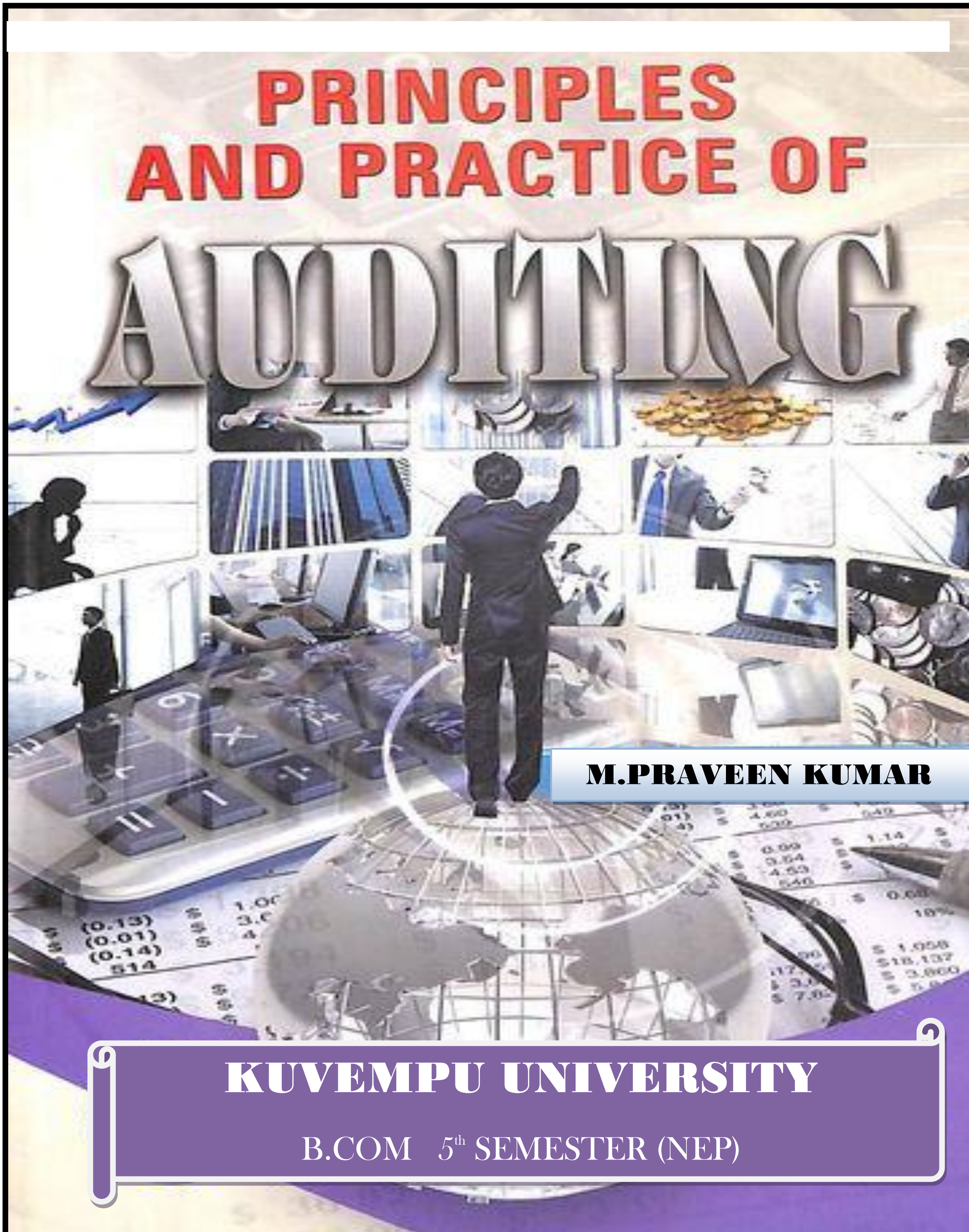

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UNIT 1 INTRODUCTION TO AUDIT

INTRODUCTION

In ancient days, the owners of the business verify their accounts by expert accountants or book keepers to detect errors and frauds. Even the Kings and Zamindars used to listen from the accounts regarding receipts and payments of their kingdom.

At the end of Fifteenth Century due to revival in Italy, there was a rapid growth in industry, trade and commerce. The principle of double entry system was introduced by Luca Pacioli, a famous Italian mathematician. Besides cash transactions, credit transactions are recorded in books, as a result complexity of accounts was increased.

As a result of Industrial revolution in England in the Eighteenth century, there was a substantial increase in the volume of business. A rapid increase in commercial activity, emergence of banking, insurance, joint stock companies and growing activities in the Government sector led the need for audit of accounts.

MEANING OF AUDITING

The term ‘Audit’ is derived from the Latin word, “Audire”, which means, ‘to hear”. Auditing is a detailed and critical examination of books of accounts and support documents to verify whether the financial statements which include Profit and Loss Account and Balance Sheet represent a true and fair view of the state of affairs of the business concern.

It is the verification of financial position as it is disclosed by the Balance Sheet and the Profit and Loss Account. It is an examination of accounts to ascertain whether the Balance Sheet and the Profit and Loss Account give a true and fair view of financial position and Profit or Loss of the business. For this purpose, all the business transactions and the manner in which these are recorded must be examined.

Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. It is concerned with examination of accounting data to determine the extent of accuracy of Profit and Loss account and the Balance sheet prepared from such data.

DEFINITION OF AUDITING

The **Institute of Chartered Accountants of India** describes audit as “the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to expressing an opinion there on”.

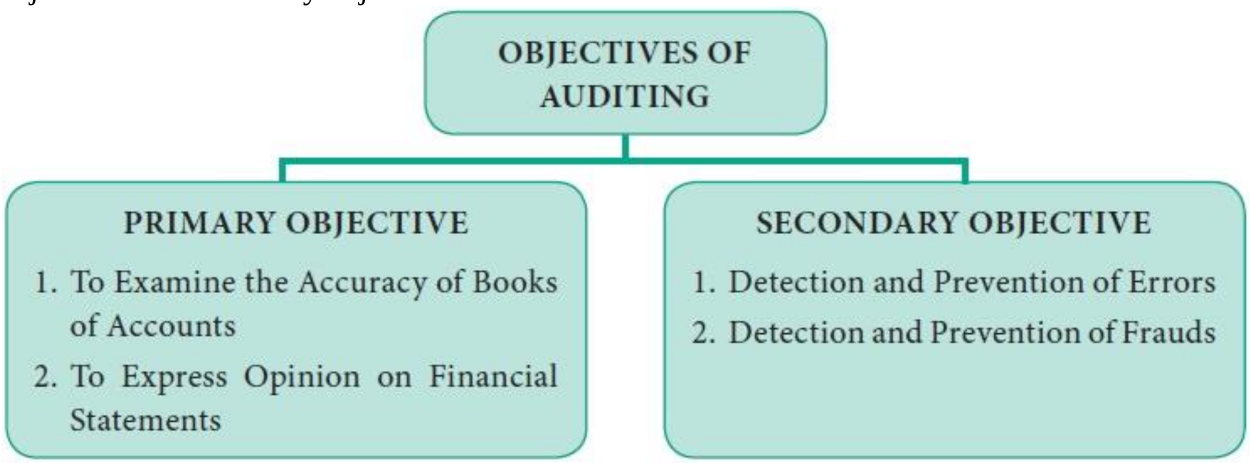
Spicer and Pegler defines auditing as, “such an examination of books of accounts and vouchers of a business as will enable the auditor to satisfy the Balance Sheet is properly drawn up so as to give a true and fair view of the state of affairs of the business, whether the Profit and Loss account gives a true and fair view of the profit and loss for the financial period, according to the best of his information and explanation given to him as shown by the books, and if not, in what respect he is not satisfied.”

In the words of **L.R.Dicksee**, "Auditing is an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transaction to which they purport to relate".

Montgomery defines the term as "Auditing is a systematic examination of books and records of a business or other organization in order to ascertain or verify and to report upon the facts regarding its financial operations and the result thereof".

OBJECTIVES OF AUDITING

The objective of an audit is to express an opinion on financial statements. The auditor has to verify the financial statements and books of accounts to certify the truth and fairness of the financial position and operating results of the business. Therefore, the objectives of audit are categorized as primary or main objectives and secondary objectives.



PRIMARY OBJECTIVES

To Examine the Accuracy of the Books of Account

An auditor has to examine the accuracy of the books of accounts, vouchers and other records to certify that Profit and Loss Account discloses a true and fair view of profit or loss for the financial period and the Balance Sheet on a given date is properly drawn up to exhibit a true and fair view of the state of affairs of the business. Therefore the auditor should undertake the following steps:

- Verify the arithmetical accuracy of the books of accounts.
- Verify the existence and value of assets and liabilities of the companies.
- Verify whether all the statutory requirements on maintaining the book of accounts have been complied with.

SECONDARY OBJECTIVES

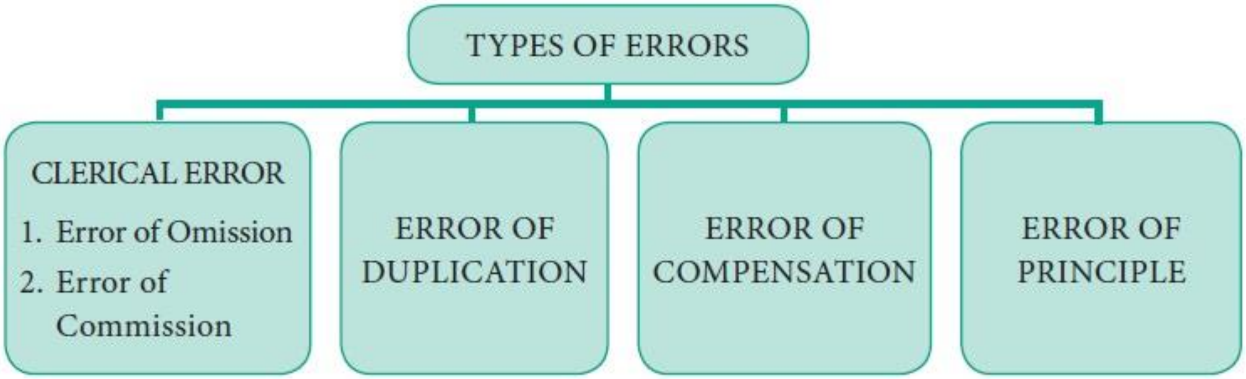
The secondary objectives of audit are:

(1) Detection and Prevention of Errors,

(2) Detection and Prevention of Frauds.

Detection and Prevention of Errors

The Institute of Chartered Accountants of India defines an error as, "an unintentional mistake in the books of accounts." Errors are the carelessness on the part of the person preparing the books of accounts or committing mistakes in the process of keeping accounting records. Errors which take place in the books of accounts and the duty of an auditor to locate such errors are discussed below:



CLERICAL ERROR

Errors that are committed in posting, totaling and balancing of accounts are called as Clerical Errors. These errors may or may not affect the agreement of the Trial Balance.

Types of Clerical Errors:

(A) Errors of Omission:

When a transaction is not recorded or partially recorded in the books of account is known as Errors of Omission. Usually, it arises due to the mistake of clerks. Error of omission can occur due to complete omission or partial omission.

(1) Error of Complete Omission: When a transaction is totally or completely omitted to be recorded in the books it is called as "Error of Complete Omission". It will not affect the agreement of the Trial Balance and hence it is difficult to detect such errors.
Example – 1: Goods purchased on credit from Mr. X on 10.5.2016 for Rs. 20,500, not recorded in Purchases Book.
Example – 2: Goods sold for cash to Ram for Rs. 10,000 on 1.7.2016, not recorded in Cash Book.

