In case of commercial firms, the cashier has nothing to do with the audit or preliminary examination of the bills which are paid by him.
4) A government audit is continuous audit because of a very large number of transaction and also because a large part of the work is concerned with the personal claims of Government officers and which have to be finalised with greate speed.	4) Commercial Audit is, in a majority of cases periodical.

2.4. Audit of the Accounts of a private individual :

Sole proprietors are not required by any law to have their accounts audited. Despite this fact it is quite usual for many of them who receive their incomes from different sources and whose expenditure is vast and varied, to get their private accounts audited. In such cases the auditor acts as an accountant also and prepares the accounts besides checking their accuracy. When he is appointed by an individual, he must get clear instructions from his client in writing as to what he is expected to do. His scope of work will depend upon the agreement that he has entered into with the client. In case the auditor is asked to do the full audit he must see that the accounts are properly prepared and the Balance sheet is correctly drawn-up in order to avoid his responsibility.

Advantages :

The following are the advantages to be derived by private individual by getting his account audited :

1) The individual is assured of having his accounts properly maintained and there is no fraud of any type by the accountant.
2) The audited accounts are generally taken as correct by the income-tax authorities for fixing the tax payable.
3) The audited books of a deceased are very helpful to the executors and administrators in preparation of the death duty accounts.
4) Wealth tax can be properly assessed.
5) The appointment of an auditor keeps a check on the accounts department.

2.5. Audit of the Accounts of Private Firms :

It is not necessary that the accounts of a firm should be audited but since there are many advantages of getting the accounts audited, many firms generally makes a provision for audit in the Partnership Deed. In such a case an auditor is appointed by an agreement between the auditor and his client. He should always bear in mind that all the partners jointly and severally are his clients, though he might have been appointed by only one of them, if so authorised under the partnership deed. He must get in writing the nature and scope of his work which is to be carried out and should make a written report in turn which can leave no doubt as to the nature of duties undertaken.

Advantages :

The following are the advantages to be derived by a partnership firm by getting the accounts of a firm audited by a qualified auditor.

1) Disputes among partners may be avoided.
2) In the case of admission, retirement or death of a partner, the valuation of goodwill and the settlement of accounts may become very easy.
3) Audited accounts will be more reliable for the purpose of assessment of income-tax.
4) Negotiations for loan from different sources become easy.
5) Auditor can suggest better ways of keeping the accounts.

In addition to the above mentioned particular advantages, a firm derives all the advantages which are usually derived in getting the accounts audited.

2.6. The Audit of Trust Accounts :

Trusts are created for the benefit of some religious or charitable institutions such as temples and educational institutions. In some cases trusts may be created for the benefit of Minors and widows who cannot look after the property themselves. The trustees took after the property left over by the testator. They collect the rents of the property, dividends on the shares etc., and distribute the income to the beneficiaries according to the terms of the Trust Deed. In many cases these trustees may not have the necessary knowledge of maintaining accounts or may not use the income of the trust for the benefit of the party for which it has been created. In other words, they may misappropriate the trusts funds without the knowledge of the beneficiaries. To avoid such a thing, generally a provision is made in Trust Deed for audit of accounts by a qualified auditor. If the accounts are audited, it helps both the trustees and the beneficiaries. Trustees will be benefited because there will be no unnecessary criticism against them, and the beneficiaries will be assured about the correctness of the accounts.

2.7. Conduct of an Audit :

An audit may be

1) Continuous Audit
2) Periodical Audit
3) Interim Audit
4) Occassional Audit
5) Partial Audit
6) Standard Audit
7) Balance sheet Audit

Now we will go through with each of the conduct of Audit and their relative advantages and Disadvantages one after the other.

1) Continuous Audit :

It is also called a detail audit which involves a detailed examination of books of accounts at regular intervals of say one month or three months. The auditor visits his clients at regular or irregular intervals during the financial year and checks each and every transaction. At the end of the year he checks the profit and loss Account and Balance sheet.

Businesses where continuous Audit is Applicable :

1) To those concerns where it is desired to present the accounts just after the close of the financial year as in the case of a bank.
2) Where the volume of transactions is very large.
3) Where the statement of account is required to be presented to the management after every month.
4) Where no satisfactory system of internal check is in operation.

Advantages of continuous Audit :

1) Errors and frauds can be discovered easily and quickly as the auditor checks the accounts at regular intervals and in detail.
2) Since the auditor remains more in touch with the business he is in a position to know the technical details of it and hence can be of great help to his clients by making valuable suggestions.
3) Most of the checking was having been already performed during the course of the year, the final audited accounts can be presented to the shareholders soon after the close of the financial year at the annual general meeting.
4) As the auditor visits the clients at regular intervals, the clerks will be very regular in keeping the accounts up-to-date.
5) If the auditor pays surprise visits it will have a considerable moral check on the clerks preparing accounts.
6) The auditors having more time at his disposal can check the accounts with great attention and in detail, so his work will be more efficient.
7) Where the directors of a company wish to declare an interim dividend continuous audit will help in the preparation of the interim accounts without much delay.
8) Audit staff can be kept busy throughout the year.

Disadvantages :

1) The figures in the books of accounts which have already been checked by the auditor at his previous visit may be altered by a dishonest clerk.
2) The frequent visits by the auditor may dislocate the work of his client.
3) It is an expensive system of audit.

4) The audit clerk may loose the thread of his work thus continuous audit lacks continuity in work.

5) The staff of the client may depend upon the audit staff to help them out of difficulties in the course of their work.

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

These disadvantages may be avoided by taking the following precautions.

1) No alteration shall be allowed to be made after the entries have been checked.

2) If any alteration has to be made it should be done by means of rectifying entry in Journal.

3) Checking of a book should be complete as far as possible in one visit to avoid loose ends. However if this is not possible he should check the transaction upto a particular date and make a note of it in his dairy.

4) If any alteration in a figure had already been made, the auditor should put a secret tick against such a figure.

5) He should pay surprise visits to the clients office.

2.9. Periodical or final audit :

Periodical audit is one which is taken up at the close of the trading period, when all the accounts have been balanced and trading and profit and loss Account and Balance sheet prepared. The audit is completed in one continuous session. In this case the auditor visits his client only once in an year and goes on checking the accounts until the audit work for the whole of the period is completed.

If the auditor has several clients whose financial year ends on the same date, it may be difficult for the auditor to complete the work of all his clients

Though this type of audit is called complete or Detailed Audit the expression is not correct because each and every transaction is seldom checked in a big business house. This type of audit is suitable to small concerns where the number of transactions are small in number.

2.10. Distinction between Final Audit and continuous Audit :

Continuous Audit	Final Audit
1) The auditor visits his staff frequently and check the accounts.	1) The auditor visit the client only at the end of the year and check the accounts in a single sitting.
2) Accounts are audited as and when recorded .	2) Accounts are audited after the preparation of final accounts.
3) It is suitable to big concerns and where a detailed checking is necessary.	3) It is suitable to small concerns.
4) It is an expensive one.	4) It is relatively cheap.

2.11. Interim audit :

It is an audit which is conducted in between the two annual audits with a view to find out interim profits to enable a company to declare an interim dividend.

Advantages :

1) This type of audit is good where the publication of the interim figures is necessary.
2) The final audit can be completed very soon, if there has been an interim audit.
3) Errors and frauds can be more quickly found and detected during the course of the year.
4) There is a moral check on the staff of the client as the accounts are checked say after three or six months.

Disadvantages :

1) Figures may be altered in the accounts which have already been audited.
2) It will mean that the audit staff will have to prepare notes when they finish the interim audit.
3) This is an additional work.

Distinction between continuous Audit and Interim Audit :

For better understanding of the interim audit and continuous audit the following points of distinction between them is provided to the students.

Continuous Audit	Interim Audit
1) The work of audit is carried on up to any date according to the convenience of the auditor and his client.	1) The work of audit is up to a definite date according to the instructions of the client.
2) Verification of assets and liabilities is done after the balance sheet has been prepared at the end of the accounting period.	2) The Assets and liabilities are verified when this audit is conducted.
3) No trail balance is prepared though the totals of certain accounts may be noted.	3) The trail balance has to be prepared or checked.
4) The object is not to know the profit or loss.	4) It is conducted to know the profit or loss.

2.12. Partial Audit :

When an auditor is asked to check some of the records and books for a part or whole of the period, it is called partial Audit eg : he may be asked not to check the payment side of the cash book. Partial audit is not permitted in the case of private or public limited companies.

2.12. Balance sheet Audit :

It is an audit to verify the items appearing in the Balance sheet and the profit and loss Account. It is a limited audit in which all the balance sheet accounts i.e. assets liabilities, reserves and provisions are verified. Those items of profit and loss account are only checked which are directly related to assets. In this kind of audit, work like vouching, casting and posting etc, is dispensed with. This type of audit can be successful in those business houses where efficient system of internal check and control is in operation. This type of audit is popular in U.S.A.

2.13. Occasional Audit :

This type of audit is conducted once a while and that too at the desire of the owner of the business. For example, the audit is not compulsory in case of sole proprietor and partnership business but whenever the need arises the proprietors can get the accounts audited.

2.14. Summary :

Audit is compulsory to certain concerns which is known as statutory audit and it is optional to sole trading concerns and partnership firm, so it is called general audit. Each type of Audit has its own advantages and disadvantages. The type of audit to be adopted depends upon the magnitude of the business.

2.15. Self Assessment questions :

1) Give the objectives of audit of government accounts.
2) What is meant by continuous audit and to what type of business it is specially applicable ?
3) State the merits and demerits of continuous audit.
4) What is periodical audit and what are the advantages and disadvantages of periodical audit.
5) Distinguish continuous audit and periodical audit.
6) Distinguish between an audit under statute and other audits.
7) Write a shortnote on various types of audits and their relative advantages.

2.16. Recommended books :

Principles of Auditing	**:**	**R.G. Saxene**
Principles & Practices of Auditing	**:**	**B.N. Tandon**
Principles & Practices of Auditing	**:**	**Jegadish Prakash**
Contemporary Auditing	**:**	**Kamal Gupta**

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LESSON - 3

AUDIT PROGRAMME

3.0. Objectives : After going through this lesson the student can know the procedure and planning of Audit. He can also know the procedure of a New Audit.

Structure :

3.1. Introduction :

After having decided as to whether continuous audit or final audit is to be undertaken the auditor should prepare himself for the work. How to proceed with the work will depend upon the circumstances of each particular case. The method of work varies with the training, experiences and knowledge of the auditor.

3.2. Procedure:

As we have already seen that the procedure of audit work will vary from case to case. Some general points are given below.

1. Distinctive ticks of different colours for say additions, postings, ledger balances, carry forwards etc. should be adopted.
2. The significance of these ticks should not be made known to the clerks of the client.
3. The same kind of tick should not be used for the same kind of transactions or for all the visits.
4. As far as possible the work of checking of one book should be completed at one sitting, otherwise some fraudulent alterations may be made by the clerks after the audit clerk has left the office for the day.
5. In every visit the audit clerk should see that there has been no alteration in the work he had already checked on the previous visit. If so, he should get an explanation and check the whole of the work again.
6. If adjustment is found to be necessary that should be carried by passing a journal entry. No alteration of a figure should be allowed.
7. Special ticks should be used for figures which had already been erased.

8. The auditor should write the correct figure with his own ink just close to the erased one and should put a circle around the erased figure with a colour pencil.
9. Sometimes the clients put the total figures with pencil. In such cases the auditor should refuse to commence his work until these figures are inked.
10. The audit clerk should not balance the books. It is not his duty.
11. The audit work should only be started after the client has closed the accounts and final accounts are prepared.
12. No transaction should be passed unless he understands and believe it as true.
13. The auditor should not discuss anything in regard to the meaning of different ticks with the client's staff.

3.3 Preliminary steps:

The audit of accounts of a concern involve sound planning, conduct and judgement. An auditor has to take certain steps before commencing the audit such steps are called preliminary or general steps. They are as follows.

1. He should see that his appointment is in accordance with the provisions of the companies act. If he does not do so he will be held liable. If he has been appointed in place of an other auditor, he should enquire from the retiring auditor the reasons for changes.

V.G. Majundar Vs J.N. Saika 1954:

1. A chartered accountant was appointed by the Directors because the company had failed to appoint the auditors in its annual general meeting. The chartered accountant wrote to the previous auditor of the company about the appointment but finished the work of audit on the same date before the receipt of any reply. It was held that the auditor was guilty, but since it was found that there was misapprehension the auditor was given a warning.
2. He should obtain definite instructions from his clients about the nature and scope of his work and duties whether he has to do the accountancy work or Audit work or both.
3. He should examine the system of accounting employed by his client. If he finds any week points he must study it thoroughly and make recommendations to his client to remove these week points.
4. He should then obtain a list of all books maintained in the office together with the names of the keepers of such books and their specimen signatures, such a list should be duly signed by a responsible official of the company.
5. If internal check system is in operation, he should get a written statement to that effect and should decide whether to rely or not on it.
6. He should get a list of the officers of the company containing particulars about their duties, powers and their specimen signatures.
7. If the business is of a technical nature it would be better to visit the work and acquire technical knowledge to some extent before he actually commences the work.
8. He should ask the clients to balance the books and prepare the final accounts and the Balance

sheet, file the vouchers in the order of occurrence of the transactions, prepare the schedules of the debtors good, doubtful and bad, creditors. Important legal papers, contracts, list of securities etc. If this has not been done so far he should never begin his work until the books have been balanced.

9. He should obtain the previous years audited Balance sheet, if any and see that the accounts during the current year have been opened with those balances which appeared in the previous Balance sheet.

10. He should carefully study all the documents which have a bearing on the accounts. He should study the partnership deed in case of partnership audit. Memorandum and Articles of Association in the case of company audit and trust deed in case of a trust audit.

11. If it is the first audit of a company he must also go through the prospectus, contracts with the vendors, promoters etc.

12. He should get the report of the auditor, if any relating to the accounts of the previous year for information regarding the state of affairs of the company during that year.

13. He should draw up an audit programme.

3.4 Audit Programme:

An audit programme is an essential preliminary to an efficient audit. Hence the auditor should prepare it before the commencement of the audit work. An audit programme is a written scheme of the exact details of the work to be done by the auditor and his staff in connection with a particular audit. It contains the selected periods for tests, dates of work, names of persons performing the work and time taken.

According to Prof. Megis, an audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.

Audit programme is generally prepared with the columns provided for the name of the clerk doing the work, the type of work the dates when he started and finished the work. Each audit assistant signs for the work, he has performed so that the responsibility may rest upon him for the work he has done.

A specimen of Audit programme is as follows.

SPECIMEN OF AUDIT PROGRAME

Messers ....& Co., Ltd.

YEAR MONTHS	Cash Book	Bank Balance	Cash Book	Petty Cash	-do-	Bought Ledger	Bought Ledger	Sales Book Additions and	Returns Book	Journal	Stock - Sheet	Bought Ledger Balances	Sales Ledger	Trial Balance	General Ledger	Profit & Loss	Balance Sheet	Remarks
JAN.																		
FEB																		
MARCH																		
APRIL																		
MAY																		
JUNE																		
JULY																		
AUGUST																		
SEPT.																		
OCT.																		
NOV.																		
DEC.																		

N.B. : Each audit assistant has to put in his initial in the relevant column after he has checked a particular item.

