Biyani's Think Tank

Concept based notes

THEORY & PRACTICE OF AUDITING (B.COM PART-III)

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Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concepts of the topics. The book is self-explanatory and adopts the “Teach Yourself” style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the readers for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director* (*Acad.*) Biyani Group of Colleges, who are the backbones and main concept provider and also have been constant source of motivation throughout this Endeavour. They played an active role in coordinating the various stages of this Endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

Author

SYLLABUS

Part-I : THEORY & PRACTICE OF AUDITING

Min. Pass marks : 36 3 Hrs. duration Max. Marks : 100

Section-A

1. **Auditing :** Meaning, Objects, Fraud, errors : Book-keeping, Accounting and Auditing; Classification of audits; Planning and procedure of audit; Audit programmes; Auditor's working papers, Test checking; Routine checking.
2. **Internal control :** meaning, objective and evaluation of internal control; internal check and internal audit; Internal control regarding sales, purchases, assets, liabilities and salaries and wages; vouching.
3. **Verification and valuation of assets and liabilities;** Rules laid down in Kingston Cotton Mills Co. Ltd. (1896); Irish Woolen Co. Ltd. (1901); Westminister Road Construction & Engineering Ltd. (1941) and Thomas Gerard and Sons Ltd. (1967).

Section-B

1. Audit of sole proprietorship and partnership concerns. Educational institutions, Cinemas, Clubs and Hospitals.
2. **Audit of joint stock companies :** Appointment, removal and remuneration of company auditor; Audit of share capital, debentures and mangerial remuneration, Audit for the purpose of Statutory Report and Prospectus; Audit of Government Companies with reference to Section 619 to the companies Act, 1956.

Section-C

1. Rights, duties and liabilities of an auditor and Rules laid down in London and General Bank Case (1895); Hedley yrne and Co. Ltd. v/s Heller and Partners Ltd. (1863); CIT v/s G.M. Dandekar (1952); Anupam Roy v/s P.K. Mukherjee (1956).
2. Divisible profits including audit of Reserves and Provisions.
3. Audit Reports and Audit Certificates.
4. **Investigation :** Meaning, objectives procedure; Investiation on behalf of perspective purchaser of business, banker and prospective investor.
5. **Cost Audit :** Meaning, Nature, Objective, Scope and types of cost audit.

Section –A

Auditing

Q. 1 Explain in brief meaning and objects of audit.
Ans

(i) Audit is critical and comparative examination of books of accounts, records, and statements.
(ii) It is done by on Independent agency.
(iii) It is done with the help of relative documentary evidences (vouchers)
(iv) It is done to ascertain true and fair view of affairs /financial position of organization.
(v) This examination is done on a particular data and certifying the financial position on this date.
(vi) Making a report on findings of audit to the management of a company (To all stake holders thorough AGM)

<u>Objective of Audit</u>

1. To ascertain and certify true and fare financial position and business.
2. **<u>To detect errors</u>**
   - Errors of omission.
   - Errors of Commission.
   - Errors of Duplication
   - Compensatory errors.
   - Errors of Principles
3. **<u>To detect Frauds</u>**
   - Mis appropriation of cash
   - Mis appropriation of goods, assets.
   - Manipulation of accounts
4. To avoid recurrence of errors and frauds.
5. Offering suggestions to the management.

<u>True and fare view means</u>:

- No over or under valuation of assets.
- No material asset or liability has been left out.
- No charge on assets.

- B/S has been prepared as per provisions of companies Act.
- Accounting policies has been followed uniformly.
- Contingent/exceptional/non-recurring items have been shown separately in financial statements.

Q.2 Differentiate between an error & fraud.

Ans

Difference between an error and fraud

	Point of Diff.	**Error**	**Fraud**
1.	knowledge	No knowledge	Done with full knowledge
2.	Intention	No Intention	Done with specific intention
3.	Planning & Implementation	No Planning is required.	Specific planning and careful Implementation
4.	Result	Not known	Result is always predicted/ planned
5.	Detection	Easy	Difficult
6.	Offence & penalty	Not an offence only civil liability can be imposed	It is offence and punishable under I.P.C.

Q.3 Explain in brief classification of audit & kinds of audit.

Ans

Classification /kinds of Audit

Depending upon the nature and scope, audit may be classified as

(i) Private Audit: - Where organization gets its accounts audited by a person under an agreement. It is optional and qualification of auditor and his responsibilities are not prescribed by law.

(ii) Statutory Audit: - Where getting accounts audited is statutory or compulsory under law e.g. audit of a company, trust, bank etc. There, qualifications duties and responsibilities and the appointment of auditor is as per law.

(iii) Government audit:- Audit of govt. departments and organizations. The highest authority is comptroller & Auditor General of India appointed by President of India. He has different units under him for auditing govt. accounts. In each state there is office of Accountant General for this purpose.

(iv) Local Fund Audit Dept. which conducts audits of Panchayat Samities,Gram Panchayat & Municipal Boards.

While practically conducting audit, we may classify audit in different kinds such as:-

(i)	Complete Audits	**(vii)**	Partial Audit
(ii)	Continuous Audits	**(viii)**	Periodical Audit
(iii)	Interim Audit	**(ix)**	Internal Audit
(iv)	Efficiency Audit	**(x)**	Propriety Audit
(v)	Performance Audit	**(xi)**	Cost Audit
(vi)	Social Audit		

(1) **Complete Audit: -** When accounts are fully or completely examined by the auditor, it is called complete audit. This examination may be six monthly or annual.

(2) **Partial Audit: -**When only part of accounts of a business concerned are examined. This partial examination may be period wise or portion of accounts e.g. only cash transactions.

(3) **Continuous or Concurrent Audit: -** When auditor visits the client at certain intervals or daily and completes, the checking of account up to his date of visit, it is known as continuous audit. In big organizations, auditor deploys his staff permanently and audit work continues nonstop. This is most common in large/ big business houses/undertakings as volume of examination is quite large.

(4) **Periodical Audit: -** When audit is conducted at end after final accounts are ready and this process continues till completion of audit, it is known as periodical audit. It is also known as final audit and balance sheet audit.

(5) **Interim Audit: -** Complete audit for an interim period say six months or a quarter for a specific purpose is known as interim audit. At times, it is conducted for declaring interim dividend.

(6) **Internal Audit: -** Audit done by persons specifically appointed to check the accounts by internal person so that least possible errors/mistakes are observed by statutory/external auditor. This audit also aims at helping management in taking key management decisions.

(7) **Efficiency Audit :-** Checking of efficiency of organization which is achieved by:

- Optimum utilization of all available resources (financial, human, material, technological).

- Enhancement in profit
- Reduction in cost without compromising on quality.

(8) **Propriety Audit:-** Checking of propriety of decisions taken by the management i.e. decision has been taken wisely, taken in good faith and decision taken leads to economy in expenditure.

(9) **Performance Audit: -** Means audit of actual performances of the business organization with reference to predetermined targets and costs involved. Big business houses are also preparing performance budget.

(10) **Cost Audit: -** Refers to audit which aims at ascertaining and ensuring that cost of the unit has been correctly worked out. Such audit has been made compulsory in items of mass public consumption such as bread, cycle etc.

(11) **Social Audit: -** Audit which evaluates social good to the society in general. It is generally resorted to examination of those schemes which has been started for common social uplift ment of poor. Recently Rajasthan govt. has started "Social Audit" of National Employment Guarantee Scheme commonly known as **"NAREGA"**

Q.4 What are advantages and limitations of Audit?

Ans

Advantages of Audit :-

1. Reliability and Credibility of accounts improve.
2. It leads to better discipline in staff due to audit fear.
3. Irregularities/errors/frauds are exposed and their rectification is possible.
4. True and fare view of financial position emerges.
5. Audit acts as a watchdog for investors.
6. Proves honesty and sincerity of organization- image building.
7. Audited accounts are helpful for assessment of taxes.

Limitations of Audit

1. Audit does not guarantee 100% correctness of accounts as it is done on test checking basis.
2. Many frauds done intelligently may remain undetected
3. Opinion expressed by the auditor may not be 100% correct.
4. Independence of an auditor is difficult as his appointment and remuneration are fixed by company.

5. Auditor does not see petty transactions and there may be chances of some manipulations in such transactions.

Q.5 How you would proceed for conducting audit?

Ans **Planning & Procedure of Audit & Audit Programme.**

Before starting audit, auditor has to prepare a complete plan of audit work to be done. If present audit is second or third audit of an organization, he has to refer his earlier audit working papers. If it is first audit of a company or organization, he shall have to collect information about following:-

1. **Scope of work:-** Quantum of work to be done in the light of terms of appointment and provisions of law, articles of association/ bye laws.
2. **Information about Organization:-** in respect of the following :-
   - Technical features of business, manufacturing, trading, fixed and current assets etc.
   - Accounting system followed
   - List of books being maintained and guidelines of AAS-20
   - Internal control system (internal check and internal audit.)
   - Staffing pattern and division of work amongst staff.
   - Acquire copy of bye-laws or articles of association.
3. **Other Information :-**
   - Type of audit whether if would be final audit or continuous audit.
   - Span of time allotted for completing audit and remuneration for audit.

Q.6 What do you understand by Audit Programme?