(2) Errors of Partial Omission: When a transaction is partly recorded, it is called as "Error of Partial Omission". Such kind of errors can be detected easily as it will affect the agreement of the Trial Balance.
Example – 1: Credit purchase from Mr.C for Rs. 45,000 on 10.12.2016, is entered in the Purchases Book but not posted in Mr.C's account.
Example – 2: Cash book total of Rs. 1,10,100 in Page 5 is not carried forward to next page.

(B) Errors of Commission:

Errors which are not supposed to be committed or done by carelessness is called as Error of Commission. Such errors arise in the following ways:

(1) Error of Recording,
(2) Error of Posting,
(3) Error of casting, or Error of Carry-forward.

(1) Error of Recording: The error arises when any transaction is incorrectly recorded in the books of original entry. This error does not affect the Trial Balance.
Example – 1: Goods purchased from Shyam for Rs. 1000 wrongly recorded in Purchases Day Book as Rs. 100.
Example – 2: Goods purchased from Ram for Rs. 1,000, instead of entering in Purchase Day Book wrongly entered in Sales Day Book.

(2) Error of Posting : The error arises when a transaction is correctly journalised but wrongly posted in ledger account.
Example – 1: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to debit side of Repairs account instead of debit side of Rent account.
Example – 2: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to credit side of Rent account instead of debit side of Rent account.

(3) Error of casting, or Error of Carry-forward: The error arises when a mistake is committed in carrying forward a total of one page on the next page. This error affects the Trial Balace.
Example – 1: Purchases Book is totalled as Rs. 10,000 instead of 1,000.
Example – 2: Total of Purchases Book is carried forward as Rs. 1,000 instead of Rs. 100.

2.ERROR OF DUPLICATION

Errors of duplication arise when an entry in a book of original entry has been made twice and has also been posted twice. These errors do not affect the agreement of trial balance, hence it can't located easily.
Example: Amount paid to Anbu, a creditor on 1.10.2016 for Rs. 75,000 wrongly accounted twice to Anbu's account.

3. ERROR OF COMPENSATION (or) COMPENSATING ERRORS.

When one error on debit side is compensated by another entry on credit side to the same extent is called as Compensating Error. They are also called as Off-setting Errors. These errors do not affect the agreement of trial balance and hence it cannot be located.
Example: A's account which was to be debited for Rs. 5,000 was credited as Rs. 5,000 and similarly B's account which was to be credited for Rs. 5,000 was debited for Rs. 5,000.

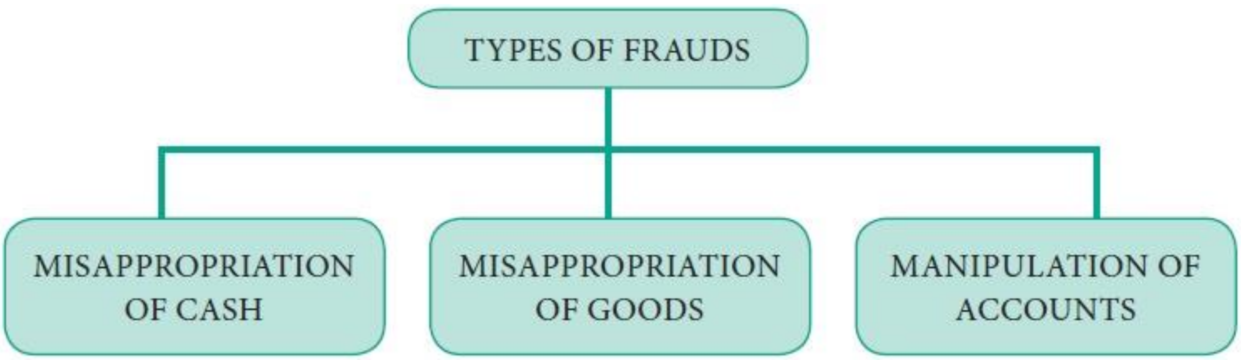
4. ERROR OF PRINCIPLE

An error of principle occurs when the generally accepted principles of accounting are not followed while recording the transactions in the books of account. These errors may be due to lack of knowledge

on accounting principles and concepts. Errors of principle do not affect the trial balance and hence it is very difficult for an auditor to locate such type of errors.
Example – 1: Repairs to Office Building for Rs. 32,000, instead of debiting to repairs account is wrongly debited to building account.
Example – 2: Freight charges of Rs. 3,000 paid for a new machinery, instead of debiting to Machinery account wrongly debited to Freight account.

DETECTION AND PREVENTION OF FRAUDS

Fraud is the intentional or willful misrepresentation of transactions in the books of accounts by the dishonest employees to deceive somebody. Thus detection and prevention of fraud is of great importance and constituents an important duty of an auditor. Fraud can be classified as:



1. MISAPPROPRIATION OF CASH

This is a very common method of misappropriation of cash by the dishonest employees by giving false representation in the books of accounts intentionally. In order to detect and prevent misappropriation, the auditor should verify the system of internal check in operation and by making a detailed examination of records and documents. Cash may be misappropriated in the following ways:

(1) By omitting to enter cash which has been received.
Example: Cash received on account of cash sales for Rs. 35,000 is not accounted in the debit side of the cash book.

(2) By accounting less amount on the receipt side of cash book than the actual amount received.
Example: Cash received on account of cash sales for Rs. 35,000 is accounted in the debit side of the cash book as Rs. 25,000. The difference of Rs. 10,000 may be defrauded by the cashier.

(3) By recording fictitious entries on the payment side of cash book.
Example: Cash book is credited for Rs. 44,000 as amount paid to Mr.X for goods purchased on credit but actually no amount is paid. Hence, cashier misappropriates Rs. 44,000 of cash as paid to Mr.X.

(4) By accounting more amount on payments side of cash book than the actual amount paid.
Example: Amount paid to Gopal for Rs. 5,000 is accounted on the credit side of cash book as Rs. 15,000. The difference of Rs. 10,000 may be defrauded by the cashier.

2. MISAPPROPRIATION OF GOODS

Fraud which takes places in respect of goods is Misappropriation of Goods. Such a type of fraud is difficult to detect and usually takes place where the goods are less bulky and are of high value.

- By showing less amount of purchase than actual purchase in the books of accounts.
- By showing issue of material more than actual issue made.
- By showing good materials as obsolete or poor line of goods.
- By showing fictitious entries in the books of accounts.

Example – 1: Goods purchased amounting to Rs. 58,000 is wrongly accounted in Purchases Book as Rs. 50,000. Hence, showing less amount of purchases than the actual and misappropriating goods worth Rs. 8,000.
Example – 2: Goods issued from stores for 1000 units is wrongly accounted in the Ledger accounts as 3000 units issued. The difference of 2000 units may be misappropriated by the storeskeeper.
Example – 3: Entries in the Purchases Book may be suppressed or inflated to show more or less profit.

Detection of Misappropriation of goods is a difficult task for an Auditor. Only through efficient system of inventory control, periodical stock verification, internal check system and adequate security arrangement the scope for such frauds can be eliminated or minimized.
Auditor has to thoroughly scrutinize the inward and outward registers, invoices, sales memos, audit notes, etc., to detect the goods-related frauds.

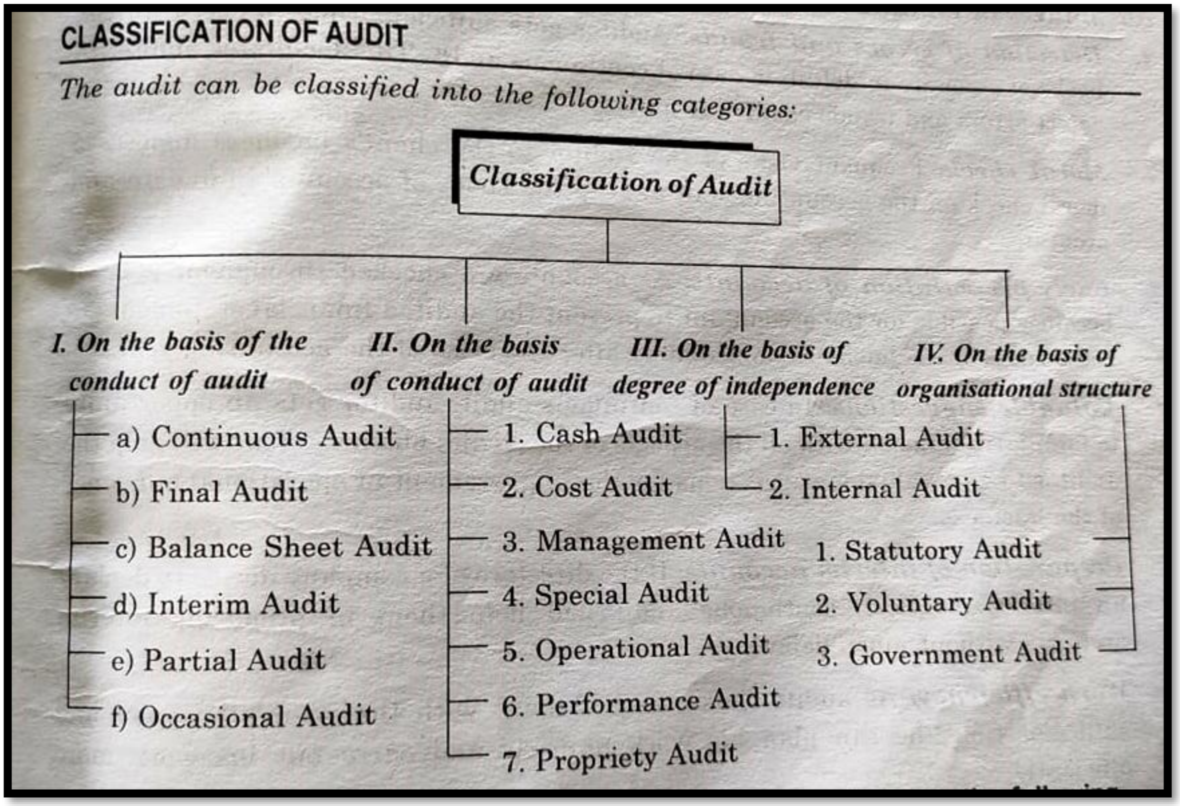
3. MANIPULATION OF ACCOUNTS

There is a very common practice almost in every organization; some dishonest employees have intention to commit this type of fraud. Manipulation of accounts is the procedure to alter books of accounts in such a way that there will be an increase or decrease in the amount of profit to achieve some personal objectives of the high officials. It is very difficult for the auditors to identify such frauds which may be due to manipulation of accounts.

Window Dressing: In window dressing, accounts are manipulated in such a manner to reveal a much better and sound financial position of the business than what actually it is, in order to mislead the outsiders by inflating the profit.
Secret Reserves: Accounts are prepared in such a manner that they disclose a worse financial position than the real. The real picture of the business is concealed and a distorted one is revealed.

TYPES OF AUDIT

1. On the basis of the conduct of audit, audit may be classified into the following types:



A. Continuous Audit
Continuous audit is an audit, where the books of accounts are verified throughout the year, either at regular or irregular intervals and the financial statements of the business are examined at the end of the year.

Advantages of Continuous Audit
1. Detection of errors and frauds: Auditor gets sufficient time to check all the books of accounts in detail, in case of continuous audit. This facilitates auditor to detect errors and frauds easily and quickly.

2. Moral check: Frequent visits of the auditor to the client's business imposes a moral check on the accounting staff to keep the books of accounts up-to-date and accurate.