Advantages of Audit Programme:

The advantages of audit programme may be listed out as follows:

1. It ensures that all necessary work has been done and nothing has been omitted.
2. The auditor is in a position to know about the progress of the work done by his assistants.
3. A uniformity of work can be attained as the same programme will be followed at subsequent audits.
4. Work of the audit can be divided amongst the different juniors who will be responsible for their work. In case a clerk goes on leave, his work can be resumed by another clerk who is in a position to know what work has already been done.
5. It simplifies the allocation of work to various grades of audit clerks.
6. In case of a charge of negligence against the auditor for not having done some work, the auditor can defend himself that the work had been done by him or his assistant who had duly signed the audit programme.
7. It is a kind of guidance to the audit clerk for the work he has to perform. Thus it is a kind of assurance to the auditor that the junior will not overlook essential points while checking the accounts.
8. In case of any fraud or error has remained undetected, the responsibility for negligence can be fixed on the clerk who had performed that work as his initials are put on the audit programme.
9. It facilitates the final review before the report is signed.
10. For a new clerk the audit programme is a guide to his duty.
11. It is a useful basis for planning the programme for the subsequent year.

Disadvantages of Audit programme:

There are however, certain disadvantages of such an Audit programme which may be listed as follows:

1. The audit may become too mechanical in its nature. Audit programme discourages initiative and interests of the assistants.
2. The audit programme even if it is well chalked out may not cover every thing that might come up during the course of audit.
3. New matters of importance arising between one period and an other may be overlooked, if the programme is not kept up to date.
4. Work may be hurried in order to complete a required schedule.

These disadvantages are not quite serious. They can be easily overcome by following certain precautions are as follows:

The auditor should consult the juniors while chalking out a programme. Their suggestions should be appreciated. So that they may not lose initiative. They should be encouraged to make surprise checks outside the audit programme and to recommend additions and improvements in the scheme. As far as possible the audit programme should be made up-to-date on the basis of experience gained and change taking place. In other words great care must be taken to ensure that the programme does not become obsolete. Efforts should thus be made to remove the disadvantages rather than avoiding chalking out the programme itself.

3.5 Audit Note Book:

An audit note book is a book which is maintained by the audit clerk. During the course of audit, the clerk comes across several difficulties or new points which he has to discuss with his senior or the auditor. He notes down these in a book which is called audit note book or Audit memoranda. Every auditor maintains an audit note book for the purpose of making notes of all important matters affecting the audit. The audit note book is of great use to the auditor. It helps the auditor to a great extent in future; specially in subsequent audits of the same concern. If the auditor is charged with negligence in his work, he may produce audit note book as evidence and show the exact work done by him and defend himself from being put in a difficult situation. Thus the audit note book is a documentary evidence in favour of the auditor.

The audit note book should be maintained clearly, completely and systematically. It should not contain the notes of unimportant matters.

The Audit Note Book should be in two parts.

1. for keeping a record of general information as regards the audit as a whole and
2. for recording special points which the audit staff may have come across during the course of audit of the accounts of different years.

An audit note book should contain the following information:

General information:

1. The nature of the business carried on and the important documents relating to the constitution of the business i.e.; Memorandum of Association, Articles of Association and partnership Deed etc.
2. A list of books of accounts in use.
3. Names of principal officers, their duties and responsibilities.
4. Particulars of the accounting and the financial system followed and the internal check in operation in the business.
5. Details regarding accounting and financial policies followed in the business.

Special matters to be recorded in the Audit Note Book:

1. Routine queries not cleared, i.e.; missing receipts and vouchers, etc.
2. The mistakes and errors discovered.
3. The points arising during the course of the audit, to which the attention of the auditor must be draw, i.e.; failure of the company to comply with the provisions of the companies Act or of the Memorandum of Association.

4. Extracts from minutes and contracts etc;
5. The points to be incorporated in the audit report.
6. The points which need further explanation and clarification e.g; a change in the basis of valuation of finished stock or in the computation of depreciation etc;
7. Dates of commencement and completion of the audit.
8. Important matters for future reference.
9. Special points requiring consideration at the time of final accounts.

Audit Note Book should be preserved by the auditor in order to avoid any type of liability which may arise in future. It is also a good reference book for future audit.

3.6. Working papers:

Working papers are those papers which contain essential facts about accounts so that the auditor may not have again to go over the accounts of his client in case he wants to refer to them later on during the course of his audit.

Objects or Aim of working papers:

The objects or Aims of working papers are as follows:

1. In order to support the auditors report these papers show the details of the work performed by the audit clerks.
2. An auditor can form an opinion about the efficiency of the audit clerk, as the working papers remain with the auditor.
3. They are permanent records and therefore in case of any suit against him for negligence, he can defend himself on the basis of these working papers.
4. The preparation of the working papers is a means to give training to the audit clerks as to how to summarise the work done by them.
5. The working papers enable the auditor to point out to the client the weaknesses of the internal control system in operation.
6. The working papers help the auditor to plan for the succeeding year.
7. It will enable the auditor to prepare the report without much waste of time.
8. He can know that his assistants had followed his instruction.

Working papers should be carefully prepared as they are the basis of conclusions and summarisations shown by the auditor in his report. They should be clear, complete and contain all essential information in regard to accounts and audit so that they may be of maximum utility. They should be properly organised and arranged so that one may not find difficulty in pin-pointing a particular matter.

8.A Essentials of good working papers:

1. The working papers should contain all the essential information so that they may be of maximum utility.

2. The working paper should be so arranged that one may not find any difficulty in locating a particular matter. If they are not properly arranged it will result in loss of time in finding a particular fact while preparing the report.
3. The facts in the working papers should be set out clearly.
4. The facts stated should be readily available to the reader later on.
5. Paper used for working papers should be of good quality so that by frequent handling it may not be damaged.
6. Paper used should be of convenient and uniform size.
7. Sufficient space should be left after each note so that any decision taken by the auditor may be taken down in that space.
8. Papers should be arranged in a logical order.

Preservation and filing of working papers:

It is necessary that the working papers should be preserved as they are important and valuable documents for the clients as well as for the auditor. It is therefore suggested that they should be filed systematically. For convenience, the working papers may be sub-divided between current and permanent files.

The current files should normally include the following documents

a) A copy of the accounts under review.
b) The audit programme and audit tests performed.
c) Minutes book of the directors and share-holders meetings or the board of trustees or partners.
d) Queries raised during the audit and the official comments.
e) Letters from clients and other sources confirming account, certificate for valuation of stock and provision for bad debts, etc.
f) A list of missing vouchers.
g) Bank and branch reconciliation statements.
h) Computation of tax, bonus and gratuity etc.

The permanent file should normally include following documents.

a) A copy of the memorandum of association and articles of association, partnership deed and trust deed etc.
b) A copy of the relevant statutory regulation.
c) A brief note on the nature of the business.
d) A copy of the letter containing client’s instructions as to the work to be performed.
e) A list of important books maintained by the client.

f) A list of officials with the nature of work performed by them and a copy of the organizational chart.

g) A short description of the system of internal control and internal audit in operation.

h) Statements setting out the basis of stock valuation and computation of depreciation etc.

3.7. Summary :

The procedure of audit work will vary from case to case. The audit of accounts of a concern involve sound planning conduct and judgement The steps which the auditor take before commencing the audit are called preliminary or general steps. The auditor should chalk out a programme before commencement of the audit work. It is a written scheme of the exact details of the work to be done by the auditor and his staff in connection with a particular audit.

During the course of audit, each audit clerk maintain a book to note points which he has to discuss with his senior or the auditor. This book is known as Audit note book.

The auditor, while auditing the accounts prepare certain papers which contain essential facts about accounts which will help to prepare his report without much difficulty. These papers also will be filed for future use.

3.8. Self Assessment questions:

1. What is an audit programme? and what are its objects ?
2. What steps an auditor should take before commencing a new audit ?
3. What is an “Audit note book” ?
4. Describe an Audit note book. What are its contents and its value to an auditor ?

3.9. Recommended books

Principles of Auditing	:	**R.G. Saxene**
Principles & Practices of Auditing	:	**B.N. Tandon**
Principles & Practices of Auditing	:	**Jegadish Prakash**
Contemporary Auditing	:	**Kamal Gupta**

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LESSON - 4

INTERNAL CHECK

4.0. Objectives : After going through this lesson the student can know what is internal check ? What are its advantages ? How can the work of internal check is drafted in case of cash receipts and payments, purchases, sales, wages etc.

Structure :

4.1. Introduction :

Internal check is a method of organising the accounts system of a business concern or a factory where the duties of different clerks are arranged in such a way that the work of one person is automatically checked by another and thus the possibility of fraud or error is minimised unless there is a collusion between the clerks; e.g; the receipt of cash is entered by the cashier on the debit side of the cash book, this entry is carried to the ledger by another clerk, the statement of account relating to this transaction is sent to the customer by a third clerk and so on. It is a kind of division of labour. This minimises the possibilities of frauds and errors unless all the three join hands in defrauding their employer. The secret among three will be a secret for all is true in this case.

4.2. Definition :

F.R.M. De Paula defines it as "Internal check means practically a continuous 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".

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

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

Thus the system is based on the principle of division of labour that is the work in the organisation, is arranged in such a way that the work performed by one individual is checked by another automatically.

4.3. Objects of Internal Check :

The internal check system is organised to achieve the following objects:

1) To prevent the commission of any error or fraud by a clerk.
2) To prevent the misappropriation of cash or goods by any clerk by keeping a check on the receipts and payments of cash and receipts and delivery of the goods.
3) To throw responsibility on a particular clerk when the fraud or mistake is detected.
4) To detect a fraud or an error quickly and easily.
5) To have an accurate record of all business transactions.

4.4. Essentials of good Internal check System:

The following points are to be taken into consideration in framing a good system of internal check.

1) No single person should have an independent control over any important aspect of business for ex ; When goods are purchased on credit, entries are made in the purchase book by the gate-keeper he enters the name of the supplier, the quantity of goods and the date on which they are received; another entry is by the keeper of the purchase book, in the purchases book. Thus, the same staff by different clerks and the possible of fraud or mistake is reduced to a transaction is entered.
2) The duties of the members of the great extent be changed from time to time without prior notice.
3) Every member of the staff should be instructed to go on leave at least once. This will help in detecting the conceal frauds.
4) Persons having physical custody of assets must not be permitted to have access to book of accounts.

5) To prevent misappropriaton of cash, mechanical devices should be employed.

6) Procedures should be laid down for the verification and testing of different sections of accounting records periodically, to ensure their accuracy.

7) The financial and administrative powers should be assigned to different officers.

8) For stock taking at the close of the year, the trading activities should be suspended for some time. The task of pricing and evaluation of stock should be done by the staff other than that of stock section.

9) No member of the staff should be allowed to take away goods without prior permission of some responsible official.

10) There should be efficient accounting control in respect of each important class of assets.

11) Ledger keepers should not be allowed to have a direct access to either the debtlors or creditors of the business.

12) A detailed record should be maintained for all goods received and sent out of the business premises.

4.5. Auditor's duty in regard to Internal check system :

To what extend should an auditor depend upon the internal check system will depend upon the magnitude of the business whose accounts he is auditing.

In the case of a concern where there is no internal check system and the clerk has full control over all the books of accounts. It would be better if the auditor should check all the transactions from the beginning to the end irrespective of the fact whether the concern is small or big.

In the case of concern where there is a good internal check system, the auditor, may rely upon it to a great extent. But he must not be negligent. He should apply a few test checks. The existence of a good internal check system reduces to a great extent the work of the auditor but does not reduce his liability. To what extent should an auditor depend upon the internal check system will depend upon the circumstances of each particular case and the efficiency of his audit will depend upon his tact, skill, experience and judgement.

4.5. Internal control :

Control is a wider term and will include all types of management controls. It is a means of assisting modern business management in discharging its function. The term internal control has been defined as "the whole system of controls, financial or otherwise established by the management in order to carry on the business of the company in an orderly manner safe guard its assets and secure as far as possible the accuracy and reliability of its record." According to this definition, internal control means a/. accounting control b/. operation controls i.e.; quality control, budgetary control, internal checks and internal audit etc.

a) Accounting controls :

Comprise primarily "the plan of organisation and the procedures and records that are concerned with and directly related to the safeguarding of assets and reliability of financial records."

Accounting and financial control include budgetery control, standard costing, self balancing ledgers and internal auditing etc. such controls ensure accuracy and reliability of financial records

b) Administrative controls :

Comprise the plans of organisation that are concerned mainly with operational efficiency. They may include controls, such as time and motion studies , quality control through inspection, performance reports and statistical analysis.

4.7. Internal control and the Auditor :

From the definition given above, that it is the responsibility of the management to instal internal control in order to carry on business of the company in an orderly manner. The institute of Chartered Accountants of India also stated the duty of safeguarding the assets of a company is primarily that of the management and the auditor is entitled to rely upon the safeguards and internal controls instituted by the management. Therefore an auditor is mainly concerned with the evaluation of the internal control system in force so that he may be able to know.. Certain things which may be listed out as follows.

1) whether mistakes, errors and frauds are likely to be located in the ordinary course of operation of the business;

2) whether an efficient internal auditing department exists or not;

3) how far the management is discharging its function in regarding to correct recording of the transactions;

4) how extensive examination he should carry out in the different areas of accounting;

5) how far administrative control has a bearing on his work;

6) What should be the appropriate audit programme in existing circumstances;

7) to what extent he can depend on the records and reports of the management.

If the auditor does not acquaint himself fully with the internal control system and its actual operations he cannot formulate a satisfactory audit programme.

4.8. Internal Audit :

Internal Audit is the review of operations and records under taken within a business by specially assigned staff. The term internal audit has been defined as "the independent appraisal of activity within and organisation for the review of accounting, financial and other business practices as a protective and constructive arm of management". From this definition it is clear that internal audit not only includes the verification of accounting matters but also financial and other matters.

The work of the internal auditor is more or less the same as that of an external auditor. Being the employee of the organisation he has to see that there is no waste and inefficiency in the organisaiton. He has to find out weakness of the internal control and internal check systems followed in the organisation and suggest necessary improvement. Internal auditor assist management in achieving the most efficient administration of the organisation.

Differences between internal Auditor and Independent Auditor.

Internal Auditor	Independent Auditor
1) He is an employee of the concern. His duties, rights and responsibilities regarding audit work are determined by the management.	1) He is appointed under statute and his scope of work and liability etc are laid down by the statute.
2) Internal auditor is appointed by the management.	2) He is appointed by the shareholders or by the Government.
3) It is optional to appoint an internal auditor.	3) It is compulsory.
4) He need not be a qualified auditor.	4) He must satisfy the qualifications mentioned in companies Act.
5) He presents accounting information to the management continuously to take policy decisions.	5) He ensure the shareholders that the financial statements show a true and fair view of the financial position of the company.
6) He has to submit his report to the management.	6) He submits his report to the shareholders through the management.
7) His work is continuous in nature.	7) His work is periodical in nature.

4.9. Internal check as regards cash receipts

There are lot of chances of misappropriation of cash if there is no well organised system of Internal check. He should enquire as to the duties of the cashier and whether he has access to the ledger and other books of original entry. If it is so, there are chances of fraud and therefore he should be vigilant. The following steps of internal check as regards receipts is suggested.