Ans **Audit Program :-**

After getting full knowledge of business, auditor has to prepare his work plan or audit programme. It is a predetermined flexible plan which functions as a guideline for audit. Audit Programmers consists of:-

- Out line of work to the done.
- Time to be allotted to each audit staff for completing work.
- Assignment of work to staff looking to their experiences and capability.
- Scope of audit work and guide lines to control audit clerks/staff.

The crucial aspect of audit program is to determine as to:-

- Who will do which work
- In how much time
- In what manner

A good audit program should be

(i) Flexible -may be changed when need arises.
(ii) Clarity in dividing work amongst staff.
(iii) Proper classification/ assignment of work amongst audit staff.
(iv) Logical flow of checking
(v) Per iodic review of program
(vi) Proper monitoring of Progress.

Advantage of Audit Program

(i) Quality of audit improves as division of work as per ability of employee's
(ii) Determining responsibility is easy
(iii) Review of progress is easy.
(iv) It ensures complete examination as planned
(v) It ensures timely completion of audit.

Q.7 Explain various steps in conducting audit.

Ans

Starting of audit: - After preparing programme auditor asks employer/organization to keep ready following:-

- Vouchers in proper file in agreement with account books.
- Completion of preliminary books and ledgers
- Trial balances and final accounts
- List of debtors & creditors and doubtful debts.
- list of investments
- schedule of closing stock
- adjustments made in accounts
- schedule of fixed assets
- details of management

After asking for getting above ready, auditor sends audit staff to start audit work. This work starts with routine checking which includes.

-Checking of casts/carry forwards, checking of trial balance, with ledgers and ensure that correct balances have been taken in to trial balance.

This routine checking ensures arithmetical correctness of account books as well as trial balances. Form trial balances, checking of trading and manufacturing accounts, profit and loss account and balance sheet is done.

Test checking:-Auditor generally resorts to test checking which means checking of sample transactions out of all if these transactions checked in sample are found in order, it is presumed that other transactions which did not form part of sample world also the correct. Auditor resorts to test checking at his own responsibility. .

Auditor's working papers /notes: - Are personal papers which are prepared with regards to audit and information he received from his employer/organization with reference to accounts and other related aspects. A complete file is maintained in which auditor keeps all relevant paper such as:-

- Agreement of appointment
- Audit programme
- Statements , information, certificates received in connection with audit
- Copy of bye-law/articles of association
- Copy of minutes of important decisions
- list of missing vouchers
- irregularities/ deserepenceis/ errors & frauds noticed during audit
- Important points observed during vouching/verification of assets/valuation of assets
- key points for discussions with management
- copy of audit report

The working papers/notes are of immense help to the auditor to defend/protect him

Case Study No. 1

On Errors and adjustment entries

You have been appointed as a statutory auditor of the company for the year 2011-12 under Indian Companies Act. The profit & Loss Account and Balance Sheet supplied to your for certification were showing a net profit of Rs. 10 lakhs. During the course of audit, following were your observations.

1. Overvaluation of stock amounting to Rs. 1 lakh was there for obsolete goods which were valued at cost price while their realizable value was much loss.

2. There was a prepaid insurance for 3 months Rs,2000/-

3. Salary to staff for march 2012 amounting to Rs. 25000/- was paid in April 2012.

4. Interest payable to bank Rs.20000/- up to 31.03.12 was not paid.

5. An amount of Rs. 50000/- spent on a concrete platform for installation of machinery was debited to repairs.

6. An amount paid to creditor 'A' was debited to 'B''s account Rs. 20000/-

7. An amount of Rs. 10000/- earned as dividend on shares was credited in bank account on 31.03.12 but was not taken in to account in final accounts.

1. Explain the nature of mistake and how such mistake can be rectified?

2. What would be the correct amount of net profit you would like to certify?

Item-2

Internal Control

Q.1 What do you understand by internal control?

Ans **Meaning: -** Internal control refers to controlling all functions/activities of a business in such a way so as to ensure:-

- Maximizing profit
- Smooth conduct of business
- Reduce possibilities of errors, frauds, embezzlements.
- Easy rectification on detection.

According to W.W. Bigg Internal control is best regarded as indicating whole spectrum of control, financial or otherwise established for the conduct of business including internal check, internal audit and other forms of control

Objective:-

(i) Correct accounting of transaction
(ii) Prevention of errors, frauds.
(iii) Fixing responsibilities/creating responsibility centers.
(iv) Safety of assets.
(v) Efficient utilization of all resources
(vi) overall improvement in performance/Internal Control can be divided in to :-
(1) Internal check
(2) Internal audit

Q.2 Explain in brief Internal Checking & Internal Audit.

Ans **Internal check: -** Under internal check, accounting of each transaction is divided in two different segments and accounting of each segment is performed by a different person. Hence, accounting activity of each transaction passes through several hands and work done by one man is examined by second and the work of second by third person in an automatic way. As per "De Paula" -An internal check means practically a Continues internal audit carried on by the staff itself by means of which work of each individual is independently checked by other members of staff."

Objects of Internal check /Advantages :

(i) Prevention of errors and frauds.
(ii) Easy discovery of errors and fraud & their timely rectification.
(iii) Easy fixing responsibility of each staff member
(iv) Ensuring correct recording /accounting of transactions
(v) Facilitating :
- Fast preparation of final accounts
- Smooth audit.

(vi) Making employees cautious and honest.

Limitations/ Disadvantages.

(i) System is expensive as more staff is required.
(ii) Fraud's through collusion of staff are possible
(iii) If auditor relies more on internal check, test checks, the quality of audit may become unsatisfactory.
(iv) Owners may become careless.

If internal, check system is adopted with due care and diligence and periodically reviewed, above limitation of internal check can be overcome easily.

Internal Audit:- It is audit by internal staff of organization "Internal auditing is the independent appraisal activity within an organization for the review of accounting, financial and other operations as the basis for productive and constructive services to management .In is conducted by regular employees of a business concern" This audit has to ensure that there are proper arrangements for accounting and security of assets.
In case of large scale enterprises, such internal audit has become almost a necessity by a qualified auditor .The companies Act also provide that audit has to make a mention in his audit report whether proper arrangements were there for internal audit in case of big companies with paid up share capital of Rs. 25 lakhs and more. So govt. also wants to promote internal audit.

Objects :-

(i) To check/ensure that internal check arrangements are working properly.
(ii) Discovering errors/frauds and preventing their recurrence.
(iii) Facilitate statutory audit.
(vi) Reviewing systems and procedures and suggest improvements in them.
(v) Reviewing performance of employees departments, internal check arrangement and to offer suggestions.
(vi) To work as an aid to management to make the organization efficient and effective.

Internal auditor should submit periodical reports for implementation to remove flaws and loopholes.

Difference between Internal Check & Internal Audit

Basis of Difference	Internal Check	Internal Audit
1- Nature of Job	System of recording transaction	Checking of Transaction
2- Discloser of errors & Frauds	During the course of recording	After recording of Transaction
3- Time	It is a continues process	Do
4- Type of Function	Operative function	Advisory function
5- Persons involved	Same Staff	Separate Staff
6- Purpose	Smooth & correct recording of transaction	To ensure that accounts summarized are free from errors & frauds and they reflect true & fair view of organization.
7- Process / nature	Continues process of recording transaction in books	More suggestive in nature

If internal check arrangements are efficiently arranged and internal audit has also been done by a qualified staff under him, if would greatly facilitate the work of statutory audit. However, the extent to which a statutory auditor has to rely on internal audit would be a decision to be taken by statutory auditor.

Limitations of Internal Audit:-

(i) Lack of independence in audit

(ii) At times, they develop intimacy with staff which adversely affects quality of audit.

Q.3 Explain in brief internal check system to the followed for purchases, credit sales, cash receipts/payments; wages/salaries.

Ans **Internal Check System for Purchase: -** The main responsibility is with purchase department which has to ensure:

- Purchase of goods of best quality
- At lowest possible price
- Error free recording of purchases

In addition to purchase dept, other departments involved are:

- Stores dept.
- Material Inspection Dept.
- Accounts Dept.

Following Process are there regarding purchased

(i) Estimation of requirement of Goods to be purchased

- Store keeper collect requisition of purchase from different departments
- Compiles the requirements
- Assess total quality of diff errant goods to be purchased
- Placing purchase requisition to purchase dept.

(ii) Placing orders for supply of Goods :-

Main responsibility is that of purchase dept. Before placing order, it has to:-

- Get quotations from different suppliers
- Compilation of rates.
- Checking of rates and quality of goods
- Approval of quotations
- Placing order as per requisition slips received from stores dept.

(iii)**Receiving of Goods :-** When ordered goods are received ,following steps are to be taken.

- Entry in goods inwards book on main gate.

- Sending the goods to stores where goods are checked (counting, measuring, weight etc.)
- Stores dept. prepares goods received note and sends it to purchase dept. and to accounts dept.

(iv)**<u>Checking the invoice and making payment</u>: -** The accounts dept would check order placed, good receipt note, check prices in invoice and finally on reconciliation of all these documents, make payment and records the transaction in purchase book.

In this whole process following departments are involved which are performing specific functions regarding purchases.

- Preparation of requisition slips by heads of all depts.
- Taking quotations for supply by purchase dept.-placing order.
- Receipt and inspection of goods by stores dept.
- Passing of invoices after checking by accounts dept.
- Making payment to suppliers another officer in accounts dept. is involved

In case above system of internal check is followed, there are very less chances of errors & fraud's in making purchase.