3. Early presentation of accounts: As accounts are checked throughout year, 1 becomes possible for the accountant to present the audited financial statements to the owners of the business immediately after the close of the accounting year.

4. Valuable suggestions: In case of continuous audit, auditor gets an opportunity to familiarize himself with all the aspects of the clients business. This will help the auditor to give valuable suggestions for the improvement of operational efficiency of the business.

5. Preparation of interim accounts: If the directors of a company decide to declare an interim dividend, continuous audit will help them in preparing interim accounts without much delay.

6. Work efficiency: As auditor has constant touch with the client's business and sufficient time, he can plan his work properly and carry out his work more efficiently.

Disadvantages of Continuous Audit

1. Very expensive: Continuous audit is very expensive, as more audit fees is required to be paid to the auditor for his continuous visits.

2. Time consuming: Continuous audit involves much time. The time spent on audit will be a sheer waste, if the size of the business is small.

3. Alteration of figures: In case of continuous audit, figures may be altered by the dishonest accountant, after the auditor has checked the books of accounts for a particular period.

4.Losing link in the audit work: If proper notes of the work done on previous visits are not correctly made, the auditor may lose the link of the work and will fail to clear up the outstanding queries

5. Monotony: As audit is carried out throughout the year in case of continuous audit, there is the danger of the audit work becoming mechanical.

6. Inconvenience: Frequent and unexpected visits of the auditor to the client's business may cause inconvenience to the client's staff and dislocation of clients work.

B. Final Audit

Final audit is an audit, where the auditor takes up his work of checking the books of accounts at the end of the accounting period, when the transactions for the whole year are completely recorded and financial statements have been prepared.

Advantages of Final Audit

1. Final audit is not very expensive. Therefore, more suitable for small concerns.
2. Final audit involves less time.
3.In case of final audit, there is less scope for alteration of figures.
4. There is no scope for the auditor may to lose the link of the work.
5: There is less danger for the audit work becoming mechanical.
6. It does not cause inconvenience to the client's staff.

Disadvantages of Final Audit

1. Auditor does not get sufficient time to check all the books of accounts in detail.

2. In case of final audit, auditor does not impose a moral check on the accounting staff to keep the books of accounts up-to-date and accurate.

3. It is not possible for the accountant to present the audited financial statements to the owners of the business immediately after the close of the accounting year.

4. Auditor does not get an opportunity to familiarize himself with all the aspects of the clients business.

5. Final audit does not help them in preparing interim accounts in time.

As final audit is not very expensive and time consuming, it is widely adopted. It is more suitable for small units, where the numbers of business transactions are very less.

D. Interim audit

It is a kind of audit, which is done between the two annual audits. It is suitable for those companies, which wants to declare interim dividend.

Advantages of Interim Audit

1The final audit can be completed very soon, if there has been an interim audit.
2. Errors and frauds can be detected easily and quickly.
3. It imposes a moral check on the staff of the client.

Disadvantages of Interim Audit

1. Figures may be altered in the accounts, which have already been audited.
2. Even in case of interim audit, auditor is required to take extensive notes of the figures audited. This would increase the work of the auditor.
3. Interim audit is comparatively expensive, as it involves additional financial burden to the organization.

C. Balance Sheet Audit

Balance sheet audit is a type of audit, which concentrates mainly on the verification of the items in the Balance sheet, such as capital, reserves and provisions, profit and loss account balance, assets and liabilities of the business. It may be noted that in case of Balance sheet audit, audit work commences from the Balance sheet, working back to the books of original entry and documentary evidences
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E. Partial audit

It is a kind of audit, where the work of the auditor is curtailed. For instance, auditor may be asked to check only the cash book to detect misappropriation of cash. It may be noted that partial audit is not permitted in case of companies

F. Occasional Audit

It is a kind of audit, which is not conducted on a regular basis and it is not suitable for Joint stock companies. (Which is conducted once a while when the need arises)

II. On the basis of specific objective, audit may be classified into the following types:

1. Cash Audit
It is a type of audit under which only the cash receipts and payments are audited in detail by the auditor. It may be noted that partial audit is not permitted in case of companies.

2. Cost Audit
Cost audit is an independent and critical examination of the various records maintained by the company by the cost auditor to ascertain whether cost of the product manufactured by the company have been correctly determined in accordance with the correct costing principles.

3. Management Audit
The auditor examines the policies and the actions of the management to ensure that there is proper and maximum utilization of available resources.

4. Special Audit
When the affairs of the company are not being managed, according to the sound business principles, the central government is empowered to appoint a special auditor to audit the company's working and its state of affairs. Such audit is known as special audit.

5. Operational Audit
It involves intelligent examination of the various operations of the different functional areas of a business, and observing the weaknesses, lapses, inefficiencies in operations and suggesting ways for strengthening the system.

6. Performance Audit
Performance audit is a procedure for analyzing the profits and losses of different economic avenues for maximizing profits.

7. Propriety Audit
Propriety audit is carried out with the objective of ascertaining that contracts
entered into with third parties are in the best interest of the concern and there is a system, which ensures the safety of the assets of the concern.

III. On the basis of degree of independence, audit may be classified into the following types:

1. Independent or External Audit
External auditors are independent firms that inspect the accounts of an entity and render an opinion on whether its statements conform to GAAP and present fairly the financial position of the company and the results of operations. The external auditor.s primary obligation is to users of financial statements outside the organization. External auditors are required to register with ISO 9000.

2. Internal Audit

Internal auditing considers the examination, monitoring and analysis of activities related to a company.s operation, including its business structure, employee behaviour and information systems. Although accounting is an important skill for an internal auditor, the focus for internal auditors is the evaluation of operational, risk management, internal control and the governance processes of the organization. An internal audit is designed to review what a company is doing in order to identify potential threats to the organizations health and profitability and to make suggestions for mitigating the risk associated with those threats in order to minimize

IV. On the basis of organizational structure, audit may be classified into the following types:

1. Statutory Audit

Statutory audit refers to the audit of accounts of a business unit compulsorily under the provisions of a statue or law. Further, statutory audit is carried out in a number organizations, such as, Joint stock companies, Banking companies, Insurance companies etc.

Features of Statutory Audit

1. Statutory audit is compulsory under law.
2. It is an independent audit.
3. It is an external audit.
4. It can be complete audit or full audit. It cannot be partial audit.
5. Statutory auditor is required to serve the interest of the owners and not the interests of the management.
6. The rights, duties and liabilities of an auditor are governed by statute. Therefore, they cannot be curtailed or restricted.
7. It should be conducted by the qualified auditor.

2. Private or Voluntary Audit

Where the audit is not compulsory under any statue, but is undertaken by the owners voluntarily to get the benefits of audit, such audit is known as private or voluntary audit. Further, the organizations, which adopt private audit are: sole trading concerns, partnership firms and other individuals.

3. Government Audit

Government audit refers to the audit of accounts of government departments and offices, government companies and statutory corporations.

Features of Government Audit

1. Government audit is undertaken either by the comptroller and auditor general of India and his staff or professional chartered accountants approved by the comptroller and auditor general of India.
2. Government audit can be considered as an internal audit.
3. It is a sort of continuous audit, as it is conducted continuously throughout the year.
4. Government auditor checks the existence of stocks and stores and their valuation and ensures that there is proper system of stock taking.

5. He also examines whether the payment has been sanctioned by the competent authority and such payment is not excessive and it is made to the right person.
6. He makes suggestions to the proper authority for improvements in the rules and regulations for greater efficiency and economy.

ADVANTAGES OF AUDITING

1. Assurance to the Owners/Investors: One of the biggest advantages of auditing is that it offers assurances to the owners, investors, shareholders etc. The owners of the business will be assured about the accuracy of their books of accounts.

2. Errors and Frauds: An error is something that is done without the intention to fraud the company, it is an innocent mistake. Fraud, on the other hand, is deliberate. During the process of auditing, both errors and frauds are discovered. Auditing also helps prevent such errors and frauds. It creates a fear of being detected.

So auditing helps us minimize the risks of errors and frauds in our books of accounts but does not eliminate the risk entirely. There is always the chance that the error may go unnoticed, and the fraud is very cleverly hidden so may go undetected.

3. Independent Viewpoint: If the auditor is an external auditor, the business can get a second opinion on their financial statements and their financial standing as well.

An external auditor will closely inspect the books and be completely true and fair in his opinion as he has no hidden agenda. If he says the accounts are true and fair, it has a lot of weightage with the company and the investors.

4.Moral Check: One of the other advantages of auditing is that the staff and the workers of the company do not try to steal or defraud the company. They are under constant scrutiny since they know that the accounts will be audited. Any irregularities can be identified during such an audit, and they will be caught eventually. This helps the staff in being honest and responsible at all times.

5.Stakeholders Confidence: After auditing stakeholders like creditors, investors, banks, debenture holders etc. can rely on the books of accounts with more confidence. And so after auditing by an independent authority, the financial statements have more credibility.

LIMITATIONS OF AUDITING

1.Cost Factor: A very thorough and detailed audit would be a costly affair. It is not cost effective. So the auditor has to limit the scope of his audit and use techniques like sampling and test checking.

2. Time Factor: Auditors generally work on a very specific timeline. Sometimes this is due to statutory requirements. This means he has to audit a whole year’s accounts in a few weeks. Hence insufficient time is one of the main limitations of auditing.

3. Inconclusive Evidence: Generally, the audit evidence the auditor collects is persuasive in nature, not conclusive in nature. So there is never cent percent conclusive evidence in most cases while auditing.

This is one of the major limitations of auditing. There also a lot of use of estimates in accounting. The auditor cannot measure or comment on the exact accuracy of these estimates. He has to rely on his knowledge.

RELATIONSHIP OF AUDITING WITH OTHER DISCIPLINES

1. Accounting
Auditor has to review and evaluate the financial statements by providing an opinion. Therefore, he should have thorough knowledge about accounting concepts and principles.

2. Mathematics and Statistics
Auditor deals with financial data and the amount that appears in financial statements. Hence, it requires knowledge of calculation procedure involved in computing various items, for example., depreciation, provision for bad debts, tax etc.
Auditor is also expected to have knowledge of statistical sampling for making meaningful conclusion.

3. Economics
Auditor requires knowledge regarding business and economic environment affecting the client. Thus, economic concepts are required to perform auditing in a meaningful way.

4. Law
Audit of a business concern has to be undertaken with respect to conformity with law. Thus, an auditor should have sound knowledge of laws affecting the client.

5. Computer Information System
In recent times, clients maintain their accounts in computer information system. Thus, working knowledge on computer is required for auditors to conduct audit in an effective way.

6. Financial Management
Auditor to understand and evaluate the financial statements in a better way should have knowledge of financial techniques.

7. Behavioral Science
Auditor has to deal with many personnel to conduct the audit efficiently. Hence, he should have the tact of getting along with people.

PREPARATION BEFORE COMMENCEMENT OF NEW AUDIT

An audit is generally conducted with some definite objects in view. This object should be kept in mind by the auditor before commencing the new audit. In other words, an auditor has to take the following steps, before he starts his work:

1. Obtaining the letter of appointment

He must have a proper letter of appointment from the appropriate authority and ensure that his appointment is an order. Further, if he has been appointed in place of another auditor, he should enquire from the retiring auditor, the reasons for the changes.

2. Knowing the nature and scope of his duties

He should obtain definite instructions from his client about the nature and scope of his work ie whether he is to do continuous audit or final audit, whether he is to do the accountancy work or audit work or both. This question will not arise in the case of companies, as his duties, powers and liabilities are laid down by the companies act itself.

3. Knowledge of the system of accounting employed

He should examine the system of accounting employed by his client. If he finds any weak point, he must study it thoroughly and make recommendations to his client to remove these weak spots.