1) When cash is received, it should be acknowledged by means of a printed receipt which should have a counterfoil or by a carbon copy. Cashier should not sign receipts and counter foils. The receipts should be consecutively numbered. The unused receipt book should be kept under lock and key. Spoiled receipts should be cancelled and must not be detached from the counterfoils. No blank counterfoils should be accepted.

2) As soon as cash is received it should be entered in a rough cash book or diary

3) Remittances should be opened by the cashier in the presence of a responsible officer who should not be connected with the cashier's office. All cheques received should be crossed.

4) All the receipts of the day should be deposited in the bank at the end of the day or the next morning.

5) Bank recociliaton statement should be prepared frequently by the cashier and also by some

one else.

6) The cashier should not have any control over the ledgers.

7) Petty cash should be organised under the imprest system.

8) Before a cheque is issued it should be presented along with the account of the payee, to a responsible officer who should not have any access to accounting records or securities for his signature. Unused cheque book should be kept under lock and key by a responsible official.

9) Castings of the cash book should be independently checked.

10) Internal control over the preparation of wage sheets to prevent fraud and manipulation should be exercised.

11) All payments as far as possible except for petty cash, should be made by cheques.

12) If travellers are permitted to collect money on behalf of the company, the issue of receipts by them and deposits of such money into the bank should be carefully controlled. As far as possible the system of collection by the travellers should be discouraged. The travellers should be given receipt books having three copies -one to be given to the customer, another to be sent to the head office and the third to be retained by them.

13) Cashier should not sanction the payments of special nature. Directors should do so.

4.10. Internal check as regards cash payments :

1) All payments should be through crossed cheques.

2) Petty cash payments should be handled by the petty cashier. This books should be maintained under imprest system.

3) For all payments made vouchers should be checked with relevant vouchers.

4) All cheques and bills should be thoroughly checked and signed by the proper authority.

5) Confirmation of accounts with the creditors should be made to maintain up-to-date records.

6) All vouchers should be serially filed.

7) Bank reconciliation statement should be prepared frequently.

4.11. Internal check as regards sales :

In big business concerns a separate department to deal with sales is kept. This is under the supervision of a responsible official known as sales manager. Following procedures should be adopted to control sales :

1) Whenever an order is received, it should be recorded in the order received book, giving details regarding the date on which the order was received, the name of the customer, the particulars about the goods, date of delivery mode of transport etc.,

2) The copy of the order is sent to the Despatch Department.

3) When the Despatch Department has packed the goods, another clerk should compare the

goods so despatched with the order to see that the whole of the order is complied with or another list is prepared showing the goods in the package which list is sent to the counting house.

4) A responsible official will now mark the rate at which the goods are to be charged.

5) A clerk will make the calculations.

6) The outward invoice is then prepared in duplicate.

7) One copy of the invoice will be sent to the invoice clerk who enters, it in the sales book and later on this is sent to the customer, another copy will be sent to the gate-keeper who will record in the goods outward book the third copy is filed for further reference.

8) If orders are received through the travellers, they should be given order books with tripicate copies - one copy to be handed over to the customer, the second to be sent to the Head office and the third one is to be retained by the traveller for his record.

The Duties of Auditor in connection with credit sales :

1) He should see that whether the internal check system in operation is efficient or not. If it is not so, he should disown his responsibility. If it is efficient, he should apply a few test checks.

2) He should compare the data of invoices with the data in sales book.

3) He should see that the sale of an asset is not treated as ordinary sale.

4) With the permission of the client, the auditor should send statements of Accounts to the customers to confirm the accuracy of the balance.

5) He should check the sales book for the last days or weeks of the financial period and the returns. Inward book for a few days or weeks after the close of the period in order to see whether fictitious sales or returns has been recorded to inflate profits.

6) He should check the casts of the sales Book.

7) The cancelled invoices, if any, should be checked with the duplicate copy of the invoice.

8) Sales tax, insurance charges etc., which are recoverable from the customers should be debited to the customer's account.

9) Sales to allied or sister concerns should be carefully examined as they may be fictious.

10) If there is a significant difference of trade discount allowed to two different purchasers, he should inquire into the reasons of such a distinction.

Sales Returns :

When the goods are returned from customers, defective or an account of any other reason, they should be entered by the gate keeper in the register known as gate-keeper's Returns Inward Book and the Stock Register. The goods returned should also be recorded in the sales returns book and a credit note should be prepared to be sent to the customers. Such a credit note should be signed by a responsible official. There are lot of chances of fraud in connection with the sales returns e.g:

The goods might not have been returned but a credit note has been sent to the customer. The auditor should, therefore, pay particular attention to such transactions.

Sometimes the customers attempt to return the goods if there is a fall in the prices after the purchase has been made. The auditor should pay attention to such a return of goods. Return from allied or sister concerns should be carefully examined to see their genuineness. The auditor should vouch these transactions with the gate - keeper's Returns Inward Book and with the carbon copies of the credit notes sent to customer or, the debit note received from the customers. He should see that returns just before the date of balancing the books are recorded both in the stock as well as in the Sales Returns Book. If they are taken into stock, but are not entered in the Sales Returns Book, result in hike in profits

Goods sold on sale-or return system :

Sometimes goods are sold to customers on approval i.e., the goods are delivered to customer on condiiton that if he does not approve of the goods, he can return them within a particular period. Until the customer approves the goods they cannot be treated as sales. The auditor should, see that until the approval, such goods must be shown as goods with customers and deducted from sales of the current period and from the list of the debtors.

Goods sent on consignment :

When the goods are sent out to agents to be sold at the owner's risk, a separate book called 'cosignment outward journal; should be maintained if the number of such transactions is large. This book should be vouched with the copies of the proforma invoice, account sales and contracts with consignees. The unsold goods with consignees should not be treated as sales but should be shown in the balance sheet as 'goods on consignment'.

4.12. Internal check as regards Purchases :

A big business concern should have a separate purchase department in order to have proper and effective control over purchases.

The department requiring supplies or assets, must send requistion to the purchase department. These requistion must be prepared in duplicate. The details about the quantity, quality and the time by which the goods must be supplied should be clearly stated in the requistion slip.

The purchase department after searching the best vendor or supplier will prepare four copies of the purchase orders. One copy will be sent to the vendor, second to the stores and third will be forwarded to the accounting department. The purchase order should be carefully written and must be approved and authorised by the head of the purchase department or officer authorised to do this work.

In receipt of goods, the purchase department should properly inspect them and must compare with the purchase order. Goods received should also be entered in the goods Inwards Books. The purchase department then send the goods to the stores and will also inform the concerned department about the receipt of the goods.

After a thorough check these invoices should be sent to the accounting department for payment. The accounting department should compare the invoice with the purchase order and the inspection report of the purchase department and should also verify the calculations. If found correct a record must be made in the purchases book. Payment of the verified invoices should be authorised by a senior officer. If some portion of the goods are returned to the supplier, proper entry must be made in the Purchases Return Book. A credit note to that effect must be obtained from the supplier and the accounts section must be informed accordingly.

4.13. Internal check as regards wages :

There are many chances of misappropriation of cash under this head. The chances of fraud or errors are there by inclusion of fictitious names of dummy or ghost workers in the wages book ? Over-stating of rates of wages, over-stating of hours of work or days of work put in by the workers etc. All these may mean withdrawal of more money than is actually needed for payment to the workers.

The following internal check for the payment of wages is however, suggested to avoid fraud.

Workers are paid their wages normally on the basis of the time spent by them. Therefore the time spent by each worker should be correctly recorded in the time record books. Each worker is provided with a time card. He should punch his card at the time of arrival and departure from the place of his work.

The purchasing of card must be supervised by the time keeper. In addition to strengthen the internal check system, the foreman of each department should be asked to keep the records of the time of his employees. At the end of the day the time-keeper and foreman should separately prepare the time records and the name of absentees.

If the workers are paid on the basis of piece - wages system, the proper books for recording the actual work done by workers should be maintained. A job card should be given to each such worker. The actual work done by a worker should be recorded on this card which should be counter signed by the foreman of the department as well as by the store helper to whom the goods produced are to be delivered. The quality of the work and job card should be finally checked by the piece-work-reviewer.

Sometimes workers are allowed to work overtime. In such cases overtime slips must be issued to such workers by the properly authorised official. No worker should be allowed to work overtime unless he is authorised to do so by the authorised officials of the organisation.

The preparation of wages sheets should be done by a separate department. This work should be done at least by four clerks, so that irregularities may be minimised. For time workers and piece workers separate wage sheets must be used. All the clerks who delt with wage sheets should initial the wage sheets before they are signed by the works manager.

The payment of wages must be made by a person who is in no way concerned with the preparation of wage sheets. The cashier should with draw the net amount as shown by the wage sheets. Wages should be paid to the workers personally. The foreman of each department should be present at the time of payment to identify the workers of his section. If possible the signatures of the workers must be obtained when they receive the amount of wages, cashier foreman or works manager should attest these statements. Wages may be handed over to the fellow worker only if he is authorised in writing by the absentee worker. A list of unpaid workers should be prepared by the cashier and the foreman of the department. If casual workers are also employed in the organisation, a list of such workers must be prepared by the foreman of each department. A surprise visit of a senior official while the wages are disbursed will be an effective measure of control.

4.14. Internal check as regards stores :

To preserve finished goods and raw materials a store is essential. To prevent pilferage and misuse proper control of stores is necessary. The following points may be of great help for effective control of stores.

1) Store should be located at a convenient place.
2) Goods received in the store must be entered into goods received sheets. These sheets should be prepared in triplicate - one for the purchase section, second for accounts section and the third copy to be retained in the store.
3) Goods received should be stored at their allotted racks.
4) The system of bin cards should be used to show the receipts, issues and balances of stores.
5) Stock - taking should be carried out at regular intervals.
6) Storekeeper should issue the goods only against proper, approved and authorised requisition.
7) A gate pass should be given to authorised persons who will take out the goods from the store.
8) When materials are returned from the job or by some department a "Material Returned Note" should be prepared.

4.14. Test check :

In those business houses where a satisfactory and effective system of internal check is in operation, it is not necessary for the auditor to do detailed checking. The usual practice is that a certain number of entries of each class is selected and checked and if they are found correct, the remaining entries are also taken to be correct. This is known as "Test checking". The selection of items and the extent of test checking would mainly depend upon the auditor's judgement and assessment of a particular situation.

Test checking can be of immense help to the auditor as it will reduce his work and he can devote his time to the more important sections of the work. But it should be kept in mind that test checking does not relieve an auditor from his liability if in future mistakes are detected. In applying test checks in auditing the following precautions must be taken.

1) Entries selected for test checking should be representative.
2) Selection of items to be checked should be at random.
3) A number of entries for the first and the last month of the period covered by the accounts should be checked.
4) Cash book should be thoroughly checked. Test check should not be applied to cash book.

5) Periods and entries selected for test check should be different at each audit.

6) The auditor should always change the methods of test checking.

7) The method of test checking should be kept secret from client's staff.

Advantages of test checking :

1) The volume of work is reduced. It saves time.

2) There is a moral check on the clients staff as they do not know the period or portion of work which will be taken up for test checking.

Limitations :

There are few limitations of test checking. Since test checking is based on the selection of the representative items, it is always possible that some of the errors or frauds remain undetected. Secondly the client's staff may become careless because they know that their work will not be checked in detail by the auditor.

4.16. Summary :

Internal check is a kind of division of labour. This minimises the possibilities of frauds and errors. It throw responsibility on a particular clerk when the fraud or mistake is detected. Internal control involves all types of management controls. Internal audit is carried by the staff to review the operations and records undertaken within the business. The system of internal check adopted to each type of transaction is different from other. To avoid a detailed checking of each and every transactions, the method of test checking may be adopted by the auditor if there is an efficient system of internal check in the concern.

4.17. Self Assessment questions :

1) What is meant by the term internal check ?

2) What are the objects of internal check ?

3) Prescribe the system of internal check for sales, purchases, wages.

4) Distinguish between internal check, Internal control and internal audit.

5) What should be a good system of internal check as regards cash receipts and payments.

6) What is test check ?

4.18. Recommended Books

Principles of Auditing	**:**	**R.G. Saxene**
Principles & Practices of Auditing	**:**	**B.N. Tandon**
Principles & Practices of Auditing	**:**	**Jegadish Prakash**
Contemporary Auditing	**:**	**Kamal Gupta**

- Dr. Ch. Suravinda

LESSON - 5

VOUCHING

5.0. Objectives : After going through this lesson the student can know what is vouching ? How the Auditor vouch the cash transactions and trade transactions.

Structure :

5.1. Introduction :

Examination of the documentary evidence in order to ascertain the accuracy and authenticity of entries in the accounts books is called "Vouching". Vouching is a technical term which refers to the inspection by the auditor of documentary evidence supporting and substantiation a transaction. Vouching means a careful examination of all original evidences i.e., invoices, statements, receipts, correspondence, minutes and 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.

5.2. Definition :

According to Dicksee : "Vouching consists of comparing entries in the books of accounts with documentary evidence in support thereof".

According to Joseph Lancaster : "It is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This, however is quite wrong, vouching comprises such an examination of the ledger entries as will satisfy the auditor not only that the entry is supported by documentary evidence but it has been properly made upon the books of accounts".

From all these definitions it is clear that vouching means testing the truth of entries appearing in the primary books of accounts.

5.3. Importance of vouching :

Vouching is the essence of auditing. Success of an audit will depend upon the thoroughness with which vouching is completed. It is an important tool in the hands of an auditor and the success of an auditor in vouching depends upon his intelligence, commonsense, observation and tact with which he handles his work. An auditor should not merely check the arithmetical accuracy of the books or compare the entries with the available documentary evidence but he should go to the source of a transaction. If he simply compares the entry, say, on the credit side of a cash book with the voucher, it is possible that he might be deceived e.g; the purchase might not have been for the business or the receipt might have been for the previous year.

5.4. Voucher : Points to be noted while vouching :

A voucher is a documentary evidence in support of a transaction in the books of account. It may be a receipt, counterfoil of a receipt book, an agreement, resolution passed by the Board of Directors or shareholders, an invoice, bank paying in-slip. Bought note, sold note, correspondence, gate keeper's books, wages book, order book and so on.

While examining the vouchers, following points must be born in mind :

1) All the vouchers are consecutively numbered and filed in order of the entries in the accounts. If the client has not done so, the auditor has a right to ask him to do so. If they are not properly arranged, much valuable time will be lost in finding out a particular voucher to check it.

2) He should pay attention to the dates which must correspond with the cash book, name of the party to whom the voucher is issued the name of the party issuing the voucher and the amount etc.

3) The voucher inspected should be cancelled by a stamp. In case stamp is not available the audit clerk should affix his initials or put a tick right across the face of the voucher. Such a mark of stamp should be put in the centre of the voucher to avoid its removal by a dishonest clerk.

4) Special attention should be paid to those vouchers which are in the personal name of one of the partners, directors, or secretary etc. In such a case original invoice, goods inward book should be examined to find out whether the goods were purchased for the business or not. He should ask his client to issue instructions to the suppliers not to address the vouchers to any individual of the firm or the company.

5) He should see that every voucher is passed as order by a responsible officer.

6) He should also note whether the voucher is stamped if the amount of the voucher is above twenty rupees.

7) He should also find out the nature of payment as to whether it relates to the business.

8) He should see the nature of payment whether capital or revenue. This is important as wrong posting will effect the profit and loss account and ultimately the Balance sheet.

9) Attention should be paid to the amount both in words and figures. If they differ the, matter should be investigated.