<u>Internal Check regarding Credit Sales</u>

(i) <u>Receiving sales order</u>:- orders are received in sales dept. they should be recorded in order received book in which particulars of order i.e date of order, quantity of goods, customer's name etc. are recorded. After approval of officer of sales dept., two copies of order are prepared and one copy sent to dispatch dept.

(ii) <u>Dispatch of Goods</u>:- On receiving copy of order , officer in charge of this dept. issues instructions for collecting packing and dispatching goods with a copy to stores dept. for necessary action. Stores dept. makes available goods to dispatch dept. which adds its packing /dispatch cost in the copy of order which is sent to Invoice clerk.

(iii)<u>Dispatch of invoice</u> :- Invoice clerk prepares invoice in 3 copies out of which original copy is sent to costumer, one copy to sales dept. and one to accounts dept.

(iv) <u>Accounts of sales & receiving payment</u> :- This transaction is recoded in sales book as per invoice in accounts dept. This sales book is not maintained in sales dept. Amount to be received is handled by another officer.

Store officer/clerk of sales dept. dispatch stores and accounts dept. is involved who work in such a way that chances of any error/fraud are minimized.
In the same way, treatment of sales return from customer is accounted
Separate staff gets information of sales return, preparation of credit note and accounting entries of credit not issued.

<u>Internal check regarding cash receipts/payment</u>

<u>Cash Receipts -</u>

<u>General Principles:-</u>

- Handling of cash and maintenance of cash book by two different persons.
- Cash received through mail/post in the form of cash/cheques /D.D/ bill of exchange should recorded in mail Receipt Register and instruments should be crossed immediately.
- Cash received should be recorded in cash book the same day.
- Cash receipts should be acknowledged by a printed receipts to be signed by authorized officer.
- Un used receipt books should be kept safe in the custody of senior officer
- For reconciling cash with bank, bank reconciliation statement should be prepared frequently.

<u>Cash Payments:-</u>

- Cashier should not have power of sanctioning payment even of small amount.
- All cash payments should be properly authorized.
- All payments be made by cheque as far as possible and cheque signing authority should be different.
- Cheque issued should always be crossed.
- For petty cash payment, a separate petty cash book needs to be maintained.

Payment of Wages/Salaries:

Internal check system with regard to payment of salary and wages should ensure that:-

- Salary & wages which are due have been paid
- Proper record of attendance/time has been prepared.
- Payment has been made as per rates decided.
- No unauthorized deduction has been made from the salary/wages
- Acknowledgement by the receiver is there.
- In case of payment to another person, proper authority of the original person should be there.
- Proper account of advance payment need to be kept.
- Separate account need to be kept for salaries and wages as accounting heads would be different .This is more relevant when cost accounts are prepared.

Vouching

Q.4 What do you mean by vouching? What are its key objectives?

Ans Vouching is process in which entries recorded in book are checked with their relative documentary evidences.

"Vouching means testing the truth of items appearing in the books of original entry" **(J.R.BATLIHOR)**

"Vouching is a technical term which refers to the inspection of documentary evidences supporting Transactions" (Arnold A Irish)

Vouching is considered as an essence of audit. It is most important aspect of audit work in which all the entries in original books are checked will reference to their supporting documentary evidences. It this work is done intelligently/carefully, around 50% of audit work is deemed to have been completed.

VOUCHERS:-

Vouchers are of two types :-

(i) **Original Voucher -:** Original written documentary evidence such as invoice received from supplier is original voucher for credit purchase.

(ii) **Collateral or supplementary voucher: -** There are vouchers which further confirm the correctness of original voucher e.g. transportation, /loading,/unloading charges are collateral vouchers which further justify the truthness of original voucher of purchases i.e. invoice.

Auditor in the process of vouching should see both the vouchers i.e. original as well as collateral

If collateral vouchers are not there, doubt is created about the correctness/truthness of original voucher.

Key objects of Vouching

To ensure that all vouchers are:-

- Properly authorized by competent person/authority
- Properly recorded in relevant book, in right head and right side
- Vouchers are Genuine/ bonafide which means that :-
  - They relate to business
  - Relate to accounting /audit period
  - They are on printed form
  - Amount in words and figures reconciles
  - Calculation in voucher is correct.

Q.5 What key points should be kept in mind which vouching?

Ans Main point to be kept in mind while vouching :

1. All vouchers are serially numbered and are properly arranged in a file.
2. Date of voucher and date of entry in books to be checked.
3. Vouchers checked must be initialed by auditor to avoid there re-production.
4. Vouchers in the name of officers/staff should be minutely checked.
5. Correct recording of voucher in capital and revenue head should be seen.
6. Duplicate vouchers should be checked carefully
7. Missing vouchers should be noted
8. Receipted invoices should not be treated as vouchers.
9. Auditor should not take the help of staff of organization while checking receipt books

10. In the vouchers pertaining to rent /taxes, insurance etc., period of payment should be seen as amount paid may be pre-paid or if may be out standing on the closing date i.e. 31^{st} March.

All above points are to be kept in mind while vouching original books of accounts such cash book, purchase book, sales book, and other subsidiary book

Case Study No. 2

On Internal Check & Internal Audit

You have been appointed as statutory auditor of big company for conducting audit for the year 2011-12. The actual turnover of the company is heavy and you have been asked to complete audit within 2 months. You do not have supporting hands with you to help you in expediting audit work. In such a situation you relied on internal check arrangements in the company and at the end you came to know that internal check system was faulty. Similarly, you relied on internal audit and left many thinks from checking which were seen by internal auditor. In the hurry to complete audit, you also relied heavily on test checking but many discrepancies were noticed in items which remained out of your test checking in this above situation:

1. To what extent you can be held responsible for negligence for relying on internal check and internal audit?

2. What would be your liability for items left out of test checking?

SECTION –A
(UNIT-3)

Q.1 What do you understand by verification and valuation of assets & liabilities?

Ans **Verification and Valuation of Assets & Liabilities**

In the process of certifying that balance sheet shows true and fair view of financial position ,auditor has to verify all items appearing in the balance sheet .The correctness of P&L & B/S greatly depends upon correctness of assets and liabilities appearing in B/S This process of checking of assets and liabilities is known as verification.

According to spicier & Pegler "The verification of assets implies an enquiry in to the value, ownership & title, existence & possession and presence of any charge on the asset. Hence the process of verification includes –the following:-

1. Reconciling balance of asset/liability shown in B/S with relevant books.
2. See physical existence of asset on the date of B/S
3. Assets are owned by the organization and are in its possession.
4. Assets have been acquired for business.
5. Assets are free from any charge other than which has been shown in B/S.
6. They have been shown on proper value in B/S

While verifying liabilities auditor has to satisfy himself that

(i) All liabilities have been recorded in the balance sheet
(ii) They are related to the business
(iii) They are fully authorized &
(iv) They have been correctly valued

Which verifying assets & liabilities, auditor has to keep in mind following precautions.

(i) Fraudulent pledging of shares & securities.
(ii) Substitution of assets.
(iii) Un due inflation in value or creating fictitious assets in B/S.

Valuation: Valuation is an essential part of verification which means enquiry in to the true and faire value of asset shown in the B/S. For this purpose, different types of assets are valued on different prices. Brief details of different prices are given below:-

(i) **Cost price: -** Price at which purchased. However in case of fixed assets, all direct expanses on these assets are included in cost price.

(ii) **Market price :-** Price prevalent in market

(iii) **Book value :-** Value shown in books

(iv) **Realizable value-:-** value which can be realized on selling the asset.

(v) **Replacement value: -** Amount involved in replacing as asset.

(vi) **Going concern value:-** Also known as use value which means original cost less depreciation.

Q.2 How different types of assets are valued?

Ans

Different Types of Assets and their Valuation

Types of Assests	Specific features	Valuation Method
1- Fixed Assets	Acquired for permanent use in business & not for sale e.g. land, building, furniture, fixtures, plant & machinery etc.	Going concern value
2- Floating Assets	Assets in which business deals & purchased for re-sale e.g. raw material, work in progress, finished products, bills receivables, debtors etc.	Goods are valued at cost or market price whichever is less. Debtors & B.R. on book value less provision for bad & doubtful debts
3- Wasting Assets	Are assets which exhaust due to depletion e.g. mines , quarries , oil wells, etc.	Cost price less nominal depreciation
4- Intangible Assets	Assets which are not legible & does not have a form or shape e.g goodwill, patent , copyright, etc.	Goodwill on cost price, patent & copywright as per fixed assets

5- Fictitious Assets	They are not assets but shown in assets side till written of from P&L & B/S e.g. preliminary expenses , loss , commission on issue of shares/ debentures.	Written down value.

Q.3 What is the legal position of an auditor regarding verification and valuation of assets? Support your answer with leading case laws in this regard.

Ans **Auditor's position about valuation of assets**

1. Auditor is not valuer – valuation is the job of management.
2. Auditor has to enquire about fairness of valuation which is primarily done by the management. However he has to see available evidence, can seek advice of specialist, see that valuation has been done according to applicable rules/norms & certificate from officers.
3. **Any Suspicion about valuation need to be mentioned in the audit report.**

Keeping in view above guidelines auditor should move to verification & valuation of different assets such as investment in shares &securities, debtors, fixed assets, closing stock which may consists of raw material, work in progress and finished products.