4. Obtaining of the list of principal officers of the client's organization

He should obtain a list of the principal officers of the client's organization together with their authorities and responsibilities. This will help him to obtain the required information from them.

5. Knowledge of internal control in force in the client's business

He should obtain a written statement of internal control system in force in the client's organization. It will help him in determining the extent of his audit work.

6. Obtaining of the list of books

He should obtain a list of all the books maintained in the office, together with the names of in charge persons and their specimen signatures. Such a list should be duly signed by a responsible official of the company.

7. Study of the previous year's financial statements

He should study the previous year's financial statements as well as the auditor's report. This will help him to know the state of affairs of the concern.

8. Study of the important documents

He should study all the documents viz., M/A, A/A etc, which have a bearing on the accounts.

9. Giving instructions to the client

He should give clear instructions to his client in regard to the following:

- The books should be closed before audit.
- Principles and Practice of Auditing
- The vouchers should be arranged date wise.
- If this has not been done, he should never begin his work until the documents are arranged as per the instructions given by him

10. Ascertain the nature of business

He should ascertain the nature of the business of his client i.e whether it is manufacturing or trading or service. Such knowledge helps the auditor in planning of the audit procedure.

AUDIT WORKING PAPERS

Audit working papers are the written private materials which an auditor prepares for each audit. They describe the accounting information which he has received from his client, the methods of examinations used, his conclusions and financial statements

CONTENTS OF AUDIT WORKING PAPERS

An audit paper consists of the following contents:

1. Contract Letter
The working papers contain the contract letter. This letter gives right to a person to a start work of audit. It states the terms and conditional of appointment of an auditor. The nature and amount of work is recorded. This letter becomes a part of audit working papers.

2. Audit Programme
An audit programme is a detailed plan of action to be used for audit. It is a time table of staff duties. The books to be examined are stated in audit programme. Every audit work requires programme and then master audit programme is prepared to cover all activities.

3. Audit Note Book
The audit notebook is a part of audit working papers. It may be bound book or loose-leaf card form. It contains useful information about the business enterprise When audit report is drafted this book provides data for such report. The weak points like missing vouchers, queries not settle are stated in it.

4. Copies of Documents
The copies of various documents are included in audit working papers. The partnership deed, article of association, memorandum of association, trust deed, lease contract and similar other papers are collected from the management. These papers are useful to determine the performance of business work.

5. Copies of Correspondence
The copies of correspondence become part of audit working papers. The auditor can write letter to other parties. The replies can be received from debtors and creditors. The audit staff must keep the exchange of letter between auditor and other people.

6. Schedule of Debtors
The client provides the schedule of debtors. This list is compared with the books of accounts. The auditors can confirm the balance from various debtors. He collects facts and figures by writing letters to the customers.

7. Stock Certificate
The stock certificate is received from the management. The auditor can watch the stock taking process. When the stock is lying in public warehouse, the certificate of warehouse keeper is accepted for audit.

8. Copies of Previous Audit
The auditor can collect copies of previous audit reports. These papers become part of audit working papers. The auditor can note the weakness stated in the old report. He can examine that same points are not repeated in the books under review.

9. Resolution Copies
Auditor collects the copies of resolutions. These copies are part of working papers. These copies are part of working papers. The decisions made by the directors and shareholders are implemented in preparing of books of accounts. The auditor can determine whether such decisions are implemented.

10. Depreciation
The audit working papers contains the particulars of depreciation. The rate of depreciation can be applied throughout the life of an asset. The reasonable amount of depreciation can be charged every year. The auditor can determine the exact amount of depreciation.

AUDIT NOTE BOOK

An audit note book is a book, register or diary maintained by the audit staff during the course of audit for recording his observations during the course of audit, the points to be discussed with the senior audit clerk or auditor, the points which require further clarifications, explanations and investigation and also the enquiries made and the replies received thereto.

OBJECTIVES OF AUDIT NOTE BOOK

Various objectives of Audit Note Book are:
i) To know about the nature of business.
ii) Detection and prevention of frauds and errors effectively.
iii) To make the future audit work easier.
iv) To know the facts where clarification and explanation are essential.
v) To check the list of debtors and creditors.
vi) To present as a proof by the auditor to clearance over the cases.

CONTENTS OF AUDIT NOTE BOOK

1. Nature of the business.
2. Organization structure of the enterprise.
3. Names of principal officers, their powers, duties and responsibilities.
4. Instructions from the management regarding the audit. List of books of maintained by the business
5. The systems of internal check and internal audit in force in the business.
6. The system of accounting followed in the business.
7. Technical details and terms used in the business.
8. Extracts from minutes and contracts.
9. Provisions of the memorandum and articles of association affecting the accounts and audit.
10. Extracts from all correspondence entered into with the bankers, debtors and creditors.

11. Queries made and replies received.
12. Dates of commencement and completion of audit.
13. Complete record of the exact nature of the work done.
14. Progress of the audit work.
15. Record of suggestions made by the audit staff.

QUALITIES OF AN AUDITOR

PROFESSIONAL QUALITIES OF AN AUDITOR

1. **Accounting**

The auditor is an expert in the field of accounting. He knows the principles, methods, and techniques of accounting. It is a process that goes on for the whole year. The accounting system includes personnel, procedures, records, forms, and devices used by any business.

2. **Auditing**

The auditor is an expert in the field of auditing. He knows the rules and regulations often audit. He has practical experience in the field of auditing. The auditor knows the checking of financial statements records and performance of any concern.

3. **Company Law**

An auditor has full knowledge of Companies Ordinance 11984, Companies Rules 1985, Modaraba Companies Ordinance 1980, Modaraba Companies Rules 1981, and Banking Companies Ordinance 1962, the auditor carry examine the statements in the light of these rules.

4. **Mercantile Law**

An auditor is an expert in the Mercantile Law. He has complete knowledge of Contract Act 1872, Sales of Goods Act 1930, Negotiable instruments Act 1881, Partnership Act 1932, Insolvency Act, Transfer of Property Act and Common Carrier Act

5. **Taxation Laws**

The knowledge of taxation is essential for professional auditor. He knows Income Tax Ordinance.2001, Sales Tax Act, Gift Tax Act, Excise, and Customs Act. He knows the rates of Tax.

6. **Business Organization and Operation**

The auditor must know organization structure and operations of the business. Placement of Workers on the job is organizational structure. He should know the working of various departments of the business.

7. **Budget Preparation**

The auditor must be expert in preparing budgets. The figures are collected from past year. The estimates are established for the next year. The various budgets are prepared for all functions of the business concern.

8. **Electronic Data Processing**

The auditor must be expert in electronic data processing. The computers are used in business for accounting and other functions. The auditor must have the training to handle data through computers.

9. **General Knowledge**

The auditor must have knowledge of general matters, which may help him in his professional life. He must be aware of economic and political conditions. He should remain in touch with the latest knowledge affecting business concerns.

PERSONAL QUALITIES OF AN AUDITOR

1. **Tact**

The auditor needs technical information to comment and criticize policies of management. When any information is missing he can collect such information with argument and debate without offending them.

2. **Honesty**

The auditor must have high moral standards. It' is his duty to report true and fair view of business matters. He must be straightforward, and honest in his professional work.

3. **Independence**

The auditor must be independent at the time of programming, investigation, and reporting. Other people do not influence him directly or indirectly.

4. **Vigilance**

The auditor is Vigilant about activities of accounting and audit staff. He can discover errors and frauds due to vigilance. He has an alert mind to watch audit work.

5. **Judgment**

The auditor must have judgment for Selection depreciation, provision for bad debts, and inventory can apply professional knowledge to make decisions.

6. **Leadership**

   The auditor is a leader of an audit team. The senior and junior audit clerks are working under his leadership- As team leader. He can guide the auditors through demonstration.
   OR

QUALITIES OF AN AUDITOR	
Professional Qualities	**General Qualities**
1. Knowledge of accounting principles and concepts.	1. Tactful and honest.
2. Knowledge of principles and techniques of auditing.	2. Ability to work hard.
3. Knowledge of Company and Mercantile Law.	3. Reasoning.
4. Knowledge of Cost accounts.	4. Vigilant, cautious and accurate.
5. Knowledge of Management accounts.	5. Communication skill
6. Knowledge of mathematics and statistics.	6. Impartial
7. Knowledge of Economics.	7. Ability to trace out facts and figures.
8. Knowledge of technical details and production process.	8. Methodical.
	9. Ability to maintain secracy.
	10. Well-behaved.
	11. Courage.
	12. Common sense.
	13. He must be a watch dog but not blood hound.

AUDIT PLANNING

Audit planning can be done only when, the auditor is having knowledge of the business of the client. It helps in accomplishment of objectives of audit and enables the auditor to cover different aspects of audit work in a systematic manner within a preset time frame. It enhances the quality of audit work.

Audit plans should cover knowledge about client's accounting systems and policies, internal control procedures and coordinating the work to be performed. Plans should be flexible so that they can be developed or revised as and when required by the auditor.

ADVANTAGES OF AUDIT PLANNING

- **Accomplishment of Objectives:** Audit plan ensures that it provides right means to accomplish audit objectives. Further it also ensures that appropriate attention is devoted to important areas of audit.

- **Identification of Problems:** A well drawn and established audit plan helps in identifying potential problems.

- **Timely Completion of Work:** It ensures that work is completed properly within the specified time and no important area is left out. It also ensures that all important areas of management receive attention.

- **Facilitates Coordination:** It facilitates coordination of the audit work done by auditors and other experts.

- **Better Audit Work:** It helps in improving the quality of audit work and provides promptness and perfection in audit performance.

FACTORS AFFECTING AUDIT PLANNING

- Size of the company and nature of its operations.
- Accounting system, internal control and adherence to standard.
- Environment in which the company operates.
- Previous experience with the client; and
- Knowledge of client's business.

AUDIT STRATEGY

Audit strategy refers to the overall approach and plan designed by auditors to conduct an audit engagement effectively and efficiently. It outlines the scope, timing, and direction of the audit, taking into consideration the specific characteristics of the entity being audited, its industry, and the level of risk associated with the engagement.

OBJECTIVES:

- Identify the significant areas of the financial statements that require special attention.
- Determine the extent of audit procedures to be performed.
- Allocate audit resources, such as personnel and time, efficiently.
- Coordinate the efforts of the audit team members.
- Communicate with the client and manage their expectations.

AUDIT ENGAGEMENT

An audit engagement is an independent and systematic examination of a company's financial records, systems, and controls by a qualified professional known as an auditor. The purpose of it is to provide an independent assessment of the financial position and performance of the organization being audited.

Initial audit engagements aim to review the company's financial statements, transactions, and accounting records. This ensures they are accurate, complete, and comply with relevant accounting standards and regulations.

The auditor will also assess the company's internal controls and risk management processes. This helps identify any weaknesses or deficiencies that could impact the accuracy and reliability of financial reporting.

PROCEDURES OF AUDIT ENGAGEMENT

1. **Planning**: The auditor will first understand the company's business, risks, and objectives under audit engagement planning. They will also assess the materiality of the financial statements and identify areas that require special attention during the audit.
2. **Risk Assessment**: The auditor will assess the risks associated with the company's financial statements, including fraud risks and other potential misstatements.
3. **Testing**: The auditor will conduct testing of the company's financial records, transactions, and systems to ensure that they are accurate, complete, and in compliance with relevant accounting standards and regulations. This may involve gathering evidence through various methods, such as sampling and analytical procedures.
4. **Evaluation of Internal Controls**: The auditor will evaluate the company's internal controls and risk management processes to ensure they effectively prevent financial misstatements or losses.
5. **Communication**: Throughout the process, the auditor will communicate with the company's management and other stakeholders to provide updates and discuss any findings or concerns.
6. **Reporting**: At the end of it, the auditor will prepare a written report that includes their opinion on the accuracy and completeness of the company's financial statements and any significant findings or recommendations for improvement. The information will be distributed to the company's management and stakeholders, including shareholders and regulatory bodies.