10) Note should be made of any item which requires further elucidation or information or evidence which is available from partnership deed, contracts, Articles of Association etc.

11) If duplicate voucher for a missing one is produced it should be properly scrutinised to avoid any fraud. Reasons and explanation for their loss should be obtained from the client and if the auditor is not satisfied with the explanation, he should mention this fact in his report.

12) The audit clerk should not take the help of any members of the staff of the client.

13) Receipted invoice should not be accepted as a voucher because there is a danger of the payment being made twice. Once as a credit purchase and again as a cash transaction against the receipted invoice.

14) Sometimes business houses issue their own printed receipts which are considered as vouchers, in such a case the auditor should get more documentary evidence such as statement or invoice.

15) While examining the vouchers for insurance, rent, rates, taxes etc, the audit clerk should note the period for which the payment has been made. If the payment is made for some months in advance, proper adjustments should be made.

5.5. Vouching of cash transactions :

The auditor after satisfying himself that there is a good internal check system regarding the receipts and payments of cash, the audit clerk should now proceed to vouch the cash book.

5.6. Vouching the Debit side of cash book :

The following are the items appear on the debit side of the cash book.

1. Opening balance :

This should be compared with the balance shown in the duly audited balance sheet of the previous year. This is done to see that the actual balance has been brought down.

2. Cash sales :

There are greater chances of fraud under this head. The salesman may sell goods and may not make an entry in the cash book and thus misappropriate the money. The following system should be avoided to avoid fraud. The sales man should neither deliver the goods to the customers nor receive cash for the goods sold. At the end of the day the salesman, the cashier and the gate keeper prepare the summaries and send them to the general manager. All the three summaries must tally. The auditor should check here and there a few items from the sales man's summaries, cashier's summaries and the gate keepers extracts. If the auditor does not do so; he will be held liable for any fraud which remained undetected as was decided in the case of Pendel bury's Ltd. Vs Ellis Green & Co in 1936.

The auditor should also compare the dates on the cash memos and the cash book. If cash discount has been allowed on sales, he should see a uniform policy and rate of discount has been followed.

3. Receipts from Debtors :

The auditor should vouch cash received from debtors to whom goods has been sold on credit in the past. The only evidence available on account of this item is the counterfoils of the receipts issued to the debtors. But this evidence is not very reliable as less amount might have been inserted in the counter foils than what had actually been received from the customer. Another method of committing fraud is when cash is received say from 'A' no entry is made in the cash book. Later on when cash is received from 'B' the amount is recorded on the debit side of the cash book by crediting the account of 'A', again when money is received from 'C' the amount is credited to 'B' and so on.

The auditor should pay attention to the following in order to check such a fraud. He should check the cash book with the rough cash book and the counter foils of the paying in slips. Particular attention should be paid to discount allowed to customers. The method of granting discount should be enquired. In case a debt is written off as bad the auditor should enquire as to who is responsible to write off debts as bad. Where ever possible after taking permission from his clients a statement of accounts should be sent to the debtors to confirm the balances and also debtors be instructed to send letters of confirmation direct to the auditor

4. Income from interests Dividends etc :

Interest received on account of fixed deposits in the bank should be vouched with the bank pass book. Dividends received can be vouched with the counter foil of 'tops' of dividend warrants or the letter covering the cheque. Where dividend and interest are collected through bank, pass book must be verified. Care should be taken to adjust the outstanding interest. Interest received from any particular fund like providend fund should be credited to that fund and not to the revenue account. If the interest has been received on account of the loan granted. Agreement with the borrower should be inspected to ascertain the rate of interest.

5. Loans :

The receipt of loan should be vouched with the agreement with the ledger, He should see whether his client is entitled to raise loans. He should examine the rate of interest payable, the terms of repayment and the securities offered.

6. Rents Received:

The auditor should examine the lease deeds and agreements to ascertain the amount of rent payable, the due date and provision regarding the repairs etc., If receipts are issued to the tenents for the rent paid, the counterfoils of the receipts would be a good evidence. Particular attention should be paid towards rent outstanding. If the outstanding is heavy one, with the permission of the client the auditor should write to the tenents requesting them to confirm the amount of arrears of rent outstanding against their names and also, the auditor should get a list of unlet property duly signed by a responsible official.

7. Bills Receivable :

The auditor should examine the entries in the Bills Receivable Book. He must compare these items with the entries in the cash book for all the bills matured. In respect of those bills which have been discounted before maturity the Bills Discounted Book should be checked. He should also see that all the records have been properly made in the books related to discounts, dishonour or retirement of all bills.

8. Commission :

Commission account should be checked with the accounts of the parties from whom commission has been received. Agreement with the parties regarding the rate of commission should be inspected.

9. Sale of Investments :

The amount received on account of the sale of investments should be vouched with the brokers sold note.

10. Bad debts Dividend :

The amount received from debtors, who have become bankrupt should be vouched with the dividend warrants received from the official receiver indicating the total debt and rate per rupee payable as dividend and the number of instalments.

11. Subscriptions received by a club or school etc.; should be checked with the register of subscribers and the counter foils of the receipts.

12. Insurance claim money :

Insurance money received against a claim from an insurance company should be checked from correspondence passing between the client and Insurance company.

13. Sale of fixed assets :

This item may be vouched with correspondence auctioneers account, sale of contract etc. If there is any profit that should be credited to the capital reserve account which is not available for distribution to the shareholders. The auditor should also see that the sale of such property has been properly sanctioned.

14. Income from hire purchase agreement :

Where money is received on account of the instalment relating to goods sold on hire purchase system. The auditor should examine the agreement. The auditor must also see that proper allocation between sales and interest had been done.

5.7. Vouching of credit side of the cash book :

The auditor should see that the payments have been actually made to the right person or party and also whether the payment is for the business itself and have been sanctioned by a person holding some authority and have properly recorded in the books of account.

1) Payments to creditors :

Money paid to the creditors can be vouched with the receipts issued by the creditors acknowledging the receipt of money. The auditor should enquire whether periodical statements are submitted by the creditors and are compared with the creditors accounts. In regard to cash purchases, cash memos and goods inward book should be compared with the entries in the cash book.

2) Wages :

Another important entry which is usually a big one is that of wages. Before the auditor proceeds with his work, he should make a through investigation regarding the internal check system which is in operation. If he finds any loophole he should probe into it and disown his responsibility. He should check the casts of the wage sheets and wages book. He should check the total amount of wages payable with the amount of cheques drawn to see that more money has not been with drawn than was needed. He should check the names of some of the workers mentioned in the wages sheets with the cards and the gatekeepers and the foreman's register to see that no dummy workers are included. He should also see that the wages sheets are properly signed by all the persons responsible for the preparation of the wages sheets. The number of workers as recorded in the wages sheets should be compared with the employees state insurance cards. Wages sheets of the previous months should be compared with the current month and if there is any increase, enquiry must be made. He must compare the signatures of the workers of two or three periods. In short the duty of an auditor in verifying the items of wages sheets. The number of workers as recorded in the wages sheets should be compared with the employees state insurance cards. Wages sheets of the previous months should be compared with the current month and if there is any increase, enquiry must be made. He must compare the signatures of the workers of two or three periods. In short the duty of an auditor in verifying the items of wages is to see that the wages as recorded in the cash book have actually been paid and that they were actually due and that they were properly authorised.

3. Loans :

He should examine the receipt given by the borrower and the loan agreement, promote or Bills of exchange. He should make enquiry whether his client is authorised to advance loans. In case of loan to the directors, managing agents he must see that the provisions of the companies act are satisfied. (Sec 295, 369 & 370).

4. Salaries :

Salaries book should be examined. He should see that the total of the salaries book for a particular month agrees with the cheque drawn for salaries. He should see that necessary deductions for providend fund, Income tax etc have been made. Salaries may be verified with the annual returns submitted to the income tax Department regarding the payment of salaries.

5. Agents and Travellers Commission :

The agreement with travellers and the agents should be examined to ascertain the terms of the appointment regarding the rate of commission. The auditor should test the payment of commission by examining the order received through the travellers.

6. Travelling allowances :

He should see the rules and regulations regarding the payment of travelling allowances. Calculations should be made. An extraordinary travelling expenses should be authorised by the Board of Directors. Where fixed travelling expenses are allowed, no calculations are necessary. He should see that the travelling bills have been duly checked by a responsible official.

7. Insurance premium :

In case of a new policy, the covering note or the receipt from the Insurance company and the policy itself should be checked. In case of a renewal the renewal receipt for the premium should be examined.

8. Bills payable :

Returned bills duly cancelled should be examined. It would be a sufficient evidence of the amount having been paid.

9. Bills receivable discounted and dishonoured :

Bills Receivable which has been discounted with the bank and which have been dishonoured can be vouched with the entry in the bank pass book. The auditor should see that the account of the acceptor is debited with the amount of bill and noting charges.

10. Freight, carriages and customs duty :

The statements of account regarding the payment of freight and carriage submitted by the suppliers clearing forwarding agents should be examined to see that the payment has been duly made and accounted for.

11. Bank charges :

Bank Charges such as commission, interest on over draft and loans etc., should be examined with the Bank Pass Book.

12. Partners Drawings :

Partnership deed should be examined as to what is the maximum amount and the time for which a partner can draw money and whether he is to be charged any interest on drawings. He should vouch this entry with the partners drawings book or account and see that the signature of the partner is there against such entry.

13. Petty Cash :

There are greater chances of misappropriation of cash as there are no vouchers for a number of petty expenses. He should therefore make an enquiry into the internal check system of petty cash payments. The petty cash book should be maintained on the imprest system. He should insist upon having vouchers for every expenditure say above Rs.20 or so. In case where getting voucher is not possible then docket system should be introduced. The counting of petty cash balances in hand is very important. If he does not do so and if there is any discrepancy in the balance as per the petty cash book and actual cash in hand. He will be held responsible to pay damages as was held in the case of London oil storage Co. Vs Sear Hasluck & Co.

14. Directors Fees :

As a general rule the directors of a company can not claim any remuneration unless the Articles expressly provide for it. According to [See 211 (2)] of the companies Act, the remuneration paid to the directors either by way of fees or commission etc., must be shown separately in the profit & loss A/c. If this has not been done the auditor must make a mention of this fact in his report.

15. Vouching of cash sales :

At first the auditor has go through the system of Internal Check followed by the concern. If he satisfied with the system of internal check employed in the concern, the auditor should check here and there a few items from the sales man's summaries, cashiers summaries and the gate keeper's extracts. If the auditor does not do so, he will be held liable for any fraud which remained undetected as was decided in the case of Pendle Bury's Ltd Vs Ellis Green & Co in 1936. The auditor should compare the dates on the cash memos and the cash book. If discount has been allowed on sales he should see that a uniform policy and rate of discount has been followed. The cancelled cash memo should not be detached from the book. He may also compare a few items of sales with the stock register.

5.8. Vouching of Trading transactions :

After completing the vouching of cash book, the auditor may now proceed to the audit of the trading transactions.

Here the auditor is concerned with the checking of the purchases book and the sales book. The main object of vouching these two books is to check and prevent misappropriation of goods. The auditor should see that his client pays only for those goods which are received by him. Therefore, the auditor should carry out the audit of these books very carefully and intelligently.

5.9. Purchases Book – Purchases Returns book :

Purchases Book :

After having satisfied himself that there is a good internal check system regarding the purchases, the auditor should now proceed to vouch the purchases book. Entries in the purchases book should be vouched with the invoices relating to the purchases and the goods inward book maintained by the gate keeper and the godown keeper and the delivery note if any. He should see that the names of the creditors in the sales book has been entered in the purchases book.

While examining the invoices the auditor should pay attention to the following points.

1) Whether the invoice is in the name of his client.
2) Whether the person who ordered the goods is authorised to do so.
3) The date of the invoice should relate to the period under audit.
4) The auditor should also see that the goods mentioned in the invoice are not capital goods
5) He should, as a test check compare some invoices with the goods inward book in order to see that the goods have been actually received.
6) The auditor should check the casts and cross casts of the purchases book.
7) He should see that the trade discount has been deducted from the invoice before making the entry in the purchases book.
8) To inflate the profits, sometimes it is the practice of the management to include the goods purchased in the closing stock, while no entry was made in the books. In this connection he should pay particular attention to the purchases made at the close of the year to see that they are included both in the purchases book as well as in the stock book, otherwise he will be held liable to pay damages as was decided in the case of Smill Vs Offers and others.
9) The auditor should stamp the invoice or cancel it after he has compared it with the entries in the purchases book to prevent its being purchased again.
10) Sometimes the officials of the company purchase goods through the company in order to take advantages of the trade discount. In such a case he should see that the adjustment regarding this has been made in the books of accounts.
11) If any duplicate invoices are produced for verification, then the auditor should satisfy himself that the reasons for the presentation of duplicate invoices in the place of original one.
12) In order to be sure that all the invoices are included, the auditor should ask his client to write to all the creditors to send their statements of accounts direct to the auditor for comparing with ledger accounts.
13) If the invoice runs into several pages the auditor should see that the grand total is correct.

Purchases Returns :

When the goods are returned to the seller, being not according to the sample, a credit note should be obtained. The auditor should compare the credit note with the purchases returns book and the gate keepers outward book or the stores record. He should pay particular attention to heavy returns.

5.10. Sales Book – Sales Returns Book

First the auditor should see that the internal check system is efficient. If it is not so he should disown his responsibility. If it is efficient he should apply a few test checks.

He should compare the date of the copy of the invoice with the date in the sales book.

The entries in the sales book should be compared with the invoices, order Received book, Delivery note duly signed by the purchaser, receipts issued by the transport company or the Railways.

He should further see that the sale of an asset is treated as ordinary sale, otherwise profit will be inflated.

With the permission of the client the auditor should send statements of account to the customer's to confirm the accuracy of the balance in their accounts.

He should check the sales book for the last days or weeks of the financial period and the returns. Inward book for a few days or weeks after the close of the period in order to see whether fictitious sales or returns has been recorded to inflate profit.

7) He should check the casts of the sales book.

8) The cancelled invoices should be checked with the duplicate copy of the invoice.

9) Sales tax, Insurance charges etc; which are recoverable from the customers should be debited to the customers account.

10) Sales to allied concerns should be carefully examined as there may be fictitious entries with a view to inflate profits.

11) If there is a significant difference of trade discount allowed to two different purchasers he should inquire into the reason of such a distinction.

Sales Returns :

When the goods are returned from customers, they should be entered by the gate keeper in the register known as gate keeper in the register known as gate keepers Returns. Inward book and the stock register. The goods returned should also be recorded in the sales returns book and a credit note should be prepared to be sent to the customers. Such a credit note should be signed by a responsible official. The auditor should pay particular attention for this transaction as there is more scope for committing fraud under this head. If there is time lag between sale and return. The auditor should see whether the returned goods were in good condition. Returns from sister concern should be carefully examined to see their genuineness.

The auditor should vouch these transactions with the gatekeepers Returns Inward Book and with the carbon copies of the credit notes sent to the customers or the debit note received from the customers.

5.11. Summary :

Examining the documentary evidence of the transactions appearing in the books is known as 'vouching'. It is the essense of auditing. A voucher is a documentary evidence of a transaction which may be a carbon copy, a receipt or a contract. Before starting the work of vouching the auditor must himself satisfy with the system of Internal check employed by the concern. After vouching the cash book both sides of receipts and payments, he should vouch the trading transactions.