Rules laid down in leading cases as regards verification and valuation of assets & liabilities by auditor.

Name of the case :- Kingston cotton Mills-1896

Facts of the case :- This mill was indulging in fraud for several years during 1890 to 1893. In the head of closing stock in B/S, it was mentioned that "Closing stock as per manager's certificate". Auditor did not examine the correctness of the stock. Due to overvaluation of stock, fictitious profit was created and as a result dividend was also distributed on the inflated profit .A case was filed against the auditor for non performing the duty with care and caution and auditor should indemnity the company for improper disbursement of dividend .

Decision/judgment - It is not the duty of auditor to count the stock. In this case he relied on the certificate of manager who is a trusted and tried servant of the company. Auditor need to be care full if there is a suspicion. However, auditor is expected to work with reasonable skill and care.

Rules for auditor: - Without any reason for suspicion auditor cannot be made liable for not tracing out ingenious and carefully laid schemes of fraud perpetrates by a tried servant of the company.

Name of case: - Irish Woolen Co. 1900

Facts of the case: - Goods purchased on credit were includes in stock while entry of invoices were not made. As a result stock was inflated and liabilities were suppressed. Adequate provision for bad debts was also not made. Due to this profit was inflated and dividend was paid out of capital for which auditor was accused for negligence.

Judgment: - For under valuation of liabilities, auditor was held liable as it could have been detected in the process of getting confirmation from creditors . For overvaluation /inflation of stock, auditor is not liable as auditor is not expected to take stock.

-Auditor cannot be held liable for not providing adequate provision for bad debts.

Rules for Auditor :-

1- It is not the duty of auditor to take stock

2- If the auditor is incapable to discover concealment of invoices, he is guilty of negligence.

3- Auditor does not insure himself against errors and frauds which mean that he has to try his level best to detect errors and frauds during audit.

Name of Case: - Westminster Road construction & Engineering co.1932

Facts of the Case: - liquidator of the company filed a suit against directors and auditor for recovering of dividend paid as dividend was paid out of fictitiou profit as a result of overvaluation of stock and undervaluation/suppressing liabilities

Judgment: Auditor is guilty of misfeasance if he fails to detect omission in liabilities. He was also held guilty for not detecting overvaluation of stock (work in progress)

Rules for Auditor: - Auditor has to ensure that all liabilities have been included in the B/S and with the help of relevant vouchers, he has to check/ensure that work-in –progress has not be overvalued.

Name of the case: -**Commission of Income Tax V/S G.M.Dandekar-1952**

Facts of the case :-Sh. G.M.Dandekar C.A. audited the accounts of A. Mohd. & Co. and besides audit, also filled income tax return or behalf of his customer. A Mohd.& Co. used to maintain two sets of accounts one for regular and other for black money transaction. Black money sale was used to be recorded in dispatch books which were not shown to the auditor. Income tax commission lodged a complaint against G.M. Dhandekar holding him guilty of gross negligence and asked for strucking off his name form the membership of Institute of Charted Accountants India.

The discipline committed of the ICAI found Mr.Dandekar quility.

Judgment of Madras High court

This matter was heard by Madras High Court under section-9 of ICA 1 schedule and held that G.M.Dandikar was not guilty of professional misconduct and he cannot be disqualified from the membership of ICAI.

Rules :-Auditor is not liable to third party

C.A in this case represented as a lawyer in civil case.

Case Study No. 3

On Verification and Valuation of Assets & Liabilities

A company of which you are working as a statutory auditor has borrowed Rs. 1 crore from Punjab National Bank. Interest payable at the yearend i.e. 31.03.12 is Rs.25 lakhs. Bank has also given notice that on the overdue loan, penal interest of Rs. 10 lakh would also be payable by the company. This company has made on application to the Punjab National Bank for rescheduling the loan & waiver of part of interest. This application is still pending with the bank & in the hope of interest waiver, provision for payable interest has not been provided by the company.

You are at the stage of finalizing audit report and position regarding this rescheduling and interest waiver is still in suspense. How you would deal this issue and what comments you would make in audit report in this regard?

SECTION –B (Item-1)

AUDIT OF SOLE PROPRIETORSHIP

Q.1 What important points should be kept in mind while conducting audit of a sole proprietor, partnership firm?

Ans This audit comes under the category of private as no act makes it obligatory for a sole proprietor to get its accounts audited. He can go for audit if he feels that there are many advantages of getting accounts audited.

The business with only one proprietor is called sole proprietorship or sole trader. Generally the size of such business is small and it is managed by owner with family member or with limited member of employees. However, if the number of employees is more, the owner can think of audit to keep control/check on staff.
In brief features of such audit are given below:

(i) **Nature of audit: -** is optional as there is no legal binding for audit.
(ii) **Scope of audit: -** would depend upon the agreement between owner & auditor.
(iii) Appointment, remuneration, removal of auditor would depend upon the wishes of owner.
(iv) Rights, duties, liabilities of auditor would depend upon the terms and conditions of agreement between owner and auditor as no statute comes in between.
(v) Audit methodology and submission of audit would depend upon scope of audit and agreement between owner and auditor.
(vi) Audit certificate: - At the end of audit the format/language of audit certificate would depend upon object of audit and scope of audit.

Audit of Partnership Firm

The scope of business in case of a partnership firm is larger than a sole trader. The scope of audit work is determined by an agreement as audit of a partnership firm is not obligatory under any act. However, partner may agree for audit in the partnership deed executed and signed by all partners. If such agreement provides for audit, auditor has to see such agreement for the scope of audit and his rights, duties & powers. However, audit should see following aspects with reference to audit work.

1. **Determination of scope of work** and his rights, duties, remuneration, audit certificate to be given at the end and submission of audit report.
2. **Partnership deed: -** Auditor has to go through the partnership deed for knowing key points agreed between partner as well as scope of audit work.
3. **Partnership Act** :- Auditor must understand the main provisions of the partnership act.1932.
4. **Acquaintance with business** :- Audit should get himself acquainted with the type of business, type of transactions, nature of assets and liabilities
5. **Audit work/program:-** after getting information about points mentioned above, he has to prepare himself for audit and prepare audit program and then proceed to checking of books.
6. **Checking of final accounts :-** After completing audit work, he has to check final accounts i.e. profit & loss account and balance sheet and has to ensure that they have been prepared in accordance with accepted principles of accountancy.
7. **Audit Report :-** As per the terms of his appointment and keeping in view his scope of audit work, he has to submit audit report and give audit certificate in the manner agreed between firm and auditor.

Item-2
Audit of Joint Stock Company

Q.1 Explain in brief qualifications & appointment of auditor in a Joint Stock Company

Ans Under Indian companies Act 1956, audit is statutory and each company has to get its accounts audited by a qualified auditor. Besides provision of Indian companies Act, the provisions of Chartered Accounts Act are also applicable on audit. Further, auditor has also to ensure that accounting principles and accounting standards have been followed in the company.

Appointment of an auditor:- As per section 226(i) & 226(ii) of Indian Companies Act, only a qualified auditor can be appointed as a statutory auditor in a company.

Qualified auditor means one who possesses at least one of the following two qualifications.

1- He is a chartered Accountant (CA)
2- He is a certified Auditor.

A Chartered Accountant is a person who is a member of Institute of Chartered Accountants of India (ICAI) Even a firm of chartered accountants can be appointed as statutory auditor provided that all partners of this firm are practicing in India and qualified for such appointment.

Certified auditor is an auditor who has been issued a certificate by central/state govt. to act as certified auditor. The central govt. has the power to frame rules for granting, renewal, suspension or cancellation of certificate of certified auditors.

Disqualification of a company auditor:-

As per section 226(3) & 226(4) following cannot be appointed as statutory auditor of a company.

(i) A body corporate i.e. a company
(ii) An officer or employee of company
(iii) A partner of an officer of the company

(iv) An employee of an officer of the company
(v) A partner of an officer of the company
(vi) An employee of an employee of the company
(vii) A Debtor or guarantor of more than Rs.1000/-

Q.2 Who can appoint auditor in a company?
Ans

Auditor of a company can be appointed by:-

(1) <u>Board of Director</u>:- Appointment of first auditor till AGM. If board fails, the first auditor would be appointed in GM. Further board can appoint auditor in case of casual vacancy which may occur due to any reason.

(2) <u>By share holders through GM</u> :- first auditor if board fails as given above. Regular appointment of auditor through AGM. Reappointment of audit would also be done in AGM.

(3) <u>Appointment of auditor by central govt</u>. :-

- In a non-govt. company, auditor will be appointed if board or AGM fails to appoint auditor.
- In Govt. companies, appointment of auditor on the advice of CAG of India.
- Appoint of special auditors by central govt. if a company is -
  - ❖ Not being managed on sound business principles & practices.
  - ❖ Being run causing serious injury or damage to industry, trade & business
  - ❖ The financial position of a company in danger & may lead to insolvency.

Q.3 How an auditor can be removed in a Joint Stock Company?
Ans <u>Removal of Audit</u>

- ❖ Removal of first auditor by special resolution in AGM
- ❖ Removal of other auditors before tenure by GM with prior permission of govt.
- ❖ Removal under CA Act. in case of death or cancellation of membership due to non-payment of fee or acquiring some disqualification under CA Act.

Rights of Company Auditor:- Statutory rights are as follows :-
(i) Access to books, accounts, vouchers

(a) As all times without any prior information during working hours.