AUDIT DOCUMENTATION

Audit documentation: SA 230 on "Audit Documentation", audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.)

NATURE OF AUDIT DOCUMENTATION

(a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

OBJECTIVES OF AUDIT DOCUMENTATION

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

AUDIT EVIDENCE

Audit evidence is the data or the information collected by auditors to review a company's financial reports and transactions. The reports may need to be verified to prove their authenticity, which can be conducted by the Auditor or the Certified Public Accountant (CPA).

Hence, evidence is required to ensure the authenticity of these reports. Audit evidence is usually considered sufficient when the company's claims, which they make in the financial statements and their adherence to the accounting laws of their country's legal framework, are at par. Without any proper audit evidence, the entire audit process cannot be completed. Hence, such proof is required to complete the task.

CHARACTERISTICS OF AUDIT EVIDENCE

- **Relevancy:** The relevancy of the Audit evidence is largely influenced by the type of audit evidence being conducted and how to the point the information is received, in comparison to the overall analysis.
- **Source:** It is one of the major factors that influence the reliability of the audit evidence. External source information will always be preferred over any internal information because it is generally considered void of any bias.
- **Nature:** Audit evidence is usually considered sufficient when the information is provided through presentations, physical confirmation, or legal documents.
- **Sufficiency:** Audit evidence also takes into account the material provided, such as bank statements, which further help determine the financial position of the company.

SOURCES OF AUDIT EVIDENCE

Physical Observations: Auditors verify the tangible and intangible assets through inspections and on-spot observations. This is typically conducted during inventory audit procedures.

Original Source Document: This means vouching of the claim made by the financial statements of the company to the original documents. The Auditor conducts this through verifying the claim against any asset by comparing its sale invoice.

External Data: Certain company assets may be actively traded in the financial markets. In these cases, it should be noted if these assets are reported at a lower cost or the market value in the given financial statements. The characteristics of audit evidence become important in these situations.

Recalculations: All the recorded documents and transactions are submitted to the Auditor based on which they make the financial statements, which then get compared to the company’s financial statement. The stated process is called recalculation.

WRITTEN STATEMENT

A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records

FORM AND CONTENT OF WRITTEN REPRESENTATION

It must be in paper form as a representation letter addressed to the auditor

CONTENT

- Request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework
- It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement
- All transactions have been recorded and are reflected in the financial statements
- As required by Other Support audit
- As required by auditor’s judgment

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UNIT 2 AUDIT RISK AND INTERNAL ASSESSMENT

AUDITRISK Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment. Audit risk is a function of the risks of material misstatement and detection risk.

COMPONENTS OF AUDIT RISK

(a) Inherent risk—The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(b) Control risk—The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

(c)Detection risk: The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements

ASSESSING THE RISKS OF MATERIAL MISSTATEMENT

As per SA 315 - "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. This will help the auditor to reduce the risk of material misstatement to an acceptably low level.

RISK ASSESSMENT PROCEDURES

Inquiries of Management and Others within the Entity: Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority

Analytical Procedures: Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

Observation and Inspection: Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. **Example:** Documents (such as business plans and strategies), records, and internal control manuals

INTERNAL CONTROL

Internal control comprises of the policies and procedures adopted by the management of an entity to assist in achieving the following objectives:

- Orderly and efficient conduct of business.
- Adherence to management policies
- Safeguarding of assets
- Prevention and detection of fraud and errors
- Accuracy and completeness of accounting records
- Timely preparation of financial statements

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

" According to American Institute of Certified Public Accountants:" Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency and to encourage adherence to prescribed managerial policies."

OBJECTIVES OF INTERNAL CONTROL

- **To encourage adherence to prescribed policies:** The system of internal control is introduced to provide reasonable assurance that the various plans, policies and procedures laid down by the entity are being followed.
- **To avoid frauds and errors:** The main objective of any control system is to detect and prevent frauds and errors by keeping an inherent check.
- **To promote operational efficiency:** The internal controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste and discourage any inefficient use of resources of the organization.
- **To safeguard assets and records:** The other important objective of internal control system is to safeguard the assets and records from unauthorized access, use and disposition.
- **To provide accurate and reliable data:** The internal control system ensures that all the transactions are recorded in the correct amount, in the appropriate account and in the accounting period to which they relate.
- **To assist in timely preparation of Financial Information:** Information is of no use if it is not provided in time. Internal control system facilitates timely preparation of financial statements.

INTERNAL CHECK

Internal check is used as tool for executing internal control. It is the arrangement of duties of staff in such a manner that the work of one person is automatically checked by another which minimizes the chances of errors and frauds.

"Internal check may be defined as an arrangement of accounting routine that errors and frauds are automatically prevented or discovered by the very operation of book keeping itself".

According to Spicer and Pegler "A system of internal check is an arrangement of staff duties whereby no one person is allowed to carry through and to record every aspect of the transaction, so that without collusion between two or more persons, fraud is prevented and at the same time the possibilities of errors are reduced to the minimum."

OBJECTIVES OF INTERNAL CHECK

1. **Early Detection of Errors and Frauds:** The main objective of internal check is to detect and prevent the occurrence of errors and frauds at an early stage. This is possible as the work of each and every person is independently checked.

2. **Minimization of Errors and Frauds:** It is one of the primary objectives of internal check. As the work performed by each individual is checked by another person, there is a check on the work of dishonest person. Hence, the possibility of errors and frauds are minimised to a greater extent.

3. **Division of Work:** Internal check provides for proper division of work based upon each and every persons skill, ability, specialisation and effectiveness.

4. **Fixation of Responsibility:** The total work is divided into smaller units and assigned to different persons. Each and every person knows what is expected from him/her and he/she will be held responsible for any errors or fraud which takes place in it. Internal check provides for clear determination of responsibility.

PRINCIPLES OF INTERNAL CHECK

- **Responsibility:** Responsibility of each individual must be properly defined and fixed. The work of the business should be allocated amongst various clerks in such a manner that their duties and responsibilities are clearly and judiciously divided.
- **Completion:** The work should be divided in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end. However, there should be no duplication of work.
- **Rotation of employees:** A good system of internal check should not allow person having custody of assets to have access to the books of account. A system of transfer or rotation of employees from one seat of work to another must be followed by the business.
- **Automatic check:** A good system of internal check must provide for an automatic checking of the work of one clerk by the other.
- **Reliance:** No clerk of the business should be relied upon too much.
- **Safeguards:** Safeguards should be prescribed to keep un-used cheque books, files and securities etc.
- **Supervision:** A strict supervision should be exercised to ensure that the prescribed internal checks and procedures are fully operative.
- **Formal sanction:** No deviation should be allowed from the established procedures till it is formally sanctioned by the top official.
- **Periodical review:** The system of internal check be reviewed from time to time to introduce improvements.

INTERNAL CHECK REGARDS PAYMENT OF "WAGES AND SALARIES"

In case of manufacturing companies, the internal check system for payment of wages and salaries is devised carefully because they employ a large number of workers and there is a great possibility of frauds. The internal check system is so planned.

- To avoid incorrect time records or piecework records.
- To avoid the inclusion of dummy workers.
- To avoid the fraudulent manipulation of wage sheet.
- To avoid misappropriation of money, etc.

1.Proper Maintenance of Wage Records: The workers are paid wages either on the basis of time spent by them or number of pieces produced by them. Therefore, there should be proper time records or piecework records. The overtime records should also be kept in the organization.

2.Preparation of Wage Sheets:
(*i*)The wage sheets should be prepared by a separate official.
(*ii*)The wage sheets should include all the essential particulars like name of employee, number allotted, total time worked, rate, bonus, overtime, etc.
(*iii*) There should be proper checking of calculations made in the wage sheet. The permissible amount (like Income Tax, Provident Fund, etc.) should be deducted from gross wages to show the net wages payable to workers.
(*iv*)The wage sheet shall be signed by the person who has prepared it before making any payment.

3.Actual Payment of Wages:
(*i*) Separate persons should be responsible for preparation of wage sheets, approval of wage bills and the actual payment thereof.
(*ii*) Every worker who is to receive the wages should be personally present and he has to prove his identity at that time.
(*iii*) If possible, wages should be disbursed in the presence of departmental foreman concerned.
(*iv*) Signatures of the workers should be obtained whenever they receive the wages.
(*v*) There should be proper arrangement for dealing with unclaimed wages.
(*vi*) If possible, a separate bank account should be operated for wage payments. It will help in maintaining track of such payments or disbursements.

INTERNAL CHECK WITH REGARD TO "CASH PURCHASES"

1. Requisition: The procedure for issuing purchase requisitions should be specified. The head of the department, who is in the need of goods, should fill in a requisition slip duly signed and then should send it to the purchases department. The details about the quantity, is quality and the time by which the goods must be supplied be clearly mentioned in the requisition slip.

2. Enquiry: Purchase department makes an enquiry about the terms and conditions of purchases from different suppliers. For this purpose tender are generally invited. But, who shall open and accept the tenders, should be clearly specified. At a rule, the lowest tender should be accepted and accordingly a decision be taken.

3. Purchase Order: The Purchase Department places orders which should be recorded in the Purchase Order book. Four copies of purchase order should be prepared. One copy will be sent to the vendor, second to the store department, third copy to the Accounts department and fourth one will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.

4. Receipt of Goods: On receipt of goods, the purchase department should be properly inspect them, and there after an entry in the goods inward (Receipt) book, the same should be sent to the stores. Concerned department should be informed about the receipt of the goods.

5. Making the Payments: The Purchase Department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with the purchase order and Incoming Inspection Report and should also verify the calculation. The Accounts Department should enter the invoice in the Purchase Book. Only responsible official should draw cheque for the payment of invoice. At the time of signing, a signing authority must verify that correct payment is made.

INTERNAL CHECK REGARDS "CASH SALES"

Cash Sales are of three types:
a. Sales at Counter / Counter Sales
b. Sales by travelling Salesmen.
c. Postal sales

1. Sales at Counter / Counter Sales: The following procedure may be of great use in regard to cash sales:
a) A specific number, name or work may be allotted to every salesman.
b) Every salesman is supplied with a separate book containing blank copies of cash memo.
c) Cash memos should be printed in numerical sequence.
d) Cash memos are printed in different colors for salesman at different counters.
e) When the sales man sells goods to a customer he prepares four copies of the Cash Memo. These copies are checked by the senior clerk.
f) Three copies of the cash memo are handed over to the customer and the fourth is retained by the salesman.
g) The customer should hand over three copies of the cash memos to the cashier, who alters collecting the amounts and recording it in his cash register, returns two copies to the customer duly stamp marked "cash paid".
h) So the cashier collects the amount and records it in his cash register.
i) The customer should present two copies of the cash memos at the counter where the goods purchased by him are to be delivered.
j) Here the customer will get the goods purchased by him are to be delivered to him.
k) The Clerk, at the delivery counter, checks the sales and delivers the goods to the customer and also keeps one copy of the cash memos.
l) In big business houses, the customer's copy of the cash memo may be checked by the security staff before the customer is allowed to check out of the place.
m) At the end of the day, each counter salesman, cashier and the delivery counter clerk should prepare summaries of Cash Sales.

n) The cash sales summary prepared by the cashier should be verified with the cash sales summary of each salesman and the delivery counter clerk.

o) The differences if any should be immediately enquired into.

p) If the summaries tally, accounts are certified as correct. Then it is sent to the General Manager and another copy is sent to accounts department.

q) Daily cash receipts should be deposited into the bank on the same day.

r) Where cash recording machines are used, the total cash received as shown by the machine should be checked with the amount actually banked.