5.12. Model questions

1) How do you vouch the receipts side of cash book ?
2) What is the voucher ? What do you understand by the term 'vouching' in Audit.
3) How would you vouch the following ?
   1) Income from investments.
   2) Petty cash payments.
   3) Travelling expenses.
4) What do you mean by 'vouching' ? What are the points an auditor should look into when examining vouchers ?
5) How can you vouch wages ?
6) How will you vouch a Sales Book and a Sales Returns Book ?
7) Explain the points you would keep in view while auditing the sales.
8) Discuss the steps that should be taken by an auditor in vouching credit purchases and purchases returns.

5.13. Reference books

Principles of Auditing	:	**R.G. Saxene**
Principles & Practices of Auditing	:	**B.N. Tandon**
Principles & Practices of Auditing	:	**Jegadish Prakash**
Contemporary Auditing	:	**Kamal Gupta**

- Dr. Ch. Suravinda

LESSON – 6

COMPANY AUDITORS – I

OBJECTIVES OF THE LESSON :

After studying this lesson, students will be able to :

- know the procedure of appointment, reappointment, filling up of the casual vacancies and removal of an auditor ;
- understand the qualifications and disqualification of an auditor ; and
- understand the remuneration of an auditor.

STRUCTURE OF THE LESSON :

6.1 INTRODUCTION :

A person who conducts an audit is an auditor. An auditor is a professional that accumulates and evaluates evidence to report whether the company complies with the established set of procedures or standards. An auditor may function as an employee or an independent professional. When the auditor works for the organization, he or she is usually referred to as an internal auditor. The internal auditor often conducts periodic audits that may encompass several areas on a rotating basis. As an example, the internal auditor may focus on the manufacturing process during one quarter of the year, while devoting a second quarter to evaluating the financial record keeping of the company. Often, the internal auditor will set up a schedule to ensure that audits are conducted on each critical portion of the company at least once per calendar. So many acts require the organizations to get their accounts audited by an independent external agency. This independent external agency is known as External auditor of the organization. The external auditor has to check the accounts of the organization, and their compliances to various rules and regulations. The idea behind using an external auditor is that the audit will be free of bias and not influenced by office politics or internal relationships that exist among the employees of the company. No connection to the company is permitted, as it may be construed as biasing the auditor's report. To be fair and equitable, an external auditor should familiarize himself with the nature of the business he is auditing prior to starting the job.

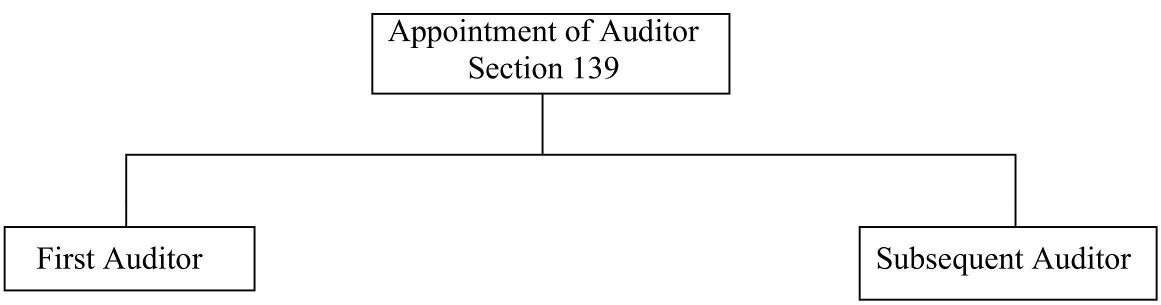
Companies Act, 2013 is rule based Act. Sections 139 to 148 of the companies act, 2013 (hereinafter refer to as the act unless otherwise mentioned) deal with provisions relating to audit of companies. Therefore, it is quite important to understand these provisions very carefully. You may also study sections 128 to 138 relating to "account" of companies for better understanding of the subject. The provisions relating to audit broadly deal with who can be appointed as an auditor under the act, i.e., qualifications and disqualification, the manner of appointment, remuneration and removal of an auditor.

6.2 APPOINTMENT OF COMPANY AUDITOR :

Every company even a private company must appoint an auditor to audit its accounts. Section 139 of the companies act, 2013 contains provisions regarding appointment of auditor. Discussion on appointment of auditors may be grouped under broad headings :

I) Appointment of first auditor

II) Appointment subsequent auditor



6.2.1 Appointment of First Auditor :

(i) Appointment of first auditor in the case of a company other than a government company :

As per section 139 (6), the first auditor of a company, other than a government company, shall be appointed by the board of directors within 30 days from the date of registration of the company.

In the case of failure of the board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

(ii) Appointment of first Auditors in the case of government company :

A "Government Company" is a company in which not less than 51 per cent of paid – up share capital held by the Central Government or by any State Government or government or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a government company.

Section 139 (7) provides that in the case of a government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor General of India (C&AG) thin 60 days from the date of registration of the company.

In case the Comptroller and Auditor's General of India does not appoint such auditor within the above said period, the board of directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

6.2.2 Appointment of Subsequent Auditor/ Re-appointment of Auditor :

6.2.2.1 Appointment of subsequent auditors in case of non-government companies :

Section 139 (1) of the companies act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard :

i. Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed , shall be obtained from the auditor

ii. Under rule – 4 of the companies and (audit and auditors) rules, 2014, the said certificate shall state the following :

a) The individual or firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the act, the chartered accountants act, 1949 and the rules or regulation made there under ;
b) The proposed appointment is as per term provided under the act ;
c) The proposed appointment within the limit laid down by or under the authority of the act ; and
d) The list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

iii. The company shall inform the auditor concerned of his or its appointment also file a notice of such appointment to the registrar within 15 days of the meeting in which auditor is appointed.

6.2.2.2 Appointment of subsequent auditor in the case of Government companies :

As per section 139 (5), in the case of a government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by Central Government and partly by one or more State Governments, the Comptrollers and Auditor – General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Therefore , it is to be clearly understood that in case of Government companies or companies controlled by Government, auditor is appointed by Comptroller and Auditor –General of India in the manner provided in section 139 (5) and 139 (7). It is to be remembered that Comptroller and Auditor – General of India is independent constitutional authority which audits all receipts and expenditures of Government of India and State Governments including those of bodies or corporations financed by Government.

6.2.3 Filling of a casual vacancy :

(i) As per section 139 (8), any casual vacancy in the office of an auditor shall: In the case of company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the board of directors within 30 days.

It such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the board and he shall hold the office till the conclusion of the next annual general meeting.

(ii) In the case of a company accounts are subject to audit by an auditor by an auditor by Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor – General of India within 30 days.

It may be noted that in case of Comptroller and Auditor –General of India does not fill the vacancy within the said period the board of directors shall fill the vacancy within next 30 days.

6.2.4 Casual Vacancy by Resignation :

As per section 140 (2) of the act, the auditor who has resigned from company shall file within a period of 30 days from the date of resignation, a statement in the prescribed form ADT-3 (as per rule -8 of CAAR) within the company the registrar.

In case of the companies referred to in section 139 (5) i.e., Government company, the auditor shall also file such statement with the C&AG along with company and the registrar.

The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation.

In case of failure, the auditor shall be able to a penalty of Rs. 50, 000 or remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of Rs. 500 per each day after the first during which such failure continues, subject to a maximum of Rs. 2, 00,000 as per section 140 (3).

6.2.5 Other important provisions regarding appointment of auditors :

6.2.5.1 A retiring auditor may be re – appointed at an annual general meeting, if –

a) He is not disqualified for re-appointment;
b) He has not given the company a notice in writing of his unwillingness to be re-appointed; and
c) A special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re – appointed.

6.2.5.2 Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

6.3 REMOVAL OF AN AUDITOR :

Section 140 of the Act permits removal of auditor before completion of his term and contains procedure for the same. It is evident that the sub-section (1) of section 140 of the Act exclusively deals with removal of auditor(s) before completion of his term fixed by the board, shareholders or Comptroller and Auditor-General of India, as the case may be and therefore, there is no specific requirement of special notice by shareholders as stipulated under sub-section (4) of section 140 of the Act for removal of auditor before expiry of his term. However, the shareholder can also move resolution for removal of auditor by virtue of right available under section 111 read with section 100 of the Act. In case of such requisition, the provisions of sub-section (1) of section 140 need to be complied with.

6.3.1 Removal of Auditor Before Expiry of Term :

According to section 140 (1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule – 7 of CAAR, 2014 –

1) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

2) The application shall be made to the Central Government whtin30 days of the resolution passed by the Board.

3) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

Further, as per e-form ADT 2 and help-kit provided by the Ministry of Corporate affairs on its website, the company is required to pass special resolution prior to making an application to the Regional Director for removal of auditor.

In view of the above it can be concluded that the company would be required to hold general meeting and pass special resolution for removal of auditor subject to approval of the Central Government i.e. before making an application to Central Government in e-form ADT– 2.

It is important to note that before taking any action for removal before expiry of terms, the auditor concern shall be given a reasonable opportunity of being heard.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

6.3.2 Appointment of Auditor Other than Retiring Auditor :

Section 140 (4) lays down procedure to appoint an auditor other than retiring auditor who was removed –

1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed consecutive tenure of five years or as the case may be, ten years, as provided under sub-section (2) 139.

2) On receipt of notice of such resolution, the company shall forthwith send a copy thereof to the retiring auditor.

3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (Not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,

   a) In any notice of the resolution given to members of the company, state the fact of the representation having been made ; and

   b) Send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. And if a copy of the representation is not sent as aforesaid because it was received too late or because of the companies default, the auditor may (without prejudice to his write to be heard orally) require that the representation shall be readout at the meeting.

6.3.3 Reasonable opportunity of being heard to be given to the auditor :

Provision to sub-section (1) of section 140 provides that before taking any action under the said sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Action means ‘the fact or process of doing something, typically to achieve an aim’. Therefore, the requirement stipulated in the provision to sub-section (1) of section 140 is that the auditor shall be given a reasonable opportunity of being heard before any action is taken by the shareholders or central government for his removal. Reasonable opportunity of being heard given under provision to sub – section (1) of section 140 of the Act is different from reasonable opportunity of being heard given under clause (iii) of sub-section (4) of section 140 of the Act (the latter is given to a retiring auditor in whose place another auditor is proposed to be appointed).

6.4 QUALIFICATIONS OF AN AUDITOR :

The auditor, like a doctor or lawyer, is a professional person, duly qualified and offering his services as expert to the general public. In the case of a company, examination of its affairs by the auditor is practically the only safeguard available to the shareholders against the enterprise being remain an efficient manner.

An efficient auditor must possess certain general qualification besides statutory qualification so that he can carry out his work efficiently and smoothly.

The section 141 of the Companies Act 2013 deals with the eligibility, qualifications and disqualifications of auditors. This section is similar to the existing section 226 of the 468 EP-CA&AP Companies Act 1956. Under the 1956 Act, a Chartered Accountant holding a certificate of practice or a firm of Chartered Accountants (only) can be appointed as auditor(s) of a company. The section 141 (1) and (2) of the 2013 Act, in addition, provides –

1. A firm of Chartered Accountants or Limited Liability Partnership (LLP) can be appointed as an auditor of a company only if majority partners practicing in India are qualified for appointment as an auditor of a company.

2. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

3. In the case of sole trading concern and partnership the law has not prescribed any qualification for an auditor. However in the case of auditors of Joint Stock Companies, the auditor must be a Chartered Accountant Act, 1949 as per section 141 subsection (1).

4. He must pass chartered accountant (C.A) examination conducted by the Institute of Chartered Accountants of India (ICAI). To be entitled to practice, a chartered accountant should obtain a certificate of practice from the council of the ICAI on payment of a prescribed annual fee.

5. A person is regarded as an Associate Member of the Institute when his name is entered in the Members Register maintained by the Institute. This entitles him to use the letters A.C.A. after his name.

6. An Associate in continuous practice in India for at least five years under any other associate who has been a member of the Institute for Five years and possesses such qualifications as prescribed by the Council of the Institute can be enrolled as a Fellow of the Institute and it is entitled to use the letters F.C.A after his name.

6.5 DISQUALIFICATIONS OF AN AUDITOR :

The Companies Act 2013 has also made addition in the list of disqualifications of auditors. According to the section 141 (3) of the Companies Act 2013, the following persons shall not be eligible for appointment as an auditor of a company :

1. A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008 ;

2. An officer or employee of the company ;

3. A person who is a partner, or who is in the employment, of an officer or employee of the company ;

4. A person who, or his relative or partner —

    a) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh ;

    b) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company in excess of rupees five lakh or

    c) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company in excess of one lakh rupees.

5. A person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except –

6. Commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts ;

7. Commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

8. A person whose relative is a director or is in the employment of the company as a director or key managerial personnel ;

9. A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies ;

10. A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction ; and

11. Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

A person who is appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor according to section 141(4) of the Companies Act 2013.

6.6 LIMITATION ON AUDITORSHIP :

The Companies Amendement Act, added two new sub-sections 1B and 1C. The objective of these sections is to prevent concentration of audits in few hands. The section was further amended in 1988.

According to sec, 224 1B, an individual cannot be auditor of more than 20 companies at a time. Further, out of these 20 companies, not more than 10 should be companies having a paid up share capital of Rs.25 lakhs or more. In case of a partnership firm of auditors, the ceiling is 20 companies per partner of the firm if a partner is also a partner in any other firm or firm of auditors, the overall ceiling in relation to such a partner will be 20.

Section 224 1B has been amended by the Companies Act, 1988 to disallow the appointment of persons who are in full time employment elsewhere. Even in case of partnership, such a partner shall be excluded from counting the number of audits per partner.

6.7 REMUNERATION OF AUDITOR :

According to section 142 of the Companies Act 2013, the remuneration of the auditor of a company shall be fixed in its general meeting or in the manner as determined in the general meeting.

1. The remuneration of the first auditor appointed by the board may be fixed by the Board.

2. The remuneration shall be in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company 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.

6.8 STATUS OF AN AUDITOR :

Status of an auditor can be observed under three heads –

1. Shareholders Representative
2. Company Officer
3. Company Employee

6.8.1 Shareholders Representative :

An auditor is appointed by the shareholders except in the case of the first auditor of the company who is appointed by the directors during the currency of the year on account of the death of the auditor or by the Central Government in certain cases. It is the right of the shareholders to appoint an auditor. He is appointed by them to keep a check on the work of the directors, as far as accounts are concern. He is to send a report to the shareholders even though he might have been appointed by them. In case he is appointed by the directors of the Government his remuneration is fixed by the directors or the Government respectively. The shareholders may allow him to continue to act as auditor for the next year or may appoint another auditor with the approval of the Central Government. It is they who pay him, of course, out of the funds of the company. The question is whether he is the agent of shareholders or of the directors, or he is an officers of the company, just like the Secretary, Manager, Accountant, etc. Apparently it appears that he perform the functions of an agent as well as that of an officer of the company. Divergent views have been expressed even by the courts. Let us deal with some of these views.

'Lord Cranworth' in the Course of his judgement in the case of Spackman Vs. Evans, said , :The auditors may be agents of the shareholders, so far as its relates to the audit of the accounts. For the purpose of the audit, the auditors will bind the shareholders.

'Lord Chelmsford' said in the same case. "It seems to me that it would be an unreasonable conclusion from the mode of appointment of these officers that they were thereby constituted agents so as to conclude the shareholders by their knowledge of any unauthorized act of the directors".