(b) All books maintained including vouchers, minutes book and all other books maintained.

(c) Right to access can be restricted by a company and court can't extend this rights.

(d) Rights of access in H.O. /Branch or elsewhere.

(ii) Rights to seek information and explanation relating to audit work. If the auditor has not received any information or explanation, he should mention the same in audit report

(iii) Right to receive notice and other information about general body meeting: - right to attend meeting and right of being heard if the meeting.

(iv) Right pertaining to the branch of the company -: visiting branch, right to access on book of branch.

(v) Right to the indemnified (As per section 201 of Indian companies Act.

Q.4 What important points are to be seen in Memorandum of Association & Articles of Association in a company audit?

Ans **<u>Audit of various items</u>**

Auditor should first of all see memorandum of association which contains details about:-

- name
- registered office
- objectives
- liability clause
- capital clause
- Association and subscription Claus.

2. **<u>He should see the Articles of Association</u>**: - which provides internal rules of company framed under Indian companies act. These internal rules may be regarding:-
   - Share capital
   - Auditor
   - Management of company
   - Regarding P&L A/c

- Other matters such as advancement of loans and minutes of company's proceedings.

3. Auditor should himself acquaint with nature of business and management of company.
4. Obtain list of books and accounts maintained and accounting year.
5. Obtain list of employees and their job description.
6. Obtain full knowledge of internal control mechanism in use.
7. Obtain previous year final accounts and audit report.

Q.5 What important points should be seen by an auditor while checking share capital, debenture, managerial remuneration?

Ans

Audit of Share Capital

Points to be seen:-

1. Capital structure is as per memorandum of association.
2. Issue/pricing/allotment/refund of money of share capital is as per guideline of SEBI.
3. He has to see calls in arrears.
4. Examination of underwriting commission & brokerage.
5. Checking of issue of shares at premium.
6. Checking of issue of shares at discount.
7. Presentation of share capital in balance sheet.
8. Checking of forfeiture of shares.
9. Transfer of shares and buy back of shares.

Audit of Debentures

A debenture is an acceptance of a debt given by a company under its seal. In this, contract is made of repayment of principal amount on a certain date and payment of half yearly interest or a certain date. Debentures may have a charge on the assets of company. Different types of debentures can be issued by a company such as mortgaged debentures naked, perpetual & redeemable, registered or bearer, convertible and non-convertible, Zero interest debentures etc. In audit of debentures, following points should be seen by auditor:-

- Checking articles of association to find out provisions about debentures and accepting loans.
- Checking of commission paid
- Provision of section 293 of Indian comp. Act. have not been violated which prescribes restrictions on borrowings.

- Maintenance of debenture registers as per section 152 of companies act.
- Auditor should see charge register if charge has been created on assets.
- Transfer of debenture is according to provisions of companies Act.

- Creation and maintenance of debenture redemption fund as per section 117c of companies Act.
- Procedure of issue of debentures is in accordance with guide lines of **SEBI** in this regard.

Audit of Managerial Remuneration

There are various provisions prescribing restriction on payment of remuneration to director/managing director of a company under companies Act. and their compliance is to be seen/ensured by auditor.

- Overall maximum remuneration to its directors and manger in a financial year shall not exceed 11% of net profit.
  - If only one managerial person, not more than 5% of net profit.
  - If managerial person are more than one, not more than 10%

  For the purpose of paying remuneration to managerial persons, net profit of a company is computed as per section 349 of the companies Act. which clearly states which provisions and expenses are to be adjusted in arriving at net profit.

Audit for the Purpose of Statutory Report

It is legal compulsion for the auditor to mention following items in the statutory report.

i- Total number of shares allotted

ii- Total cash received on allotted shares

iii- Abstract of receipts and payments consisting of the following.

- Total cash receipt on shares, debentures & other sources.
- Payment made by the company against receipts
- Amount of preliminary expenses.
- Name and occupation of directors, managers, secretary
- Extent to which contract of underwriting has not been fulfilled.

- Commission, brokerage paid & payable to directors/managers on issue of shares and debentures.

Certification: - Statutory report shall be certified by two directors and one of them should be managing director if there is any. Besides reports, auditor has to certify amount received on shares & receipt and payment of the company after careful examination.

Q.6 Explain in brief whole process of audit of Government Companies.

Ans <u>Audit of Govt. Companies</u>

<u>Under Section 619 of companies Act.</u>

According to section 617, a govt. company is a company in which of least 51% shares capital is owned by central govt. / state govt. / state governments. Section 619 says that audit of govt. companies would be conducted by a charted accountant to be appointed by the central govt. on the advice of comptroller and Auditor General of India.

Auditor so appointed shall have all rights & duties as in case of statutory audit of a company under various sections of company's Act.

<u>Special Directions under section 619(3) of companies Act. for govt. company audit</u>.

Auditor has to examine, point out deficiencies and suggest remedial measures in respect of following:

1. System of accounts.
2. System of Financial control
3. Assets and investments
4. Liabilities and loans.
5. Profit and loss account
6. Inventory and contracting
7. Preparation of cost accounting & cost sheet
8. Internal audit in operation, its adequacy
9. Audit committee of board and comments upon its functions.

Time schedule for submitting report under section 619(3) (a) by auditors.

Branch Auditors: - To prepare report within two weeks from signing the report and send the same to:-

1- Statutory auditors consolidating the accounts of the company.
2- The concerted principal director commercial audit
3- The Board of Director of the company.

Statutory Auditor: - To prepare consolidated report within 3 weeks of singing the report and send the same to:-

(1) In case of a central govt. undertaking to
 a) Chairman Audit Board & Dy. Controller & Auditor general.
 b) Concerned Principal director commercial audit
2) In case of state govt. undertaking
 a) Additional Dy. Controller and Auditor general (Commercial Audit)
 b) Accountant general (commercial audit) of state
3) The board of directors of the company.

Where there is more than one statutory audit, the report under section 619(3) (a) will be prepared jointly by all the statutory auditors and signed by all of them.

Q.7 What do you understand by the term supplementary Audit & Test Audit?

Ans **Supplementary or Test Audit**

Under section 619(3)(b) of companies act, the Comptroller and Auditor general of India is authorized to perform supplementary or test audit of accounts of companies which is also known as efficiency -cum-propriety -audit to see following points :-

(a) To examine the decision of board of directors that they were in the best interest of company.
(b) The extent to which directors worked in accordance with accepted principles of financial propriety.
(c) Whether the chief Executives exercised their power properly
(d) To examine the cost accounts where necessary to find and that.
- The undertaking is run efficiently and economically.

- Its costing and performance are better than other undertakings of the same type.

  Under section 619(4) of the Companies Act. an auditor of a govt. company is obliged to submit one copy of the report to CAG who shall have the power to make his comments on it and give a supplementary report on it generally on financial position, capital structure, reserves and surplus, liquidity and solvency, working capital, sources and uses of funds, working results cost trends, production performance, inventory and production, sundry debtors and turn over etc.

  Under section 619(a) it is the responsibility of a govt. company to put up Annual Report on the working of company before the parliament, state assembly

Case Study No. 4

On Audit of Govt. Companies

Comment/express your view on the following:

1. Mr. Jain a Chartered Accountant has been appointed as statutory of a Govt. Company in AGM.

2. In a company owned by Central Govt., auditor has submitted his report to the board of directors of company.

3. In a state Govt. company, one auditor was appointed for Head Office and two more auditors were appointed for 10 branches (5 branches to one auditor). However the final report has been signed by the auditor appointed for H. O.)

4. The auditor of a Govt. Company has not pointed out deficiencies and did not offered suggestions in respect of following-

   (i) Cost account & Cost Sheet (ii) Adequacy of internal audit.

Section-C

Item-2

Rights, duties & liabilities of an auditor & rules laid down in following cases

Q.1 Explain in brief duties of an auditor under Indian Companies Act and other Acts.

Ans Duties of Company Auditor:-

<u>Duties under Indian Companies Act.1956</u>

1- **<u>To inquire the following :-</u>**

- ❖ Whether loans advanced are secured and their terms are not against the interest of members.
- ❖ Personal expenses have been charged to revenue account
- ❖ Whether position shown in books of accounts and in the balance sheet is correct, regular and not misleading.

<u>To submit the audit report to the members of the company</u>: - This job is over once he submits report to the company secretary. It is the duty of comp. secretary & board of directors to place the report in general body meeting.

2- **<u>To Specify a few points in audit report such as</u>** :-

- ❖ Whether he has received all information & explanation required for completing audit.
- ❖ Books have been maintained as required
- ❖ B/S & P&L have been prepared as per provision of company law.
- ❖ P&L exhibits true position of profit.
- ❖ B/S show true and fare view of financial position of the company.
- ❖ He has received audit reports of branches which were not audited by him.

- ❖ B/S & P&L is in agreement with books.
- ❖ No director is disqualified as per companies act.
- ❖ Cess payable by company under section 441-A has been paid.

Negative answers need to be mentioned in the audit report.