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Unit 3 VERIFICATION AND VALUATION OF ASSETS

VERIFICATION

Verification means proving the correctness. One of the main works of auditor is verification of assets and liabilities. Verification is the act of assuring the correctness of value of assets and liabilities, title and their existence in the organization. An auditor should be satisfied himself about the actual existence of assets and liabilities appearing in the balance sheet is correct. if balance sheet incorporates the incorrect assets, both profit and loss account and balance sheet do not present true and fair views

DEFINITIONS

1. "Verification is the proof of accuracy of extension, footings, posting, existence and ownership of assets." - Arthur Holmes

2. "Verification of assets implies an inquiry into the value, ownership and title, existence and possession and presence of any charge on the assets." - Spicer and Pegler

OBJECTIVESS OF VERIFICATION

- **correct Valuation of Assets and Liabilities :** To ascertain whether the assets and liabilities have been shown in the Balance Sheet at their correct value, the valuation should have been made on the principles of accounting.
- **True and Fair View :** The purpose of verification is to determine the health of financial statements. After verification, the auditor can say that financial statement shows a true and fair view of the state of business affairs.
- **Existence of Assets :** The purpose of verification is to ascertain the existence of assets. The books and papers may show the existence of assets, But it may have been destroyed, sold, discarded or stolen, The verification is used to see the actual position of assets. The existence of assets is essential.
- **Ownership and Title of the Assets** :The purpose of verification is to certify ownership. The vouchers, documents, deeds, agreements and other papers can be used to note the Teal ownership. The auditor can satisfy himself that assets are really owned by the business.
- **Free of Charge :** The purpose of verification is to check that asset is free of any charge. The assets may be pledged or mortgaged for borrowing money; In this case, lenders have charge over the assets, The freeholds leasehold and mortgage property can be stated in the Balance Sheet.
- **Arithmetical Accuracy :** The purpose of verification is to note the arithmetical accuracy of the assets stated in the accounting books. The recording, posting totals, sub-totals, addition, disposal and deprecation of some sort of calculations. The auditor should examine the accuracy of whole work.
- **Verify Possession**: The purpose of verification is to see the possession of assets. The assets must be safeguarded. The responsible officers may be given a position of assets. The assets should be used only for the business. The verification can determine the actual location of assets.
- **Depreciation Plans**: The purpose of verification is to examine the deprecation plans Of Management. The assets are not the same in nature. The life of an asset is different. There is a

need to charge deprecation according to accounting principles. The auditor can note the reasonable deprecation has been charged on all assets.

AUDITOR'S POSITION AS REGARDS TO VALUATION OF ASSETS

It is not an auditor's duty to determine the-value's of various assets. It has been judicially held that he is not a valuer or a technical man to estimate the value of an asset. But he is definitely concerned with values set against the assets. He has to certify that the profit and loss account affairs shows true of profit or loss for the year and balance sheet shows a true and fair view of the state of the company at the close of the year.

Therefore he should exercise reasonable care and skill, analyses all the figures critically, inquire into the basis of valuation from the technical experts and satisfy himself that the different classes of assets have been valued in accordance with the generally accepted assumptions and accounting principles. If the market value of the assets are available i.e., in the case of share investment then he should verify the market value with the stock exchange quotations. If there is any change in the mode of the valuation of an asset, he should seek proper explanation for it. If he is satisfied with the method of valuation of the assets he is free from his liability.

VALUATION OF ASSET

Valuation of assets means determining the fair value of the assets shown in the Balance Sheet on the basis of generally accepted accounting principles. The valuation of assets is very important because over-statement or under-statement of the value of assets in the Balance sheet not only distorts the true and fair view of the financial position but also gives wrong position of profitability. The

valuation of the assets is the primary duty of the officials of the company. The auditor is required to verify whether the value ascertained is fair one or not. For this, he may rely on the technical certificate issued by the experts in the field. Valuation of assets means not only checking value of the assets owned by an organization as on Balance Sheet date, but also critical examination of the value of these assets (comparative analysis of different assets). Auditor has also to see that the principle of valuation of assets is consistently adopted

PLANT AND MACHINERY:

1. Now-a-days as per provision of Section 227(4A) of the Companies Act, 1956 every company is required to maintain a Fixed Asset Register showing full particulars including cost, location, depreciation, details of purchase, expenses capitalized, etc. Therefore, the auditor should ask for such a register maintained by the client and see that all items of plant and machinery are recorded properly giving full details.

2. As per the provision of the same section, all fixed assets are required to be physically verified by the management. Therefore, the auditor should enquire whether such physical verification was undertaken or not. If yes, he should ask for necessary papers pertaining to the same. If there is any discrepancy, reasons for the same should be asked.

3. Any new purchase made during the year are to be verified with reference to purchase invoice and other papers regarding installation of the same.

4. Total value of plant and machinery as shown by Fixed Asset Register should tally with ledger account maintained in the financial books.

5. Where any item of plant and machinery is sold, scrapped or transferred the auditor should check relevant entries for the same and verify that they are removed from the Fixed Assets Register.

6. The auditor should verify that adequate depreciation is provided on all items of plant and machinery and method of depreciation is consistently followed from year to year.

7. Auditor should see that the entire plant and machinery stands in the name of the client and are free from any charge or encumbrances. If plant and machinery is mortgaged, then he has to verify that the documents are properly executed and mention of mortgage is made in the Balance Sheet.

LAND & BUILDINGS

1. The auditor has to examine the title deeds of the property owned by the client and confirm that the same is freehold.

2. If the property has been purchased during the year, the auditor has to examine the correspondence with the broker, or solicitor in details.

3. When a building has been constructed on the freehold property, the same is to be verified from builder's bill or architect's certificate.

4. Where the title deeds are deposited with the mortgagee on a mortgage, then a certificate from him to that effect is to be obtained for verification.

5. If the title deeds are deposited with the bankers or solicitors for safe custody, the auditor should get a certificate from them to confirm the fact.

6. If required, the auditor should ask the solicitor of the client to confirm the validity of the title deeds relating to the property.

7. The auditor has to see that the conveyance of the property is in the name of the client and the same is properly registered.

8. The auditor has to ensure that the property is properly insured.

9. The auditor should see that separate account for land and building is maintained, because on land, usually no depreciation is provided.

10. In case there is appreciation of land and buildings value by revaluation, the auditor has to see the basis of revaluation and confirm that the same is properly disclosed in the Balance Sheet, to comply with the generally accepted accountancy principles and also the provision of Companies Act, 1956.

GOODWILL

1. Whenever the company has purchased or acquired a running business and has paid for it an amount, in excess of the book value of its net assets, the excess is called `Goodwill'. It can be verified from the vendor's agreement and the auditor has to see whether there is a specific sum which is paid or whether it is the excess of price paid over the tangible assets and see that it is properly recorded.

2. When the company has written up the values of all its assets on a revaluation and has raised a Goodwill Account in the books, the Goodwill appears in the Balance Sheet. In this case, the auditor has to see the basis of valuation and get satisfied about the same. If he is not satisfied, the fact should be reported to the shareholders.

3. He has to see that such excess is credited to a Capital Reserve or Revaluation Reserve and no dividend is being declared from it.

4. He has also to see the disclosure requirement of Schedule VI and ensure that the fact is disclosed for 5 years subsequent to the date of revaluation.

5. Sometimes, Goodwill which is written off earlier may be brought back in the books of account to adjust the debit balance of Profit and Loss account. In this case, the auditor should investigate the fact and satisfy in full before approving such method of creating Goodwill. He should also refer to the board resolution. In case he is not satisfied, the fact should be reported to the shareholders.

6. If Goodwill has been created by any other means, the auditor should see that all relevant facts are properly disclosed and are supported by documentary evidence.

INVESTMENTS

Investment may be a share certificate, government bond certificate, government loan certificate, debenture certificate, etc. For verification of such securities, the following procedure is adopted.

1. Obtain a schedule of investments in hand at the beginning of the audit period. Obtain the details of description of investments together with distinctive number of face value, date of purchase, book value, market value, rate of interest, date of payment of interest or, date around which dividend is declared, etc., with also the details of interest or dividend received along with tax deducted at source.

2. Add to the above list, purchase made during the year and delete the investments sold during the year with all the above details.

3. Balance this schedule and compare the balance with general ledger and Balance sheet.

4. Check the market value of investments with reference to stock exchange quotations or other suitable method, on Balance Sheet date and see that the values are disclosed in the Balance sheet.

5. Inspect the certificates or securities physically on the Balance Sheet date.

6. Compare the income received with amount due and adjust the accrued income.

7. Confirm the uncalled liability on partly paid shares held as investment shown as contingent liability by way of a note to the Balance Sheet.

8. See that adequate provision is made for any shortfall in the book value of investment shown in the Balance Sheet.

9. See that, regarding the investment in subsidiaries, disclosure requirement of section 212 of Schedule VI of the Companies Act, 1956 are complied with.

10. For investment in the capital of partnership, the partnership deed and copy of accounts of partnership firms, is to be verified. Also adjust the share of profit and loss for the partnership period.

11. Investments which stand in the name of persons other than that of the company are to be confirmed with appropriate sanction.

12. For investment lodged with others as security or lying with banks or share brokers, obtain a certificate from the parties concerned.

13. In case of application money paid for shares which are still to be allotted, that fact is to be specially disclosed in the Balance Sheet.

TRADE CREDITORS

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

2. The auditor should obtain a Schedule of creditors and verify them with the balances of ledger accounts and statements of account received from creditors.

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

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

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

6. He should examine the discount allowed to creditors during the period and see that these substantiate the credit balances.

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

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

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

BILLS PAYABLE

In case of bills payable, the auditor should follow the following verification procedure:

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

2. The bills paid after the Balance Sheet date should be examined with the entries passed in the Cashbook.
3. The auditor should obtain confirmatory statements from the drawers directly with the permission of his client.
4. He should pay special attention to the bills that have been paid between the date of the Balance Sheet and the date of his audit have been duly written in the books.

CONTINGENT LIABILITIES

1. In case of outstanding liabilities, the auditor should obtain a certificate from a responsible officer of the company stating that all expenses become payable have been brought into account.
2. He should see whether necessary provision for all the outstanding expenses have been made by checking receipts and other vouchers.
3. He should compare the expenses shown as unpaid during the current year with those of the last year and if he finds any difference, the same should be enquired into.

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UNIT 4 COMPANY AUDIT AND AUDIT OF OTHER ENTITIES

Company Auditor is **an individual appointed for preparing an independent audit report of the company**. They can be either appointed by the company's Board of Directors, Shareholders, Central Government or Comptroller and Auditor General of India (C&AG) accordingly. An individual must have expert knowledge and a practicing certificate from the Indian Institute of Chartered Accountants for becoming a company auditor.

Appointment of first auditor

Every company shall appoint first auditor who hold the office till the conclusion of first annual general meeting. This appointment is classified below for Government or Non-Government Company:

- **In Government company:**

The first auditor is appointed by Comptroller and Auditor General of India (C&AG) in case of Government Company. The time-period for the appointment of first auditor is 180 days from the commencement of every financial year.

- **In Non-Government Company:**

The first auditor is appointed by Board of Directors (BOD) within 30 days of incorporation of a company. If Board of Directors is not liable in appointment then they informs the members about their failure and after that members shall appoint first director within 90 days from the date when BOD informs the members about their failure.