6.8.2 Company Officer :

Auditor is appointed by the company and his position is described in the section as that of an office of the company. He is not a servant of the Directors on the companies, he is appointed by the company to check the directions and for some purposes and the same extent, it seems to me quite impossible to say that he is not an officer of the Company.

Auditor is to be considered as an officer of the company, he will be held liable under sections 477, 478,539,543,545,621,625 and 633 of the Companies Act, 1956. These sections refer to the following matters respectively :

a) Power of the Court in winding up to summon persons suspected of having poperty of the company. S.477.
b) Power of the Court to order public examination of persons guilty of fraud, etc., in the promotion, formation of management of the company, S.476.
c) Penalty for the falsification of books, Section 539.
d) Power of the court to assets damages against delinquent officers, Section 545.
e) Prosecution of delinquent officers and members, Section 545.
f) Cognizance of offenses under the Act, Section 621.
g) Payment of compensation in case of frivolous or vexatious officers, Section 625.
h) Power of the Court to grant relief to officers in proceedings for negligence, default, breach of duty, misfeasance, etc., provided that in a criminal proceeding, the court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust, Section 633.

6.8.3 Company Employee :

Auditor may be treated as an employee of the Company, because the law as the ultimate authority provides certain responsibilities to him. He is appointed by the company and he gets remuneration as an employee.

6.9 SUMMARY :

First auditor of the company, other than a Government company, shall be appointed by the BOD within 30 days from the date of registration of the company; If BOD fails to appoint, by the member of the company within 90 days at an extraordinary general meeting appoint the first auditor ;

In case of Government company, first auditor shall be appointed by C&AG within 60 days from the date of registration; If C&AG fails to appoint, by the BOD of the company within next 30 days; If again BOD fails to appoint the first auditor of the company, by the member of the company within 60 days at an extraordinary general meeting; Tenure of the first auditor of the company in both the above cases shall be till the conclusion of the first annual general meeting. In case of subsequent auditor at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting; Before such appointment, the written consent of the auditor to such appointment and a certificate from him shall be in accordance with the condition as may be prescribed.

Within 15 days of the meeting the company shall file a notice of such appointment with the Registrar. No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint (a) an individual as auditor for more than one term of five consecutive years; and (b) an audit firm as auditor for more than two terms of five consecutive years.

A retiring auditor may be re-appointed at an annual general meeting, if he is not disqualified for re-appointment; he has not given the company a notice in writing of his unwillingness to be re-appointed; and a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed; Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company; Where provision of section 177 is applicable i.e., constitution of Audit Committee, all appointments, including the filling of a casual vacancy of an auditor shall be made after taking into account the recommendations of such committee.

The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein; provided that the Board may fix remuneration of the first auditor appointed by it. The remuneration under sub-section shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company 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.

6.10 TECHNICAL TERMS :

Auditor : A person who conducts an audit is an auditor.

ACA : Associate Chartered Accountant

AGM : Annual General Meeting

BOD	:	Board of Directors
CAAR	:	Company Audit and Auditor Rules
CA	:	Chartered Accountants
C&AG	:	Comptroller and Auditor-General
FCA	:	Fellow Chartered Accountant
Form ADT – 1	:	FORM ADT- 1 is used by a company to intimate the registrar of companies about the appointment of an auditor after the completion of its annual general meeting (AGM).
Form ADT – 2	:	FORM NO. ADT-2 Application for removal of auditor(s) from his/their office before expiry of term
Form ADT – 3	:	FORM NO. ADT-3 [See rule 8 of Companies (Audit and Auditors) Rules, 2014] Notice of Resignation by the Auditor
ICAI	:	The Institute of Chartered Accountants of India
LLP	:	Limited Liability Partnership
ROC	:	Registrar of Company
Section 139	:	Section 139 of the companies act, 2013 contains provisions regarding appointment of auditor

6.11 SELF ASSESSMENT QUESTIONS :

1. Explain the manner and procedure of selection and appointment of auditors
2. What are the qualifications and disqualifications of an auditor? Briefly explain.
3. Describes the status of an auditor.
4. How the remuneration of an auditor is fixed?
5. State the removal of an auditor.

6.12 REFERENCE BOOKS :

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LESSON – 7

COMPANY AUDITORS –II

OBJECTIVES OF THE LESSON :

The objectives of the lesson are :

- To understand the rights of an auditor ;
- To know the duties of an auditor ;
- To describe the powers of an auditor ; and
- To acquaint the liabilities of an auditor.

STRUCTURE OF THE LESSON :

7.1 Introduction

7.2 Rights and Powers of an Auditor

7.3 Duties of an Auditor

7.4 Liabilities of an Auditor

7.5 Summary

7.6 Technical Terms

7.7 Self Assessment Questions

7.8 Reference Books

7.1 INTRODUCTION :

An auditor is an authorised personnel that reviews and verifies the accuracy of financial records and ensures that companies comply with tax norms. Their primary objective is to protect businesses from fraud, highlight any discrepancies in accounting methods, among other things.

The role of an auditor, in general, is no walk in the park. Having been regarded as a certified professional, the auditor has placed himself, responsibilities to various parties and the duties that go with it.

Auditors require certain rights and powers to do their duty honestly and justify their authority. Non-company auditor is free to determine his rights powers with the organisation he agrees to audit. A Company auditor cannot have this flexibility. The law binds him with certain duties and liabilities along with bestowing certain rights and powers.

7.2 RIGHTS AND POWERS :

As per section 143 (1) of the Companies Act, 2013, Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

The auditor must have certain powers to perform his duties honestly and successfully. The conferred rights and powers of the auditor cannot be restricted or curtailed by the Articles of Association of the company or by the Board. The various rights and powers enjoyed by the auditors under the Companies Act, 2013 are as follows.

7.2.1 Right of Access to Books and Vouchers :

Section 143 (1) of the Companies Act provides that the auditor of a company, at all times shall have a right of access to the books of accounts, records and vouchers of the company, whether kept at the registered office of the company or at any other place or elsewhere and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

It may be noted that according to section 2 (59) of the act, the term officer includes any director, manager or key functional manager or any person in accordance with whose direction or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

The phrase books, accounts, financial statements, substantive documents and vouchers includes all books which have any bearing, or likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books, memoranda books, e.g., inventory books, costing records and the like may also be inspected by the auditor. Similarly, the term voucher includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts. Thus, the right of access is not restricted to books of accounts alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.

The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor conspires it necessary to have access there to as per section 143 (8).

7.2.2 Right to Obtain Information and Explanation :

This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind delivery by the directors from an company, which may not be know from an examination of the book. It is for the auditor to decide the matters in respect of which information and explanation are required him.

7.2.3 Right to Make a Statement at the General Meeting :

He has a right to make any statement or explanation he desires at such a meeting in connection with the accounts. If the finds that some wrong statement have been made by the directors relating to the accounts he has the right to correct it.

i. The company auditor thus shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor, and

ii. Shall have a right of access at all times to the books and vouchers of the company maintained at the branch office.

7.2.4 Right to Receive Notices and to Attend General Meeting :

The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Section 146 of the companies act, 2013 discusses right as well as duty of the auditor. According to the section 146:

“all notice of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, useless otherwise exempted by the company, attend either by himself or through his authorized representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.” Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matters of this concern, however, it is duty of the auditor to attend the same or through his authorized representative unless otherwise exempted.

7.2.5 Right to Report to the Member of the Company :

The auditor shall make a report to the member of the company on the accounts examined by him and on every financial statement which are required by or under this act to be laid before the company in general meeting and the report shall after taking into account the provisions of this act, the accounting and auditing standards and matter which are required to be included in the audit report under provisions of this act or any rules made there under or under any order made under this section and to the best of his information and knowledge they said accounts, financial statements give a true and faire view of the state of the company's affaires as at end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

7.2.6 Right to Lien :

In terms of the general principles of law, any person having the lawful possession of somebody else's property on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents. The Institute of Chartered Accounts in England and Wales has expressed a similar view on the following conditions :

i. Documents retained must belong to the client who owes the money.

ii. Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.

iii. The auditor can retain the documents only if he has done work on the documents assigned to him.

iv. Such of the documents can be retained which are connected with the work on which fees have not been paid.

7.2.7 Right to Visit Branches and Right of Access to Book :

Where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor (a) shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor; and (b) Shall have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.

7.2.8 Right to Receive Remuneration :

The auditor shall have the right to receive remuneration for auditing the accounts of the company.

7.2.9 Right to Take Legal and Technical Advice :

He has the right to take expert or technical advice but he must give his opinion in the report and not that of the expert.

7.2.10 Right to Correct Wrong Statements :

Auditor not only acts as an agent of the shareholders or an officer of the company for limited purposes but also as an observer of law. As an observer he has the right to advice the directors to amend their faulty system of accounts and, if not followed, to report the inadequacy of the methods of accounts by specifying that the proper books of accounts have not been kept by the company. He can also comment on and correct the wrong statements if any, made by the directors.

7.2.11 Right to be Indemnified or Granted Relief :

An auditor has a right to be indemnified against any liability incurred by him in defending himself against any civil or criminal proceeding by the company provided it is proved to the satisfaction of the court that he has acted honestly.

7.2.12 Right to Sign the Audit Report :

Only the person appointed as auditor of the company, or where a firm is so appointed, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by the law to be signed or authenticated by the auditor.

7.3 DUTIES OF AN AUDITOR :

The duties of an auditor correspond and must necessarily be so with the objectives of audit in hand. The end product of an audit is the auditor's report. Thus, making a report to the members on the accounts of the company becomes the first and foremost duty of an auditor though this duty itself cannot be performed unless he examine and enquires about the various aspects of accounts as well as the mode of keeping these. The law also seeks to ensure that all his legal duties be within his power and justify his profession. Inspite of many provisions in law on this subject there are certain misgivings and unsolved queries regarding the extent of liability relating to these duties.

In short his duties can be divided in to two categories :

1. regarding his reporting to members
2. other duties

7.3.1 Duties of an auditor regarding his reporting to members :

Sections 143 of the companies act, 2013 specifies the duties of an auditor of a company in a quite comprehensive manner. It is noteworthy that scope of duties of an auditor has generally been extending over all these years

7.3.1.1 Duty of auditor to inquire on certain matters :

Under provisions of section 143 (1), it is duty of auditor to inquire into the following matters –

a. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been are prejudicial to the interests of the company or its members ;

b. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company ;

c. Where the company not being an investment company or a banking company, whether so much of the assets of the company as consists of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company ;

d. Whether loans and advances made by the company have been shown as deposits ;

e. Whether personal expenses have been charged to revenue account ;

f. Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the accounts book and the balance sheet is correct, regular and not misleading.

7.3.1.2 Duty to report :

Under provisions of section 143 (2), the auditor shall make a report to members of the company on the accounts examined by him and on every financial statements which are required by the company in general meeting and report shall after taking into account the provisions of this act, the accounting and auditing standards and matters which are required to be included in the audit under the provisions of the act or any rules made there under or under any order made under subsection (11). Further auditor has to report whether to best of his information and knowledge, the said accounts, financial statement give a true and fair view of the state of the company’s affairs as at the end of its financial year and profit or loss and cash flow for the year and following matters as prescribed under relevant rules :

a. Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement ;

b. Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any ,on long term contracts including derivative contracts ;

c. Whether there has been any delay in transferring amounts, required to be transferred, to the investor education and protection fund by the company.

As per section 143(3), the auditor's report shall also state –

i. Whether he has sought and obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details there of and the effect of such information on the financial statements ;

ii. Whether, in his opinion, proper book of accounts as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him ;

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

iv. Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns ;

v. Whether, in his opinion, the financial statement comply with the accounting standards ;

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

vii. Whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164 ;

viii. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected there with ;

ix. Whether the company has adequate internal financial controls with reference to financial statement in place and the operating effectiveness of such controls ;

However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statement shall not be applicable to a private company which is a One person company ; or Small company or Company having turnover less than Rs. 50 crore per latest audited financial statement and having aggregate borrowing from banks or financial institutions or anybody corporate at any point of time during the financial year less than Rs. 25 crores.

x. Such other matters as may be prescribed. Rule 11 of the companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report.

7.3.1.3 Duty to sign the audit report :

As per section 145 of the companies act,2013, then person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company, in accordance with the provisions of section 141 (2).

Section 141 (2) of the companies act, 2013 states that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

The qualifications, observations or comments on 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.

7.3.1.4 Duty to comply with auditing standards :

As per section 143 (9) of the companies act, 2013, every auditor shall comply with the auditing standards. Further, as per section 143 (10) of the act, the Central Government may prescribe the standards of auditing as recommended by the institute of chartered accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

7.3.1.5 Duty to report on frauds :

The Companies Act, 2013 had introduced Section 143(12) which requires the statutory auditors of companies to report to the Central Government about fraud/suspected fraud committed against the company by officers or employees of the company.

a. Reporting to the Central Government :

As per section 143 (12) of the companies act, 2013 read with rule 13 of the companies (Audit and Auditors) rule, 2014 if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually sum of Rs. 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

b. Reporting to the Audit Committee :

In case of a fraud involving lesser than the specified amount (less than Rs. 1 crore), the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.

c. Disclosure in the Board's Repot :

The companies, whose auditors have reported frauds under this sub –section (12) to the audit committee but not reported to the Central Government, shall disclose the detail about such frauds in the Board's report in such manner as prescribed.

7.3.1.6 Duty to report on any other matter specified by Central Government :

The Central Government may, in consultation with the National Financial Reporting Authority (NFRA), by general or specific order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

However, as per the notification dated 29.3.2016, till the time NFRA is constituted, the Central Government may hold consultation required under this sub-section with the committee chaired by an officer of the rank of Joint Secretary or equivalent in the MCA and the committee shall have the representatives from the ICAI and Industry Chambers and also special invitees from National Advisory Committee on Accounting Standards (NACAS) and the office of the C&AG.

7.3.2 Other Duties :

The companies act contemplates the circumstances which oblige a chartered accountant to report on the statements of accounts, operating results and assets and liabilities of a going company which issues a prospectus. The circumstances are :

(i) when it issues more capital for public subscription ;

(ii) If the proceeds of the issue of the shares or debentures are too applied directly or indirectly.

  a. In the purchase of a business or

  b. In the purchase of an interest in any business which would make it a holder of more than 50 per cent interest, and

  c. If the proceeds of the issue of shares or debentures are to be applied for purchasing shares in a company, making the investing company the majority shareholders.

The report in reference to first case is to be made by the auditor of the company and in remaining cases by any chartered accountant.

7.3.2.1 Duty to Assist Investigator :

It is the duty of an auditor to assist the inspectors in every possible way when the affairs of the company are being investigated (sec. 240 (5) (6)).

7.3.2.2 Duty to Call for Information :

It is the duty of an auditor to call for information on various points such as

(a) whether loans have been properly secured ;

(b) whether the shares, debentures, and securities etc., have been sold at what price

(c) whether personal expenses have been charged to revenue account etc.

7.3.2.3 Duty to Certify the Statutory Report :

An auditor has to certify the statutory report as correct according to (Sec.165).

7.3.2.4 Duty to Certify Profit and Loss A/c in Prospectus :

The prospectus issued by an existing company should contain a statement with regard to profits and losses and assets and liabilities of the company and its subsidiaries, the auditor has to certify such statements in the prospectus.