3. **Duties under section 227(4A) :-** If auditor conducts audit of any of the company engaged in following business, he has to see those aspects also which has been mentioned in the appointment order.
   - ❖ Manufacturing , mining, processing
   - ❖ Supplying and rendering services
   - ❖ Trading
   - ❖ Business of financing, investment, chit fund.
4. **<u>If existing companies issues</u>** a prospectus, audit report should ensure that following are included in the prospectus.
   - ❖ profit and loss for last five years
   - ❖ assets and liabilities of previous year
   - ❖ Rate of dividend paid on different share's during last 5 years.
   - ❖ Certificate of statutory report: - he has to certify that following portion of statutory report are correct.
     - shares allotted by the company
     - cash received against allotted shares
     - receipt and payments of the company
5. **<u>To submit report on the B/S & P&L</u>** appended in the declaration of solvency at the time of voluntary winding up- such a declaration is made by creditors to pay off debts, this declaration should have auditor's report in respect of B/S & P&L
   - Further, there are duties under chartered accountants Act which auditor has to discharge such as:
   - Not to allow unqualified person to practice in his name.
   - Not to share income of an advocate/ auctioneer/ broker or any person who is not member of CA institute
   - No partnership with unqualified persons.
   - Intimating his appointment to previous auditor.
   - Not to accept fee/remuneration linked with profit of the company
   - Maintain secrecy of accounts

- No certificate without proper checking
- To include material misstatements in the report.
- Not to be negligent & use of reasonable skill and care.

Q.2 Explain in brief liabilities of an auditor of a Joint Stock Company.

Ans <u>Liabilities of an auditor</u>

The liabilities of a company auditor can be divided in two categories i.e.

1- Civil liability :-
2- Criminal liability :-
   - Under companies Act.
   - Under Indian Penal code.

The civil liability may be towards.

Employer for:-

- negligence
- breach of duty or misfeasance
- Under companies act.

Towards third parties.

<u>Civil liability may be in the form of:-</u>

- compensation
- indemnity

<u>Criminal Liability may be in the form of:-</u>

- Fine
- compensation
- Imprisonment.

<u>Civil liability</u>:-

1- **<u>Liability for negligence</u>:** - If auditor does not discharge his duties with reasonable skill and care resulting in loss to the plaintiff, auditor is guilty of negligence.
2- **<u>Liability for misfeasance or breach of duty</u>** i.e. auditor does not approach and perform his duties - here also plaintiff must suffer loss due to nonperformance of duty by auditor.
3- **<u>Liability towards third party :-</u>**
   - Auditor is not liable towards third parties for negligence.

- Auditor is liable towards third party if fraud is proved against auditor.
- Auditor owes moral liability towards society as society expects auditor to be impartial, fair and expert.

Criminal Liability :

1. **Any person who violates section** 57 including auditor Section 59 says that for violating section 57, person can be punished with fine up to Rs.50000/- This pertain to including a statement in the prospectus by an expert including a auditor (CA)
2. **For not signing/authenticating** any document statement, fine up to Rs.1000/- if default is will ful.
3. **For not helping inspector** or not handing over books/documents to inspector, fine up to Rs.20000/-. If default continues, further fine of Rs.2,000 per day.
4. **For destroying, mutilating** altering falsifying books papers securities of a company being would up imprisonment up to 7 years and also fine.
5. **Making false statement in audit** report by previous or present auditor, imprisonment up to 2 years and fine.
6. **For a misstatement** in the prospectus, imprisonment for 2 years and five up to Rs,50000/-
7. **For fraudulently inducing a person** to invest in a company, imprisonment up to 5 years or with a five up to 100000 or both.
8. **For making a false statement** on examination on oath imprisonment up to 7 years and also five.

Criminal liability under Indian Penal Code :-

	Act of auditor	**Guilty under Section**
1.	for giving false evidence	section 191
2.	for issuing a false certificate	section 597
3.	Un law full use of company's assets	section 403
4.	for damaging prestige or assets of Company through deception	section 415
5.	for destroying/harming assets of company	section 425
6.	misrepresenting accounts	section 477

(i) <u>London & General Banks Case (1985)</u>

- Making suggestion to directors/share holders is not the duty of auditor.
- It is duty of auditor to ascertain true & correct financial position at the time of audit.
- Auditor does not give guarantee of correctness of books.
- Auditor must be honest
- Auditor must perform his duty with reasonable care and skill.
- Auditor is not bound to exercise more than reasonable care and skill even in the case of suspicion.
- If auditor is not satisfied with accounts, he must express the same in clear terms to share holders.

(ii) <u>Hedly Bynce & co.Vs Heller & Partners Ltd</u>.

- Auditor can be held liable to third party for negligence.

(iii) <u>Aupam Roy Vs P.K.Mukharjee (1956)</u> -

- Auditor must be honest to his article clerk and should pay promised remuneration.

(iv) <u>Commissioner of Income Tax V/s G.M.Tandekar (1952)</u>

Following three points emerged from this case :-

- Auditor is not liable for third parties.
- Auditor under this case cannot he disqualified for professional misconduct.
- Auditor in this case represented as a lawyer in a civil case.

Q.25 Write in brief points to be seen while conducting audit of Educational Institutions, Club, Cinema, and Hospital.

Ans

<u>Points to be seen in audit of different types of constitutions like Educational Institutions, Clubs, Cinema, Hospital</u>

<u>Educational Institutions</u>: - They include school, colleges, universities and Hence while auditing them; auditor must see the rules governing them particularly provisions relating to maintenance of accounts, audit investment of surplus etc. Key items of income and expenditure to be seen during audit are:-

<u>Income</u>:-

(i) **Fees: -** To be checked with relevant receipts and relevant record maintained like cash book and individual record of students. Different types of fees should be credited with respective account/ head.

(ii) **Donations :-** To be checked with donation register receipts of donations issued and cash book.

(iii) **Govt. Aid: -** Most of the institutions get govt. aid and generally as a percentage of expenditure. Auditor should see the grant register and ensure compliance of grant rules by the institution. He should also check utilization of grant as per directions of govt.

(iv) **Income From assets/investments: -** Should be checked with relevant vouchers and see that proper accounting entries hare been made for income receivable and income received in advance.

Expenses:

(i) **Salaries: -** Should be checked with salary register and ensure that they were properly authorized and no undue deductions were made.

(ii) **Administrative expenses: -** To be checked with relevant vouchers-extra ordinary increase need to be probed.

(iii) **Capital Expenditure: -** Assets created to be examined with relevant record -proper authorization for purchase to be seen.

(iv) **Refundable Fee: -** Like caution money, library fee etc. to be properly checked.

(v) **Purchases: -** Made to be seen with reference to purchase procedure.

(vi) **Income & Expenditure :-** To be examined with reference to budget approval

(vii) **Deduction of staff provident fund:-** To be examined with reference to rules, depositing P.F. with concerned authorities in time. PF register to be examined. Investment of PF if any to be seen with reference to rules and similarly withdrawals and final payment is as per rules.

CLUB

Aim of a club is to provide entertainment facilities to its members. It is managed on no profit no loss basis. It is managed by a managing body.

Auditor should see that body has been elected properly and they are exercising their power in accordance with rules governing them.

Income of the club consists of admission fee, annual fee, aid from govt., donations, sale of absolete items and there may be some miscellaneous receipts. All these items are to be examined with reference to relevant vouchers and records.

Audit of payments:-Audit should see that payments were properly authorized, properly recorded in books. Items purchased need to be checked with relevant vouchers and records.

Assets and liabilities:- Are to be verified and examined with reference to final accounts and their relevant record. Similarly, the position of capital fund created to met future contingencies also to be examined.

Cinema Company

Auditor should check internal control system for recording receipts and expenses.

Income:- The main sources of income is sale of tickets of box office - to be checked with counterfoil and other record.System of advance booking to be seen.Income from advertisement to be seen with reference to advertisement book and relevant tenders.

Expenditure:- Main expenditure is on hiring of films and payment to distributors. They need to be checked with relevant record of film distributors and contract signed with them. Payment on advertisement to be checked with reference to their bills.Similarly wages and salaries paid to be examined with reference to concerned registers & vouchers.

Entertainment Tax:- Accounts to be seen and ensure that this tax has been timely deposited with govt. authorities.

Assets & liabilities:-To be verified

HOSPITAL

Auditor should first of all see whether hospital has been established by Govt. or under trust on private public partnership (PPP)
basis. Hence auditor has to see the rules governing the hospital or trust deed.In case of a trust, the power and duties of trust members. Auditor should also see in detail internal check system regarding various items of stores, their purchases, maintenance etc.

The income may consists of registration fee from patients, subscriptions/donations, rental income from patients, income from pathological tests, govt. aid etc. Internal control system about various items of income should be seen.

Expenditure side may consists of purchases of various hospital items like medicines, plaster, bandages, medical instruments, furniture, blankets, X-Ray plates, equipments etc, salary and wages to staff ,electricity & water charges, stationary ,telephone expenses, etc. these expenses are to be vouched with relevant vouchers/records/registers.

Auditor should also verify assets & liabilities and also verify and check consumable stores which may be in huge quantity at the end of year.

ITEM C (2)

Divisible Profits and Audit of Reserves & Provisions

Q.1 What do you understand by term "Devisable Profits"? What are important provisions of Companies Act in this regard?

Ans

Divisible profit is that part of net profit out of which divided can be declared so that capital is not distributed in the form of dividend .In other words, it is that net profit which is available for appropriation including dividend distribution.

Section-205 of Indian company's Act-1956

(i) **Sources of dividend (section-205(i) :-** Dividend can be distributed from the **following sources :-**

1- Profit of the year
2- Profit of the previous years.
3- Out of total of above
4- Amount received from govt. for payment of dividend.