Appointment of Subsequent Auditor

Every company shall appoint subsequent auditor who hold the office from the date of first annual general meeting till the conclusion of sixth annual general meeting. This appointment is classified below for Government or Non- Government Company:

In Government Company:

The subsequent auditor is appointed by C&AG within 180 days from the commencement of every financial year who shall hold the office till the conclusion of sixth annual general meeting.

In Non- Government Company:

The appointment of subsequent auditor is done by the members of a company who shall hold office till the conclusion of sixth annual general meeting. He shall be appointed in first annual general meeting.
Before the appointment of subsequent auditor, company shall take written consent from the auditor and containing a certificate.

Manner of auditor's appointment

The manner of auditors' appointment typically depends on the type of audit and the legal and regulatory requirements in a specific jurisdiction. Here are some common ways auditors are appointed:

Appointment by Shareholders:
In many publicly traded companies, shareholders have the authority to appoint auditors during the Annual General Meeting (AGM) or Extraordinary General Meeting (EGM). Shareholders may vote on the appointment of auditors or reappointment of existing auditors.

Appointment by the Board of Directors:
In some cases, especially in smaller private companies, the board of directors may appoint auditors. This is more common when there are no specific legal requirements for shareholder involvement in the appointment process.

Appointment by Regulatory Authorities:
In certain industries or jurisdictions, regulatory authorities may have the power to appoint auditors or require specific audit firms to conduct audits to ensure compliance with industry or regulatory standards.

Rotation Requirements:
Some countries and regulatory bodies have imposed mandatory audit firm rotation requirements. This means that companies are required to change their audit firm after a certain number of years, typically to maintain auditor independence and objectivity.

Tendering Process:
In some cases, companies may use a competitive tendering process to select their auditors. They invite audit firms to submit proposals, and a selection committee reviews these proposals before making a final appointment.

Audit Committee Involvement:
Many companies have audit committees composed of board members who oversee the audit process. The audit committee may recommend auditors to the board, shareholders, or regulatory authorities.

Regulatory Compliance:
Companies are often required to comply with specific regulations and standards regarding auditor appointment. These regulations may dictate the qualifications and independence requirements of auditors.

Special Purpose Audits:
For specific audits, such as forensic audits or internal audits, auditors may be appointed based on the needs of the organization or the situation at hand.

Appointment in Government Entities:
In government entities and public institutions, auditors are often appointed through a competitive process or by government officials responsible for financial oversight.
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QUALIFICATIONS

For becoming a company auditor one should have any one of the following qualifications:

1. **Chartered Accountant**

- According to Sec 141(1) of the Companies Act an individual holding a practicing certificate of being a certified chartered accountant from the ICAI (Indian Institute of Chartered Accountancy) is qualified for being an auditor of a company.
- Chartered accountancy firm where all partners are practicing in India is also qualified for being a company's auditors. However, any partner of the firm acting on behalf of their firm can work as company auditor.

2. **Confined State Auditor**
   The certificate holder issued by the law entitling him to act as a company's auditor in India holds the right to become an auditor of a company.

DUTIES OF AN AUDITOR

1. Provide an Audit Report

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.

Such an opinion of the auditor enhances the credibility of the financial statements. This is because it provides reasonable assurance from the auditor that the financial statements give a true and fair view of the company's state of affairs.

2. Make Proper Enquiry

It is the duty of every auditor to seek access to books of accounts, vouchers and other information and explanation from the company. Furthermore, an auditor can also inquire information regarding the company affairs.

3. Assist in Branch Audit

The accounts of a branch office can be audited by:

- a company's auditor
- any individual appointed as the branch auditor as per the act
- company's auditor or accountant or any competent person appointed as per the laws of the foreign country in case of a foreign branch

4. Compliance With Auditing Standards

The central government establishes the auditing standards in consultation with the ICAI and National Financial Reporting Authority (NFRA).

These standards help the auditors to examine the books of accounts effectively and with great accuracy. Thus, every auditor must comply with the established auditing standards while examining a company's books of accounts.

5. Reporting of Frauds

A company's auditor while performing his duties might encounter fraudulent situations. In such circumstances, the auditor may believe that an offence equivalent to a fraud has been committed against the company.

And such a fraud has been committed by any of the officers or the company's employees. Thus, in such situations, it is the duty of the auditor to report such matters to the central government within 60 days of his knowledge.

6. Provide Assistance in Investigation

Investigation refers to checking of specific records of a business systematically and critically.

Such an examination is conducted when a fault on the part of the company already exists and the intent of the investigation is to find out a reason and person involved in such an activity.

7. Adhere Principles of Auditing

One of the basic principles that govern an audit is confidentiality. Thus, the auditor should maintain confidentiality of information acquired while performing his duties as an auditor.

He should not disclose the client information without his prior permission. Furthermore, the auditor must be honest, sincere, impartial and free from biasness. Thus, he should exercise a high degree of integrity and objectivity while examining the company's books of accounts.

8. Provide Negative Opinion

The auditor needs to give his opinion in the auditor's report. Such an opinion can be qualified or unqualified.

An unqualified opinion is the one that concludes that the company's financial statements present its affairs fairly in almost all the important aspects.

A qualified opinion, on the other hand, concludes that the company has dealt with most of the issues except for the few ones. Under this, it is the duty of the auditor to give even an adverse opinion regarding the company's financial statements.

LIABILITIES OF AN AUDITOR

An auditor to audit the accounts of a public limited company is appointed under the provisions of the Indian Companies Act. His duties and liabilities are also laid down in this Act. If he fails to perform his duties in accordance with the provisions of the Companies Act, he is held liable. The liabilities of professional accountants broadly falls under the following heads:

I. Civil Liability

Civil Liability of an auditor arises where it is proved that certain financial losses have actually been suffered by the company and the company auditor is liable for those losses. The civil liability of a company auditor may be studied on the following lines:

(i) Liability for Negligence: Negligence means acting carelessly or failing to perform a duty enjoined upon a person. An auditor is appointed by the shareholders and he is expected to safeguard the interests of them. He is an agent of the shareholders and therefore he should exercise reasonable degree of skill and care in the performance of his duties. If he fails to do so and his client have suffered a loss due to his professional negligence, he will be held liable to make good that loss on an action being taken against him by the party.

(ii) Liability for Misfeasance: The term 'misfeasance' means breach of trust or breach of duty imposed by law or negligence in the performance of duties, which has resulted in some loss or damage to a company or its property. If the auditor does something wrongfully in the performance of his duties resulting in a financial loss to the company, he is guilty of misfeasance. For example, the duties of an auditor have been statutorily laid down in the Companies Act, 1956. If the auditor does not perform his duties properly and as a result the company suffers, he may be held liable for misfeasance. The directors, managing agents and other officials of a company may also be held liable for misfeasance.

II. Criminal Liability

Under the Companies Act, an auditor of a company may be found guilty of criminal offences if he willfully makes a false statement in any report, return, certificate or balance sheet etc.
The criminal liabilities of a company auditor under different sections of the Act are as follows:

1. **Making default in report willfully, Section 233:** If the auditor willfully makes a default in making his report to the share holders according to the provisions of Sections 227 and 229. If his default is proved wilful, he will be punishable with fine which may extend to Rs. 1,000.
2. **Not helping the Inspector, Section 240:** The auditor of a company is required to help an inspector appointed by the Central Government to investigate the affairs of the company. If the auditor does not do so he is punishable with the imprisonment upto six months or with fine upto Rs. 3,000 or with both.
3. **Not assisting the Prosecution, Section 242:** When on the basis of report submitted by an inspector, the Central Government takes action and prosecutes any person connected with the company affairs, the auditor is required to assist the prosecution. If the auditor does not do so, he is guilty of contempt of court and punishable with imprisonment upto six months or with fine up to Rs. 500 or both.
4. **In case of not returning the documents, Section 277:** In the course of winding up of a company, the auditor is required to return to the court any documents in his possession. If the auditor fails to appear before the court, he can be arrested.
5. **Public Examination by Court, Section 478:** On the application of the official Liquidator, the company auditor can be publicly examined in the High Court. The notes shall be taken down and be signed by the auditor. Such signed notes may be used in evidence against him in any civil or criminal proceedings.
6. **Falsifications in Accounts, Section 539:** If the auditor is found guilty of destruction, mutilation, alteration, falsification or secreting of any books, papers or securities, he may be held responsible. Further, if the auditor makes any false or fraudulent entry in any register, books of accounts or documents of the company, he will be liable for punishment with imprisonment up to seven years and shall also be liable to a fine.
7. **Prosecution of Auditor, Section 545:** The auditor can be prosecuted by the liquidator as an officer of the company during the course of winding up of the company, if he is found guilty of any criminal offence in relation to the company.
8. **For deliberate act of commission or omission, Section 628:** If any office (including auditor) of a company deliberately makes a statement in any return, report, certificate, balance sheet, prospectus, etc. which is false in any material respect, or deliberately omits any material fact, he shall be punishable with imprisonment for a term which may extend to 2 years, and shall also be liable to fine.

PROFESSIONAL ETHICS OF AN AUDITOR

1. Integrity
A professional accountant should be straightforward and honest in all professional and business relationships.

2. Objectivity
A professional accountant should not allow bias, conflict of interest, or undue influence of others to override professional or business judgments.

3. Professional Competence and Due Care
A professional accountant must maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation, and techniques.

Professional accountants should act diligently and by applicable technical and professional standards when providing professional services.

4. Confidentiality
A professional accountant should respect the confidentiality of information acquired from professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose it.

Confidential information acquired from professional and business relationships should not be used for the professional accountant's or third parties' advantage.

5. Professional Behavior
A professional accountant should comply with relevant laws and regulations and avoid any action that discredits the profession.

THE AUDIT PROCEDURE FOR NGO

The NGO carries out its social activities with the help of donations, and so an NGO needs to prepare the financial accounts and statements to showcase the authenticity of its performance and efforts to the general public. When an independent CA audits the accounts, it sums up its validity in the eyes of the public. The procedure for auditing is as follows:

- Auditor first checks the books with the previous data, accounts and trial balance.
- Auditor then checks the receipt and payment accounts and also the income and expenditure accounts.
- Then the auditor checks the total amount the NGO has received and its expenses. He also checks the nature of expenses.
- The auditor, at last, prepares the audit report after thoroughly verifying and checking all the financial statements.

THE AUDIT PROCEDURE FOR CHARITABLE INSTITUTION

1. In relation to subscriptions and donations, the auditor may evaluate the internal check relating to the accounting of amount collected.
2. He shall examine all the receipt books used during the period under audit and apply special care while verifying the cancelled receipts.
3. He may test check the counterfoils with cash book.
4. He should also confirm that the total amount collected in the form of subscriptions and donations, as shown by the statements, agrees with the books.
5. He should ensure that the unused receipt books are under the custody of a responsible person.
6. In the case of Legacies and grants, the auditor should examine the correspondence, minute's books and other available information.
7. While verifying the income from investment, the auditor may vouch all the receipts, and examine the schedule of investments to confirm that all income &om the investments are duly accounted. While verifying interest, the rates and calculation of interest are to be checked.
8. The rent received account is to be vouched with the counterfoils of rent receipts and counter checked with the entries in the cash book. The auditor should also examine the tenancy agreement to find out the amount of rent to be collected and the due dates, on which the rents become due.
9. The institution may organize special events, and generate income for charitable purposes. The auditor should thoroughly vouch the receipts and payments relating to such events.