7.3.2.5 Duty to Certify Profit and Loss A/c when Managing Agents Resign :

When the managing agents of a company or secretaries and treasures resign, the Board of Directors shall prepare a statement of affairs from the beginning of the year till the date specified. Such a profit and loss account and balance sheet have to be certified by the company's auditor (Sec. 342).

7.3.2.6 Duty Regarding Public Documents by the Company :

The auditor of a non-banking company is obliged to enquire under sec.58 (A) and rules made under the directives of the Reserve Bank of India Act, 1934 whether the company has furnished the necessary statement regarding public deposits.

7.3.2.7 Duty to Produce Document and Evidence :

In terms of Sec.240, a company auditor is under a duty to preserve and produce to an inspector or any other person authorised by him in this behalf with the previous approval of the central government, all books and papers of, relating, to, the other body corporate which are in their custody or power and otherwise to give to the personal all assistance in connection with the investigation which they are reasonably able to give.

7.3.2.8 Report on Accounts on Voluntary Winding up :

Under Sec.488 (1) where it is proposed to wind up a company voluntarily, the directors of the company have to make a declaration of solvency which includes.

a. A profit and loss account for the period beginning from the end of the last financial year and ending with a practicable date the making of the declaration ;
b. A Balance Sheet as on the last mentioned date; and
c. A statement of the company's assets and liabilities.

The auditor of the company is required to make a report on such balance Sheet and profit and Loss Account.

7.3.2.9 Duty to Comply with the Directives of the Central Government and that of the Institute of Chartered Accountant of India :

This relates to the power of the government to amplify the scope of audit, Sec. 227(4) (a). In case the company auditor does not comply with directions given by such bodies, he shall be guilty of professional misconduct.

No limitation can be placed upon the statutory duties of the auditor either by the articles on the other hand the duties of the auditor can be extended by the articles. Therefore the auditor must make himself acquainted with his duties under the articles and under the act.

7.3.2.10 Scope of Duty of an Auditor :

The scope of duties of an auditor depends upon the nature of the business carried on by the concern. The duties & the responsibilities can be briefly summarized as follows :

i. To verify that the statements of account are drawn up on the basis of the books of the business. However, the auditor is not liable for facts which are concealed & kept out of books which he cannot verify in the ordinary course of the exercise of reasonable care & diligence.

ii. To verify that the statements of the account exhibit a true & fair state of affairs of the business.

iii. To confirm that the management has not exceeded the financial administrative power vested in it by the articles or by any specific resolution of shareholders passed at a general meeting.

iv. To investigate matters in regard to which his suspicion is aroused as to the result of a certain action on the part of the servants of the company.

v. To perform his duties by exercising reasonable skill & care. He should not rely on the certificate of the management for those items which he can verify directly.

7.4 LIABILITIES OF AN AUDITOR :

A Chartered Accountant is associated with the valuable profession. His primary duty is to present a report on the accounts and statements submitted by him to members of the company. He is responsible not only to the members of the company but also to the third parties of the company, i.e., creditors, bankers, shareholders, Government etc. Normally the liability of auditor based on the work done by him as professional accountant and carry out his work due care, caution and diligence. The nature of liabilities of an auditor is discussed below:

7.4.1 CIVIL LIABILITY :

The auditor can be held liable for civil damages if they fail to detect material misstatements in the company's financial statements. The auditor's negligence or breach of duty can cause financial losses to the company, shareholders, or other stakeholders. The auditor can be sued for damages by the affected parties. Here are some of the civil liabilities of a company auditor :

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

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

7.4.2 LIABILITIES UNDER COMPANIES ACT :

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

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

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

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

2. **Criminal Liability of Auditor under Companies Act :**

The auditor can be held criminally liable if they are found guilty of fraudulent activities, such as :

i. Untrue statement in Prospectus [Sec.34]: The auditor is liable when he authorizes a false or untrue prospectus. When a prospectus includes any untrue statement, every person who authorizes the issue of prospectus shall be imprisoned for a period of six months to ten years or with a fine, which may be three times the amount involved in the fraud or with both.

ii. Non compliance by auditor [Sec. 143 and 145]: If the auditor does not comply regarding making his report or signing or authorization of any document and makes wilful neglect on his part he shall be punishable with imprisonment upto one year or with fine not less than ₹. 25, 000 extendable to ₹. 5, 00, 000.

iii. Failure to assist investigation [Sec.217 (6)]: When Central Government appoints an Inspector to investigate the affairs of the company; it is the duty of the auditor to produce all books, documents and to provide assistance to the inspectors. If the auditor fails to do so he shall be punishable with imprisonment upto one year and with fine up to ₹.1, 00, 000.

iv. Failure to assist prosecution of guilty officers [Sec.224]: An auditor is required to assist prosecution when Central Government takes any action against the report submitted by the Inspector. If he fails to do so, he is found guilty and is punishable.

v. Failure to return property books or papers [Sec.299]: When a company is wound up the auditor is supposed to be present and subject himself to a private examination by the court and is also liable to return to the court any property, books or papers relating to the company. If the auditor does not comply, he may be imprisoned.

vi. **Penalty for falsification of books [Sec.336]:** An auditor when destroys, mutilates, alters or falsifies or secrets any books of account or document belonging to the company. He shall be punishable with imprisonment and also be liable to fine.

vii. **Prosecution of auditor [Sec.342]:** In the course of winding up of a company by the Tribunal, if it appears to the Tribunal that an auditor of the company has been guilty of an offence, it shall be the duty of the auditor to give all assistance in connection with the prosecution. If he fails to give assistance he shall be liable to fine not less than ₹ 25, 000 extendable upto ₹.1, 00, 000.

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

7.4.3 CRIMINAL LIABILITY UNDER INDIAN PENAL CODE :

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

7.4.4 LIABILITY UNDER INCOME TAX ACT [SEC.278] :

For tax evasion exceeds ₹.1, 00, 000 rigorous imprisonments of six months to seven years.

A person who induces another person to make and deliver to the Income Tax authorities a false account, statement or declaration relating to any income chargeable to tax which he knows to be false, he shall be liable to fine and imprisonment of three months to three years. An auditor may also be charged in case of wrong certification of account.

A Chartered Accountant can represent his clients before the Income Tax Authorities. However, if he is guilty of misconduct he can be disqualified from practicing.

An auditor can face imprisonment upto two years for furnishing false information.

7.4. 5 LIABILITY FOR PROFESSIONAL MISCONDUCT :

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

7.4. 6 LIABILITY TOWARDS THIRD PARTIES :

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

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

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

7.5 SUMMARY :

In the above statement, the auditor of the company is required to make a report on such balance sheet and profit and loss account. The scope of duties of an auditor depends upon the nature of the business carried on by the concern. No limitation can be placed upon the statutory duties of the auditor either by the articles on the other hand the duties of the auditor can be extended by the articles. Therefore the auditor must make himself acquainted with his duties under the articles and under the act.

Thus an auditor undertakes a job which is responsible as well as accountable not only to his client but to others as well. An auditor's rights statutory ones and cannot be avoided or curtailed in any way by any resolution or even under a provision in the articles of association. The duties of an auditor are necessary to submit report which is end result of the audit programme. On the other hand he can be held liable and called upon to pay the damages it they prove fraud and willful or misconduct or part of the auditor.

In conclusion, the liabilities of a company auditor are significant, and they need to be careful while performing their duties. The auditor needs to follow the auditing standards and guidelines to avoid liabilities. The auditor should also maintain independence, integrity, objectivity, confidentiality and professionalism while conducting the audit.

7.6 TECHNICAL TERMS :

Auditor : A person who conducts an audit is an auditor.

Duty of an Auditor : The fundamental duty of a company's auditor is to make a report regarding accounts and financial statements.

examined by him and present the same to the members of the company.

Misfeasance : Breach of duty.

Expert : Includes amongst others an accountant and any other person whose profession gives authority to a statement made by him.

BoD : Board of Directors.

CARO : Company Auditors Report Order.

C&AG : Comptroller & Auditor-General.

ICAI : The Institute of Chartered Accountants of India.

ICAEW : The Institute of Chartered Accountants of England and Wales.

MCA : Ministry of Corporate Affaires.

NFRA : National Financial Reporting Authority.

NACAS : National Advisory Committee on Accounting Standards.

7.7 SELF ASSESSMENT QUESTIONS :

1. What are the rights of an auditor?
2. Describes the duties of an auditor.
3. Briefly explain the scope of duty of an auditor
4. Explain different types of liabilities of an auditor.
5. What are the liabilities of an auditor under companies act?

7.8 REFERENCE BOOKS :

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Dr.VISHNU VADDE

LESSON – 8

AUDIT REPORT

OBJECTIVES OF THE LESSON :

After studying this lesson, students will be able :

- To know the Audit Report
- To understand the concept of Audit Report
- To learn the types of Audit Reports
- To understand the features of a good Audit Report

STRUCTURE OF THE LESSON :

8.1 INTRODUCTION :

The auditing of the accounts of a company is usually done by an independent external auditor. An audit report is a letter from the auditor of a company that is the end result of the audit process. It states the auditor's opinion on whether the company's financial statements such as the balance sheet are in compliance with the generally accepted accounting principles (GAAP) and if they are free from material misstatement.

The audit report is generally accompanied by the company's annual report. The audit report is required by banks, financial institutions, investors, creditors, and regulators. When the auditor issues a clean report, it means that the company's financial statements have been found to be fully compliant with accounting standards. An unqualified report will tell you that the financial statements could have some errors.

Audit reports are very important to a company. Investors rely on the audit report to assess the financial health of the company and they base many important decisions on the audit report. Regulatory bodies also read the audit report as it tells them how accurate the financial information reported is. When an audit report is adverse it can seriously affect the company's status and reputation. It is essential to have good accounting practices so that the audit of accounts goes well.

"A Report is nothing but a statement of facts", An Auditor's Report is the formal result of all the effort that goes into an audit. Communicating the auditor's findings to interested users is part of all audits. Thus, the final phase of an audit involves preparing that communication, which is known as the auditor's report. It presents the results of the examination done by the auditor. An audit involves collection of evidence about the financial statements. The conclusions drawn are communicated to the interested parties through the auditor's report.

8.2 MEANING AND DEFINITION OF AUDIT REPORT :

While conducting every audit auditor has to go through three phases –

(a) Preliminary work for audit.

(b) Conduct of actual audit, and

(c) Conclusion of audit, which means submission of Audit Report.

Therefore, Audit Report is called as the ultimate and final product of every audit. The meaning of Audit Report can be well understood from the following selected definitions.

According to J.B.Roy. "The Report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons there for should be stated. In all cases, where Auditor's Name is associated with financial statements the report should contain a clear cut indication of the character of the auditor's examination if any, and the degree of responsibility he is taking".

According to “Lancaster’ Audit Report is “a statement of collected and considered facts, so drawn up as to give clear and concise information of persons who are not already in possession of the full facts of the subject matter of the report.”

The information set forth in it should be written in clear and concise words. There should be no room for any ambiguity. Further, the facts and information which have been incorporated therein are to be conveyed to those persons who do not possess full facts.

8.3 IMPORTANCE OF AUDIT REPORT :

The language and words used in audit report are of great importance. The importance of the auditor’s report can also be gauged from the following points.

1. Auditor’s report is essential for the shareholders of a Company as they do not possess full facts about it.

2. It is the management who are in possession of full facts about the company’s affairs and they may present a wrong picture in their own interest.

3. An independent opinion about the financial affairs of the Company is essential to the Government to impose tax.

8.4 FEATURES OF AUDIT REPORT :

1. A good Audit Report shall state –

   a) Whether the financial statements are prepared and presented in accordance with generally accepted principles of accounting.
   b) Whether such principles have been consistently followed.
   c) Whether all the informative disclosures have been adequately covered.

2. An Audit Report shall contain an expression of an opinion regarding the financial statements. If an opinion cannot be expressed, the reasons thereof must be stated.

3. It shall be preferably state an indication of the extent and character of the Auditor’s examination.

4. It shall disclose all material facts known to the auditor which are not disclosed in the financial statements.

5. It shall also disclose all material misstatements known to him to have appeared in the financial statements.

6. It shall clearly identify the financial statements which are under his report.
7. The report shall be addressed to the shareholders who authorize the auditor to examine and audit the accounts.
8. The date of the report shall be the actual date of completion of audit.
9. The auditor generally signs the report in the name he is registered as a practitioner.

8.5 OBJECTIVES OF AUDIT REPORT :

A Report is a statement of collected and considered facts, drawn up so as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report. In this context the preparation of report should have the following objectives.

a. To disclose facts without any inference or interpretation.
b. To give complete and informative disclosures as required under law to the management.
c. To give clean opinion in his report.
d. To give suggestions to the management in managing accounts according to Company Act, 1956.

8.6 CONTENTS OF THE REPORT :

The Audit report generally shows the nature and scope of audit conducted by the auditor and his opinion on the final accounts of the company. Companies Act, 2013 and International Auditing Guideline has laid down certain guidelines relating to the contents of auditing reports as under:

i. **Title:** It should have a title that indicates that the report is an independent audit report.

ii. **An addressee**: An addressee identifies the party or parties to whom the audit report is directed. The audit report is ordinarily addressed to the engaging party. But in some cases, there may be other intended users.

iii. **Description of the level of audit**: The report shall include an identification or description of the level of audit obtained by the auditor, the subject matter information and, when appropriate, the underlying subject matter.

iv. **Identification of the applicable criteria:** The audit report identifies the applicable criteria against which the underlying subject matter was measured or evaluated so that the intended users can understand the basis for the auditor's opinion / conclusion.

v. **Description of significant inherent limitations**: Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria.

vi. **Designing of applicable criteria for a specific purpose**: When the applicable criteria are designed for a specific purpose, the report shall include a statement alerting readers to this fact and that, as a result, the subject matter information may not be suitable for another purpose.

vii. **Description of responsibilities**: The report shall include a statement to identify the responsible party and to describe their responsibilities.

viii. **Compliance with Guidance Note(s):** The report shall include a statement that the engagement was performed in accordance with the respective/concerned Guidance Note(s).

ix. **Quality Control**: The report shall include a statement that the firm, of which the practitioner is a partner, has applied Standard on Quality Control (SQC 1).

x. **Code of Ethics**: The report shall include a statement that the practitioner complies with the independence and other ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

xi. **Informative summary**: The report shall include an informative summary of the work performed as the basis for the auditor's opinion/conclusion. The summary must be written in an objective way that allows intended users to understand the work done as the basis for the auditor's opinion/conclusion.

xii. **The auditor's opinion / conclusion :**

a) When appropriate, the opinion/conclusion should inform the intended users of the context in which the practitioner's opinion/conclusion is to be read.

b) In a reasonable assurance engagement, the opinion is expressed in a positive form.

c) In a limited assurance engagement, the conclusion is expressed in a form that conveys whether, based on the procedures performed and evidence obtained; a matter has come to the practitioner's attention to cause the practitioner to believe that the subject matter information is materially misstated.

xiii. **The auditor signature**: The audit report has to be signed by the practitioner in his name. Where a Firm is appointed to carry out the engagement, the report has to be signed in the personal name of the practitioner and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the ICAI.

xiv. **The date of the audit report**: The audit report should be dated no earlier than the date on which the auditor has obtained the evidence on which the auditor's opinion/conclusion is based.

xv. **The place of signature**: The audit report shall mention the place of auditor's signature.