(ii) Dividend out of above sources can be distributed after making following deductions:-

- Current depreciation :- (section-205(2)) on assets (depreciable assets) at the rate specified in table xiv of the Act.
- Transfer to reserves (section-205(2a))- A prescribed percentage of profit not more than-10% shall be transferred to reserves.

A higher percentage can also be possible if company wants to voluntarily transfer more amounts.

- Arrears of depreciation (section-205(a)) Arrears of depreciation not charged in the precious years should also be deducted for arriving at divisible profits.
- Past losses (section 252b) past losses of any previous financial year are also to be deducted.
- Hence profit available for appropriation and distribution for dividend would be arrived at after making deductions of above 4 points.

Q.2 Explain in brief capital profits.

Ans

<u>Capital profit - Whether they are available for distribution as dividend</u>?

Capital profit are those which are generated by sources other than routine business transactions such as :

- Premium on issue of shares/ debentures
- Amount of forfeiture of shares
- Profit earned before in corporation
- Profit from sale of fixed assets

The capital profit can be disbursed as dividend on fulfilling following conditions:-

(i) Articles of Association of company permits

(ii) Surplus has been realized in cash

(iii) Surplus remains surplus even after revaluations of all items of assets of company.

If seen from business angle, such capital profit should not be distributed but they need to be kept for use to write off capital losses which may arise in future.

Q.3 What do you understand by reserves & provisions? Differentiate between the two.

Ans

<u>Reserve & Provisions</u>

Provisions means any amount written off or retained by way of providing for depreciation, renewals, diminution in value of assets or for providing any unknown liability of which amount cannot be determined with a substantial accuracy, for example provision for bad debts, depreciation, and doubts full debts etc.

<u>Reserve means setting</u> apart part of profit to meet future contingencies or to strengthen financial position.

<u>Difference between provision & reserve</u>

	Provisions	Reserves
1.	Created for specific purpose	Created not for specific purpose
2.	To be utilized for the purpose for Which created	Reserves can be freely used for any purpose?
3.	Created compulsorily profit or no profit	Created only out of profit
4.	Created to meet likely loss	Created to strengthen financial position or enhancing working capital

As regards reserves and provisions, auditor has to ensure that they have been created in accordance with:-

- Provisions of Indian Companies Act
- As per articles of association of a company

Provisions also depend upon financial prudence and looking to the nature of business. Auditor may look in to following:

1- **<u>Provision for bad & doubtful debtor</u>:-** On examination of debtors, auditor has to assess the likely doubtful and bad debts and provision for them should be made.

2- **<u>Provision for fall in prices of investment</u>:-** Which is known as investment fluctuation fund fraud to meet any contingency of fall in prices of investments.

For creation of reserve, this being a financial matter, it all depends upon the decision of management. He has to abide by bye laws or articles of association in this regard.

<u>Secret Reserve</u>

It is a reserve which exists but is not visible and does not appear in the B/s. It is hidden behind the cover of assets & liabilities. For e.g. book value of building is Rs. 10 lac after depreciation while it markets value is 40 lac. The secrete reserve exist to the extent of Rs.30 lac behind building in B/S. It is created by overvaluation of liabilities, under valuation of assets, not adjusting prepared expenses, treating capital expenditure in to revenue, making access provisions etc. It existence indicate strong financial position

TOPIC- C-3
Audit Report & Certificate

Q.29 To whom audit report is submitted and what important point's are to be included in this report?

Ans After completing audit, auditor is required to submit audit report along with his certificate in which he expresses sum and substance of job performed by him. In it, he expresses mutual integrity of company.

Audit report is important to the following:-

- **For Share Holder:-** They are owners but they do not directly manage the company as they are located far of from the head office of the company .As owners they are interested in this report.
- **For Directors:-** They lay down broad policies and hence they are interested to know how far their policies were followed through this audit report.
- **For Creditors: -** Audit report reveals correct financial status and hence creditors are also interested in the audit report.
- **For Income Tax Officers:-** They find it easy to assess tax on the basis of audited financial statement.
- **For the Govt.:** To ensure that company is being run according to Companies Act and share holders of the company are not being exploited. Further company is not violating or working against govt. policies and programmes.

Facts/Points to be included in the Audit Report

As per section 227 of Indian companies Act 1956, an auditor has to submit his audit report to members of the company. This audit report shall include the following:-
Relevant

Relevent Section No.	Particulars of the matter to be included
227(2)	Reflection of true & fair view by B/s & P&L Auditor on the basis of information & explanation given, the B/S exhibit & fair view of company's affairs at the end of financial year and P&L shows correct profit or loss for the year.

227(3) various points about audit whether

- Auditor received all information/explanation required for the purpose of audit.
- Proper books as required have been maintained and proper returns received from branches.
- Report on branches was received and now they were included in preparing final report.
- B/S & P&L are in agreement with books.
- B/S & P&L are in compliance with relevant accounting standers as per section 211(3-e)
- Directors are not disqualified from being appointed.
- Cess payable under section 441A has been paid, details of cess not paid.

227 (4A)Compliance of Govt. order in case of specific type of companies.

According to Govt. order, to include those points in the audit report in respect of companies for which such order have been issued.

227(5) Matters not to be disclosed in B/S & P&L

Mention those provisions due to which company has not disclosed points in B/S & P &L There provisions may be of companies act or other act.

211 Compliance of accounting standard-:

B/S & P&L have to comply accounting standards prescribed by ICAI/central Govt.

228 Branch Accounts:-

Auditors doing audit of a branch have to submit their report to the company's auditor who would appropriately include the same in the company's audit report .

229- Signatures on the audit report:-

Auditor appointed by company would sign the report. In case of firm, a partner practicing in India would sign the report.

230 Reading & Inspection of Audit Report

Audit report would be read in the general body meeting and would be subject to inspection by any member of the company.

In brief the audit report would contain following points:-

(i) Audit report is to be presented to members.

(ii) Accounts have been maintained as prescribed under schedule VI of Indian companies act.

(iii) B/S for the end of year & P&L for the year show true and fair view of affairs of company. Many aspects are to be seen in this regard such as proper accounting of adjustment entries, verification & valuation of assets etc.

(iv) Company is maintaining proper books at its registered office particularly for recording receipts and expenses, purchases and sales, assets and liabilities and on this basis he will form his opinion as to whether B/S & P&L shows true and fair view.

(v) He has received all information's/explanation required for the purpose of audit.

(vi) He has received proper returns from branches for inclusion in final report.

(vii) Proper signature of auditor on the audit report.

Further, central govt. is empowered to issue points to be included in the audit report of:

- Manufacturing companies
- Mining or processing companies
- Service company
- Trading company
- Finance, investment, chit fund, auditor mutual fund company.

The directions issued by govt. are also to be included by auditor in respect of above companies.

Q.30 What do you understand by qualified & unqualified report?

Ans

Types of Audit Report:-

(i) Clear or Unqualified Report:- If auditor is fully satisfied on various points to be mentioned in audit report(as mentioned in preceding pages) he will submit a clear or unqualified report on final accounts. It means that he does not find any irregularities in books, there is no complaint and auditor has no suspicion about being true and fair. This clean report is based on:

- Adequate examination of books
- Follow up of generally accepted principles of auditing
- Adoption of necessary procedure as demanded by circumstances.
- Use of reasonable care and skill.

(ii) Qualified Report: if auditor is not satisfied about various points to be mentioned in the audit report, he must mention his dissatisfaction in the report and such report is called qualified report. Following reasons may be mentioned for this qualified report:-

(i) Auditor could not adopt necessary procedure in examination of accounts for want of evidences in the form of vouchers documents.

(ii) Generally accepted principles of auditing have been violated.

(iii) Auditor could not receive adequate information & explanation sought by him due to incomplete accounting system.

(iv) Inconsistency in principles of accounting adopted by the company from year to year-e.g. changes in valuation of closing stock change may not be acceptable to the auditor.

(v) Any other reason due to which auditor may be dissatisfied.

Case Study No. 4
On Qualified Audit Report

Following problems were faced by you during audit, of a company.

1. You wanted to see general ledger for some checking but you were told that this book has been destroyed under the directions of Managing Director.

2. You were refused access to minutes book in which you wanted to see decision of heavy purchases of plants & machinery.

3. You wanted to see the title deeds of building shown at Rs. 1 crore in balance sheet but they were not produced before you.

4. There was a closing stock of Rs. 2 crores at the end of year and its overvaluation was done by management. Stock registers of such goods were not produced for audit.

5. Contingent liability on account of pending cases of employees in there but it was not properly reflected.

How you would deal each of above problem while drafting audit report and audit certificate?

Topic C-4
Investigation

Q. 1 What do you understand by investigation? How it differs from audit?

Ans Investigation is an intensive examination of books and depth of transactions for a specific purpose. Its objective is to expose actual facts in such a way that party/person for whom investigation is done may draw conclusions and take decisions on that basis. It can be conducted on behalf of creditors, financial institutions etc. Even central Government can also order investigation under section 235 of companies Act when there is a suspicion of fraudulent or on lawful activities carried on by a company and this person so appointed is called inspection. Investigation is also different from special audit ordered by central Govt. as special auditor submits the report to the Govt. and is a middle course. Investigation on the other hand is more damaging to the company than special audit.