THE AUDIT PROCEDURE FOR EDUCATIONAL INSTITUTION

1. That the admission fees are credited to capital fund A/c.
2. That the fines and penalties are collected after due authorization and accounted properly.
3. That a separate register is maintained for caution deposit received from students and the refund due out of caution deposit is refunded to the students.
4. That long outstanding tuition fees, hostel fees etc., are periodically reviewed and reported to the management for further action.
5. That the funds created for specific purpose are maintained separately, the investments representing such funds are kept separately and the surplus income from such funds are accumulated and invested along with the capital fund maintained for the purpose.
6. That the amounts that are refundable to the students are shown as liability in the Balance sheet.
7. That all the capital expenditure are approved by the managing committee.
8. That the internal control procedure relating to purchase of stationery, provisions, clothing and other items are effective and chances of pilferage and fraud are minimum.

The auditor may verify all the expenditure in the usual manner and examine the payment out of funds created for specific purpose thoroughly and ensure that the receipts and payments out of this funds are accounted and presented separately in the Balance Sheet.

AUDIT PROGRAMME FOR LOCAL BODIES

(i) The Local Fund Audit Wing of the State Govt. is generally in-charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc have power to appoint their own auditors for regular external audit. So the auditor should ensure his appointment.

(ii) The auditor while auditing the local bodies should report on the fairness of the contents and presentation of financial statements, the strengths and weaknesses of system of financial control, the adherence to legal and/or administrative requirements; whether value is being fully received on money spent. His objective should be to detect errors and fraud and misuse of resources.

(iii) The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.

(iv) He should ensure that all types of sanctions, either special or general, accorded by the competent authority.

(v) He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.

(vi) The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

AUDIT PROCEDURE FOR HOSPITAL

(1) Register of Patients: Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

(2) Collection of Cash: Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.

(3) Income from Investments, Rent etc: See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.

(4) Legacies and Donations: Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

(5) Reconciliation of Subscriptions: Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).

(6) Authorization and Sanctions: Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorized.

(7) Grants and TDS: Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

(8) Budgets: Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.

(9) Internal Check: Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorization.

(10) Depreciation: See that depreciation has been written off against all the assets at the appropriate rates.

(11) Registers: Inspect the bonds, share scripts, title deeds of proper ties and compare their particulars with those entered in the property and Investment Registers.

(12) Inventories: Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.

(13) Management Representation and Certificate: Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

AUDIT PROCEDURE FOR CLUB

(1) Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.

(2) Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.

(3) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.

(4) Check totals of various columns of the Register of members and tally them across.

(5) See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.

(6) Verify the internal check as regards members being charged with the price of foodstuff s and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.

(7) Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

(8) Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.

(9) Vouch purchases of foodstuff s, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.

(10) Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.

(11) Inspect the share scripts and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.

(12) Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee

AUDIT PROCEDURE FOR HOTELS

(1) Internal Controls - Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to intro duce controls which will minimize the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated.

(2) Room Sales - The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor. The source of these entries is invariably the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.

(3) Inventories - The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

(4) Fixed Assets - The accounting policies for fixed assets of individual hotels are likely to differ. However, many hotels account for certain quasi-fixed assets such as silver and cutlery on inventory basis. This can lead to confusion between each inventory items and similar assets which are accounted for on a more normal fixed assets basis. In such cases, it is important that very detailed definitions of inventory items exist and the auditor should carry out tests to ensure that the definitions have been closely followed.

(5) Casual Labor - The hotel trade operates to very large extent on casual labour. The records maintained of such wage payments are frequently inadequate. The auditor should ensure that defalcation on this account does not take place by suggest ing proper controls to the management.

(6) Other points - (i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
(ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.
(iii) The auditor should ensure that proper records re-maintained for booking of halls and other premises for special parties and recovered on the basis of the tariff.
(iv) The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.
(v) The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, where as costs of major alterations and additions to the hotel building and facilities capitalized.
(vi) The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.
(vii) The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities.

AUDIT PROCEDURE FOR COOPERATIVE SOCIETY

1. Examination of overdue debts - Overdue debts for a period from 6 months to 5 years and more than 5 years will have to be classified and shall have to be reported by an auditor. Overdue debts have far reaching consequences on the working of a credit society. It affects its working capital position. A further analysis of these overdue debts from the viewpoint of chances of recovery will have to be made, and they will have to be classified as good or bad. The auditor will have to ascertain whether proper provisions for doubtful debts are made and whether the same is satisfactory.

2. Overdue Interest - Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

3. Certification of Bad Debts - A peculiar feature regarding the writing off of the bad debts as per Maharashtra State Co-operative Rules, 1961, is very interesting to note. As per the said rules, bad debts can be written off only when they are certified as bad by the auditor. Bad debts and irrecoverable losses before being written off against Bad Debts Funds, Reserve Fund etc. should be certified as bad debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exists, the managing committee of the society must authorize the write-off.

4. Valuation of Assets and Liabilities - Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation.

5. Adherence to Co-operative Principles - The auditor will have to ascertain in general, how far the objects, for which the co-operative organization is set up, have been achieved in the course of its working. The assessment is not necessarily in terms of profits, but in terms of extending of benefits to members who have formed the society. Considered from the viewpoint of social benefits it may be looked into that how far the sales could be affected at lower prices.

6. Observations of the Provisions of the Act and Rules - An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.

7. Verification of Members' Register and examination of their pass books - Examination of entries in members pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organization to assure that the entries in the books of accounts are free from manipulation..

8. Special report to the Registrar - During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance, a special report may become necessary:

9. Audit classification of society - After a judgment of an overall performance of the society, the auditor has to award a class to the society. This judgment is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.

10. Discussion of draft audit report with managing committee - On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalized without discussion with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

AUDIT PROCEDURE FOR GOVERNAMENT INSTITUTION.

(i) Compile and submit Accounts of Union and States - The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. Financial statements as they may reasonably ask for.

(ii) General Provisions Relating to Audit - It shall be the duty of the Comptroller and Auditor General—
(a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;

(b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;

(c) to audit and report on all trading, manufacturing and profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

(iii) Audit of Receipts and Expenditure - Where anybody or authority is substantially
financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

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(iv) Audit of Grants or Loans - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organization, the Comptroller and Auditor General shall scrutinize the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

(v) Audit of Receipts of Union or States - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

(vi) Audit of Accounts of Stores and Inventory - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.

(vii) Audit of Government Companies and Corporations - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013.

UNIT 5 AUDIT REPORT AND PROFESSIONAL ETHICS

AUDIT REPORT

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

MEANING OF AUDIT REPORT

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

DEFINITION OF AUDIT REPORT

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

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

ELEMENTS OF AUDIT REPORT

1. Title of the report

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

2. Name of the Addressee

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

3. Introductory Paragraph

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

4. Scope

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

5. Opinion

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

- Whether the financial statements are arithmetically correct and correspond to the figures recorded in the books of accounts.
- In case of unqualified opinion, whether the financial statements represent a true and fair view of the state of affairs and the results of operations.
- In case of qualified opinion, if the Balance Sheet and Profit and Loss account do not present a true and fair view, the reasons for what and where is wrong.

6. Signature

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

7. Place of Signature

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

8. Date of the Report

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

TYPES OF AUDIT REPORT

The audit report may be of the following types:

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

2. Qualified Report
In qualified report the auditor believes that overall financial statements are not fairly stated. The reasons for giving Qualified Report are be as follows:
i. The books of accounts, Profit and Loss Account and the Balance Sheet do not represent the true and fair view of the state of affairs and results of the operations, due to lack of conformity with the accounting principles and statutory requirements,
ii. The auditor is not able to verify the value and existence of certain assets,
iii. The information requested by the auditor is not furnished,
iv. Proper books of account are not maintained as required by law,
v. Part of audit examination done by other auditors.

3. Adverse or Negative Report

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

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

4. Disclaimer Report

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

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

DIFFERENCES BETWEEN UNQUALIFIED, QUALIFIED DIFFERENCES BETWEEN

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

INDEPENDENT AUDITOR'S REPORT is an official opinion issued by an external or internal auditor as to the quality and accuracy of the financial statements prepared by a company. The report is a primary source of communication between the auditor and users of financial statements. The users include equity holders, lenders, creditors, and any other potential investors in the company.

PROFESSIONAL ETHICS

Professional ethics refers to the professionally accepted standards of personal and business behaviour, values, and guiding principles. It encompasses the personal, organizational, and corporate standards of behaviour expected of professionals.
Professionals and those working in acknowledged professions exercise specialist knowledge and skill.

How this knowledge should be governed when providing a service to the public can be considered a moral issue and is termed professional ethics.

Professionals can make judgments, apply their skills, and reach informed decisions in situations that the general public cannot because they have not received the relevant training.

ETHICS FOR PROFESSIONAL AUDITOR

1. Integrity
A professional accountant should be straightforward and honest in all professional and business relationships.

2. Objectivity
A professional accountant should not allow bias, conflict of interest, or undue influence of others to override professional or business judgments.

3. Professional Competence and Due Care
A professional accountant must maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation, and techniques.
Professional accountants should act diligently and by applicable technical and professional standards when providing professional services.

4. Confidentiality
A professional accountant should respect the confidentiality of information acquired from professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose it.
Confidential information acquired from professional and business relationships should not be used for the professional accountant's or third parties' advantage.

5. Professional Behaviour
A professional accountant should comply with relevant laws and regulations and avoid any action that discredits the profession.

CODE OF ETHICS FOR PROFESSIONAL AUDITOR

1. The Self-interest Threat

Self-interest threat occurs when a firm, network firm, or an assurance team member could benefit from a financial interest in or other self-interest conflicts with an assurance client.

2. The Self-review Threat

Self-review threat occurs when any product or judgment of a previous assurance engagement or non-assurance engagement needs to be re-evaluated in reaching conclusions on the assurance engagement; or a member of the assurance team was previously a director or officer of the assurance client or was an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement.

3. The Advocacy Threat

Advocacy threat occurs when a firm, a member of the assurance team, or a member of the network firm, as applicable, promotes or may be perceived to promote an assurance client's position or opinion to the point that objectivity may or may be perceived to be, compromised.

Such might be the case if a firm or an assurance team member were to subordinate their judgment to that of the client.

4. The Familiarity or Trust Threat

Familiarity threat occurs when a close relationship with an assurance client, its directors, officers, or employees, a firm, or a member of the assurance team or network firm, as applicable, becomes too sympathetic to the client's interests.

5. The Intimidation Threat

Intimidation threat occurs when a member of the assurance team may be deterred from acting objectively and exercising professional scepticism by threats, whether actual or perceived, from the directors, officers, or employees of an assurance client.

6. Safeguards

The auditor's responsibility is to ensure that they remain independent of the client entity.When no effective safeguards are available to reduce the threats to an acceptable level, the only possible actions are to eliminate the activities or interest creating the threat or to refuse to accept or continue the assurance engagement.

In assessing threats to independence and the possible safeguards to mitigate or eliminate these threats, auditors are required at all times to consider what is in the public interest.

It is also important to note that adopting certain safeguards may not address "independence in appearance."

FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS

1. Integrity
A professional accountant should be straightforward and honest in all professional and business relationships.

2. Objectivity
A professional accountant should not allow bias, conflict of interest, or undue influence of others to override professional or business judgments.

3. Professional Competence and Due Care
A professional accountant must maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation, and techniques.
Professional accountants should act diligently and by applicable technical and professional standards when providing professional services.

4. Confidentiality
A professional accountant should respect the confidentiality of information acquired from professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose it.
Confidential information acquired from professional and business relationships should not be used for the professional accountant's or third parties' advantage.

5. Professional Behaviour
A professional accountant should comply with relevant laws and regulations and avoid any action that discredits the profession.

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