8.7 TYPES OF AUDIT REPORT :

In financial accounting, an auditor's opinion is the published outcome an auditor's review of a company's or organizations financial statements. The auditor's opinion does not pass judgment on the organization's financial position or financial performance or otherwise interpret the financial data. In the audit opinion, the auditor states that he or she has examined the client's financial statements for the year ended in accordance with the generally accepted accounting principles including tests of the accounting records and other necessary auditing procedures. The auditor then indicates whether in his or her opinion the client's financial statements present fairly the financial position, results of operations, and changes in financial position for the year-ended in conformity with Accounting Principles applied on a consistent basis. The Auditors opinion may be of the following types :

1) A Clean or clear or Unqualified Report
2) A Qualified Report
3) Adverse or Negative Report
4) Disclaimer of Opinion
5) Piecemeal Opinion

8.7.1 A CLEAN OR UNQUALIFIED REPORT / OPINION :

Where auditor does not have any reservation, objection regarding the information under audit, then he issues an unqualified opinion. This opinion signifies that the auditor accepts the accounting treatment given to the various transactions and the profit and loss account shows the true and fair view of the transaction entered by the organization during the period and the balance sheet shows the true and fair view of the state of affairs of the organization at that point of time. It is also known as “Clean report”. The report may be given in the form in detail below

Specimen of Clean Report or Unqualified Report

To
The shareholders
MNO Ltd., GUNTUR.

We have audited the attached Balance Sheet of MNO Ltd. as at…… and the statement of profit & loss account of the company for the years ended on that date, and the schedules annexed thereto and the report as follows :

We report that -

a) We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of the audit.

b) In our opinion, proper books of accounts as required by law have been kept in accordance with the standard accounting practices.

c) The Balance Sheet and Profit & Loss dealt with in the report are in agreement with the books of accounts.

d) In our opinion, and to the best of our information and accounting to the explanations given to us, the said accounts read with the notes thereon, give the information required by the Companies Act, in the manner so, required and give a true and fair view :

   i. In the case of the Balance Sheet, of the state of affairs of the company as at……,and
   ii. In the case of Profit and Loss Account of the Company for the year ended on that date.

Date :
Guntur.

For A,B &Co.
Chartered Accountants
Partner

8.7.2 QUALIFIED OPINION / REPORT :

In a situation where neither the unqualified, nor adverse opinion is appropriate the auditor gives the qualified opinion. This is a situation where the auditor has some reservation about the financial statements which though significant but not that significant so as to warrant adverse opinion and auditor agrees to a large extent with the true and fair view of the financial statement then he gives qualified opinion. As per this opinion subject to certain reservation or qualification stated, the auditor agrees with the proposition stated in the financial statements.

Where auditor expresses a qualified opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect. The words "Subject to" are written to show qualification. If the qualification is quantifiable (measurable) then the auditor has to quantify it. And if these are not quantifiable, Auditor has to clearly state that quantification is not possible. The report may be given in the form in detail below

Specimen of Qualified Report

To
The shareholders
ABC Ltd.

We have audited the annexed Balance Sheet of ABC Ltd. as at…… and also the Profit and Loss account for the year ended on that date. We report that

a) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of our audit.

b) In our opinion proper books of accounts as requires by law have been kept by the company, in accordance with the accounting standards, so far as it appears from our examination of the books subject to the comments given hereunder-
    i. In the absence of Stock Registers, adjustments relating to balances on the register have been accepted on the basis of the decisions of the management.

c) The Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns.

d) Subject to the qualification given below, in our opinion and to the best of information and according to the explanation given to us, the accounts together with the notes thereon and documents attached there to give the information required by the law and accounting standards and gives a true and fair view :

1. In the case of the Balance Sheet of the state of affairs of the company as at_____ and

2. In the case of the Profit and Loss Account of the profit for the year ended on that date.
    i. The provision for depreciation of fixed assets is inadequate.

Dated : For M.N. & Co.

Guntur. Chartered Accountants

8.7.3 ADVERSE OR NEGATIVE OPINION / REPORT :

Whereas a result of the examination of the books of accounts, the auditor concludes that he does not agree with the true and fair view of financial statements under audit, he express adverse opinion or negative opinion. The adverse opinion is appropriate in circumstances where the auditor has reservation on matters such as the accounting policies selected and their application, adequacy of disclosures made and where the auditor considers that the impact of reservation or qualification is so material and pervasive that the financial statements as a whole do not give a true and fair view.

Where auditor expresses an adverse opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect.

8.7.4 DISCLAIMER OF OPINION / REPORT :

The above three are the opinions which the auditor expresses but the disclaimer of opinion is a situation when auditor is not in a position to give his opinion. Where there is a situation where auditor is not in a position to collect sufficient appropriate audit evidence which enables him to draw his conclusion then it is proper for the auditor to disclaim an opinion due to lack of sufficient appropriate audit evidence. Where auditor expresses a disclaimer of opinion, he should also state in his report the reason for the same, so that the readers can assess their significance and effect.

8.7.5 PIECEMEAL OPINION :

The Auditor, may in some cases, finds that the financial statements he has examined present only a partial true and fair view. In such cases, he may report that he is unable to express an opinion, limited to certain items in the statement, with which he is satisfied. Such a situation would warrant a Piecemeal Opinion. As the name suggests, the auditor gives a divided opinion on matters with which he is satisfied and with which he is not. The auditor should state the reasons for having given a Piecemeal Opinion.

8.8 CLEAN AUDIT REPORT V/s QUALIFIED AUDIT REPORT :

The following are the differences between Clean Audit Report and Qualified Audit Report :

Clean Audit Report	**Qualified Audit Report**
The auditor issues a clean report (also called as unconditional opinion) when he does not have any reservation with regard to the matters contained in the financial statements.	A qualified audit report is one where an auditor gives an opinion subject to certain reservations.

In a clean report, the auditor states that the financial statements give a true and fair view of the state of affairs and results for the period	The Auditor's reservation is generally stated as - "subject to the above, we report that the balance sheet shows a true and fair view."
The auditor is justified in issuing a clean report i f – i. The accounts are prepared using generally accepted accounting principles. ii. The auditor has examined sufficient reliable evidence in respect of transactions recorded in the books. iii. The transactions recorded represent a true recording of the events. iv. The transactions are within the legal competence of the entity. v. There are no material misstatements in the financial statements. vi. The financial statements comply with the format and disclosure requirements as per the statute	A qualified opinion should be expressed when the auditor concludes that – i. An unqualified opinion cannot be expressed, ii. The effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or iii. The limitation on scope is not so material and pervasive as to require a disclaimer of opinion.
There is no specific duty of management for clean reports	Management is bound to give explanation & full details in respect of each qualification in the auditor's report. [Section 134]

8.9 AUDIT CERTIFICATE :

An audit certificate is a document issued by an independent auditor attesting to the accuracy and reliability of a company's financial statements. t is used to provide assurance to stakeholders that the financial statements have been examined and found to be free from material misstatements and to confirm that the company's financial records comply with generally accepted accounting principles (GAAP). The audit certificate is typically included in a company's annual report and is required by law in many jurisdictions.

Sometimes apart from an audit report for general use, an auditor often called on to give a certificate for special purpose. The certificate should include the following :

i. Auditor should see that there is suitable declaration by the management about the subject matter.

ii. Auditor should give the certificate on his letter head or on stationery carrying his name and address to avoid misunderstanding.

iii. Auditor should clearly state his limitations and indicate the extent to which he has relied upon a technical expert if any.

iv. Auditor should indicate the specific record covered by the certificate.

v. Auditor should mention the manner in which the audit was conducted.

vi. Auditor should indicate in the certificate if he has made certain fundamental assumptions. Auditor should make a reference to the information and explanations obtained. Auditor should give clear title to it indicating whether it is a report or a certificate.

8.10 DIFFERENCES BETWEEN AUDIT REPORT AND AUDIT CERTIFICATE :

An audit report essentially contains the expression of an opinion. Thus, what an auditor communicates through his report is primarily his opinion about the financial position of the company that he formulate on the basis of his evaluation of the evidence collected during the course of audit. A report should be distinguished from a certificate. A certificate involves confirmation of certain facts it does not contain any opinion. The audit certificate is a document provided by an external auditor (in case of a public body it may be provided by a competent public body officer) certifying that cost claimed during a specific period.

There are some basic differences between audit report and audit certificate and all of them are mentioned in detail below :

Basis	Audit Report	Audit Certificate
Meaning	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts.	While Audit Certificate is a written confirmation of the accuracy of the information stated there in
Opinion	Audit Report contains the opinion of the auditor on the accounts	While Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.
Basis	Audit Report is made out on the basis of information obtained & books of account verified by the auditor	while Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy
Guarantee	Audit Report may not guarantee correctness of financial statement in absolute terms	While Audit Certificate guarantees absolute correctness of the figures & information mentioned in the certificate.

Coverage	Audit Report always covers entire accounts of the concern	While Audit Certificate covers only certain part of the accounts of the concern
Responsibility	Audit Report does not hold auditor responsible for anything wrong in the accounts,	While Audit Certificate makes an auditor responsible if anything mentioned in the certificate found as wrong later on.
Suggestion	Audit Report may provide certain suggestions for improvement	While Audit certificate does not provide any such suggestion.
Nature	Audit Report is based on the vouching & verification of books of accounts, voucher, assets & liabilities.	While Audit Certificate is based on checking arithmetical accuracy of the facts.
Scope	Audit Report covers all transactions done during the year	While the Audit Certificate is very specific.
Characteristics	Audit Report is subjective as it is opinion oriented,	While Audit Certificate is objective as it is fact oriented.
Form	Audit Report is required to be presented in the prescribed format,	While Audit Certificate, except in few cases, is not required to be presented in any standard format.
Address	Audit Report is addressed to the members of the company at large or appointing authority,	While Audit Certificate is addressed to particular person or sometimes may include the words like "To Whomsoever it may concern"

8.11 AUDITOR'S REPORT UNDER THE COMPANIES ACT, 2013 :

As per the provisions of the Companies Act 2013, the following matters are required to be included in the auditor's report:

1. **True and Fair View Exhibited by the Financial Statements [Section 143(2)] :** The auditor shall make a report to the members of the company on the accounts examined by him and on financial statements which are required by or under the Act to be laid before the company in the general meeting. In the audit report, the auditor shall state whether to the best of his information and knowledge and as per his opinion, the accounts and the financial statements represent a true and fair view of the company's state of affairs as at the end of its financial year and profit or loss and cash flow for the year.

2. **Availability of Information and Explanation [Section 143(3)(a)] :** The auditor's report shall state whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

3. **Maintenance of Proper Books of Accounts [Section 143(3)(b)] :** The auditor's report shall state whether, in his opinion, proper books of accounts as required by law are maintained and whether proper returns adequate for the purpose of audit have been received from the branches not visited by him.

4. **Report of the Branch Auditor [Section 143(3)(c)] :** The auditor's report shall state whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him.

5. **Agreement between Books of Accounts and Financial Statements [Section 143(3)(d)] :** The auditor's report shall state whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.

6. **Compliance with Accounting Standards [Section 143(3)(e)] :** The auditor's report shall state whether, in his opinion, the financial statements comply with the accounting standards.

7. **Comments or Observations Having Adverse Impact on Functioning [Section 143(3)(f)] :** The auditor's report shall state the observations or comments of the auditor on financial transactions or matters which have any adverse effect on the functioning of the company.

8. **Disqualification of Director [Section 143(3)(g)] :** The auditor's report shall state whether any director is disqualified from being appointed as a director under sub-section (2) of Section 164.

9. **Adverse Comment on Maintenance of Books of Accounts [Section 143(3)(h)] :** The auditor's report shall state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

10. **Adequacy of Internal Control System [Section 143(3)(i)] :** The auditor's report shall state whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

11. **An Explanation for Negative Remark [Section 143(4)] :** Where any of the matters required to be included in the audit report under this section is answered in negative or with a qualification then in that case auditor is required to state the reasons of such reservations and negative remark.

12. **Compliance with Directions from CAG [Section 143(5)] :** In the case of Government Company, the Comptroller & Auditor General (C&AG) will appoint the auditor to conduct the audit of the company. The C&AG will also give the directions and the manner in which the accounts of the Government Company are required to be audited by the auditor.

13. **Report of Fraud [Section 143(12)] :** If an auditor of the company, in the course of 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 an officer or the employee of the company then the auditor will immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

14. **Matters as per CARO :** The auditor's report shall also include a statement on the matters prescribed by Companies (Auditor's Report) Order.

15. **Other Matters [Rule 11 of Companies (Audit and Auditors) Rules, 2014] :** The auditor's report shall also include his views and comments on the following matters :

    a) Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement ;

    b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts ;

    c) Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

8.12 SUMMARY :

Each audit starts with an auditor and ends with his report. It is a medium through which the 'audit' function is discharged. A report is a summary of the conclusions as derived from collected and considered data in the opinion of the auditor. It is a statement of facts and a medium of communication. It communicates financial facts. The auditor's report assumes different types according to the opinion formed by the auditor.

The report must expressly state : Whether, in his opinion the accounts give the information required by the Act and in required manner; Whether the balance sheet and profit and loss account gives a true and fair view; Whether he has obtained all the information and explanations required; Whether, in his opinion, proper books of account as required by law have been kept by the company, and proper returns for the purposes of his audit have been received from the branches not visited by him; Whether the company's balance sheet and profit and loss account are in agreement with the books; Whether in his opinion, the profit and loss account and balance sheet comply with the Auditor's observation or comments; Whether any director is disqualified from appointment; reason for negative answers. essentials of audit report- title; addressee; identification; reference to auditing standards; opinion; signature; auditor's address; date of report. Types of auditor opinion- unqualified opinion; adverse or negative opinion; qualified opinion ; disclaimer and piecemeal opinion express.

8.13 TECHNICAL TERMS :

Auditor : A person who conducts an audit is an auditor

Audit Report : Audit Report is called as the ultimate and final product of every audit.

ACA : Associate Chartered Accountant

AGM : Annual General Meeting

BOD : Board of Directors

CAAR : Company Audit and Auditor Rules

CA : Chartered Accountants

C&AG : Comptroller and Auditor-General

FCA : Fellow Chartered Accountant

8.14 SELF ASSEEMENT QUESTIONS :

1. What do you mean by Audit Report?
2. Briefly explain objectives of Audit Report.
3. Discuss the basic elements of the Auditor's Report.
4. What are the features of an auditor?
5. Describes the types of Audit report.
6. What are the difference between an audit report and an audit certificate?
7. What is the difference between an unqualified and a qualified audit report?
8. What are the requirements of Auditor's Report As per the Companies Act, 2013? Explain.

8.15 REFERENCE BOOKS :

1. **Joseph Lancaster**, 'Principles and Practice of Auditing', Donnington Press, California, 2007.
2. **S.Vengadamani,** "Practical Auditing", Margham publications, Chennai.
3. **Ghatalia,** "Principles of Auditing", Allied Publishers Pvt. Ltd., New Delhi.
4. **Pradeesh Kumar, BaldevSachdeva & Jagwant Singh,** "Auditing theory and Practice, Kalyani Publications, New Delhi.
5. **N.D.Kapoor,** "Auditing", S.Chand, New Delhi.
6. **R.G.Saxena,** "Principles and Practice of Auditing", Himalaya Publishing House New Delhi.

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