Difference between Audit & Investigation

S.No.	Audit	Investigation
1.	Compulsory under companies Act	Not compulsory
2.	Done by Chartered Accountant	By any person
3.	Appointed by share holders in AGM	By creditors incoming partners
4.	Period covered is one year	My be less than a year or may be even 2-3 years
5.	Purpose is to ascertain true & fair view	Purpose may vary from case to case
6.	Conducted on behalf of share holders	Conducted on behalf of Creditors/ incoming partner
7.	Generally relate to books & accounts	May be beyond books
8.	Test checking is generally resorted	Thorough checking is done
9.	Format of report is specified under Section 227	No specific format
10.	Addressed to share holders	Addressed to those who have appointed investigator

Nature of Investigation

1. **Private and Statutory** - Normally private but statutory when resorted under companies Act
2. **External or Internal**
3. **Optional or compulsory** – Normally optional but compulsory when resorted under companies Act.
4. **Normal or Intensive checking** – It is intensive checking keeping in view objectives

Q. 2 What are key objectives of investigation for different interest Groups?

Ans Following are interested in getting investigation done and each has different interest behind this investigation.

(i) Person intending to purchase business: - He would like to know earning capacity, price to be paid is reasonable and position of P & L & Balance Sheet.

(ii) New partner willing to join: - He would be interested in knowing earning capacity, position of shares in market, shares to be purchased, goodwill and other relevant information.

(iii) For a prospective lender: - A lender would like to assess credit worthiness by knowing assets to be pledged, general financial position, purpose of loan, earning capacity, nature of business and goodwill of management.

(iv) For proprietors for suspected fraud: - They would be interested in knowing points of fraud, internal control system, area of fraud such as fraud of cash, goods, manipulation of accounts, the method used for such fraud.

(v) For directors to know decline/fall in percentage of gross profit to sales: - They would be interested to know reasons for such decline such as increase in the cost of purchases, direct expenses, increase in wages, selling price, omission of sales, valuation of closing stock etc.

(vi) For intending investor: - He would be interested in knowing financial status, earning capacity, security against investment trends of business. In case of a company, position of loans and debentures, preferences and equity shares etc.

(vii) For valuation of shares of company: - Investor may be interested in knowing trend of business, dividend rates of last 3-5 years, position of Money Market, provision for bad/doubtful debts future prospects of dividend.

(viii) Investigation by Govt. under section 235 of companies Act: - Person is known as inspectors-he is having all those powers which are enjoyed by a statutory auditor. Even statutory auditors are supposed to help inspector by providing him information so required. He would particularly like to examine assets and liabilities of company and subsidiary companies. Based on the investigation reports, govt. may file suit for criminal liability, recommend for liquidation of company or start recovery proceeding from erring persons.

(ix) Investigation for reporting in prospectus: - Many facts are incorporated in the prospectus on the basis of:

(a) Audit Report: - Facts such as P & L A/c, B/S, details of dividend paid, details of subsidiary companies.

(b) Accountants Report: - P & L & B/S for preceding 5 years, assets and liabilities for the last financial year, funds received on shares, debentures etc.

Investigation officer has to submit the report to those who have appointed him.

Section C (5)
Cost-Audit

Q.1 What do you understand by cost audit? How it differs from financial audit?

Ans

In this highly competitive age, efforts are on to reduce cost and ensure optimum utilization of material labour, plant & machinery and full control on overheads. It is necessary to pre-plan cost and act according to the plan. Cost accounts are maintained for this purpose and this has necessitated audit of cost accounts also. Hence cost audit is verification of correctness of cost accounts and of the adherence to the cost accounting plan. During this, audit not only correctness of cost ascertained is to be examined but also see whether the cost is as per plan or not and if there are deviations, what are the reasons of such variances.

Difference between Cost & Financial Audit

S.No.	Financial Audit	Cost Audit
1.	Performed where financial accounts are maintained	Performed where cost accounts are maintained.
2.	Object is to ascertain true & fair view of financial position.	Object is to certify cost per unit & determination of total cost correctly/accurately.
3.	Checks expenses with relative documents/vouchers	Checks whether optimum results could be obtained or not from expenses incurred.
4.	Auditor certifies correctness of profit arrived at	Auditor examines whether more profit could have been earned in the circumstances.
5.	Auditor examines regularity, honesty etc.	He checks efficiency & propriety of expenses.
6.	Done on behalf of share holders.	May be done on behalf of Govt. industrial tribunal regarding wages, customers to know that cost and margins are appropriate.

Two aspects of Cost Audit

1. **Propriety audit: -** It may be defined as audit of executive action and plans bearing on the finance and expenditure of the company. In it, auditor sees
   - Whether expenses have been so planned so as to obtain optimum results.

- Whether optimum results could be obtained from planned expenditure
- Could profit be increased from the expenditure through alternative efforts?

2. **Efficiency audit: -** It is to ensure application of basic economic principles that resources will flow in to most remunerative channels. Under it, auditor would see whether:
   - Optimum income is generated from every unit of money invested in capital or other spheres.
   - Money has been invested in such a way to obtain optimum results.

Q.2 Explain in brief objectives/advantages of Cost Audit.

Ans

Objects depend upon on whose behalf cost audit has been undertaken. However, cost audit is done with following general objectives.

- To ascertain the correct cost per unit
- To examine accuracy of cost accounts
- To find out that procedure laid by the management for ascertain ment of cost is adequate or need changes.
- To find out that procedure laid down is helping in proper decision making pertaining to cost.
- To ascertain and ensure that there is no excess wastage in all three components of cost i.e.
  - -Material
  - -Labor
  - -Over heads

If this audit is efficiently done, it would be of great benefit to:

- Management & administration of the enterprise
- Investors in the sence that cost audit would ensure that money has been optimally initialized
- If also makes the work of financial auditor easy because in it valuation of stock as well as checking of expenses pertaining to material is done in great detail

Q.3 Explain brief scope of cost audit ?

Ans It includes checking of following items:

(i) Material

- Checking of store ledger with material requisition note, material received, material returned, issue price of material.
- Entire procedure of material purchase, issue and stock record to be seen.
- Obsolete and damaged material to be checked.
- Wastage of material to be checked and ensure that it is within prescribed limits.
- Adequacy of stock of material to be seen.
- Whether minimum stock, ordering level, ordering quantity have been fixed and adhered to
- Physical verification of stock of material

(ii) Labour

- To see whether proper arrangements of recording labour days/hours
- Record of Pay Rolls to be checked with amount actually paid.
- Correct calculation of wages, overtime, bonus etc. is to be checked.
- Unpaid wages to be seen
- Internal check system about wages is proper.
- Checking of direct and indirect labour cost.
- Utilization of man power is optimum, no wastages is there in labour/days hours.

(iii) <u>Overheads</u>

- To see that abortion and apportionment of overheads is correctly done.
- Overheads are in consonance with production, they are not on higher side.
- They are as per standard fixed.
- Proper charging of overheads to a job is correct.
- There is no wastage in overheads

(iv) <u>Plant & Machinery</u>

- To see that plant & machinery was optimally utilized
- Plant & Machinery did not remain idle.
- Maintenance and repair was within limits.

Main Functions of Cost Audit

- Planning of cost and sales
- Material control
- Labour control
- Control on overheads
- Utilisation of plant & machinery
- Control over sales and expenses relating to sales and distribution expenses

Q. 3 Narrate in brief Key annexure to the Cost audit report.

Ans

New Section 233 has been added for cost Audit under section 233 B, Govt. is empowered to decide type of companies where cost audit would be compulsory. This audit is generally done by cost Accountants within meaning of cost & work Accountants Act 1959. However, if adequate cost Accountants are not available, this audit can be allowed to be conducted by Chartered Accountant.

Appointment of cost Auditor shall be made by Board of Directors as per section 1B of section 224 Cost Auditor shall have same powers and duties as are available to a C.A. while conducting statutory audit.

Cost audit conducted under Indian Companies Act would be in addition to financial audit conducted under section 224. Cost auditor shall have same powers and responsibilities as are enjoyed by auditor under section 227. It would be the duty of company to provide all books and information required by cost auditor. The Central Govt. is also empowered to direct the company to circulate full or part of the cost under report in the AGM.

If a company makes default in complying provisions relating to cost audit, company attracts a fine up to Rs. 50,000. Further every officer of the company who is involved in default is like by to be punished with imprisonment which may extend up to 3 years or with a fine up to Rs. 50,000 or with both.

The report of cost Audit is to be submitted to the company Law Board. A copy of report is also given to the management of the Company for members. Cost Auditor has to submit audit report to Company Law Board 60 days before AGM of the company in the prescribed performa as provided in Cost Audit Report Rules. Performa of audit report has also been provided which need to be adhered to.

Annexure to the Cost Audit Report

1. **General –** Name & address of the company, its location, year of audit, name and address of cost Auditor, location of factories, date of first commencement of business/manufacturing work, copy of Annual Report along with audited P & L & B/S.

2. **Cost Accounting System –** System of Cost Accounting in view of requirement of Cost Accounting Record Rules. The description of the system shall cover accounting of material, labour, overheads, depreciation allocation & apportionment of overheads, byproducts joint products, scraps etc.

3. **Financial Position –** Showing details of
   - Capital employed
   - Net worth
   - Profit
   - Net sales
   - Operating profit
   - Value addition
   - Ratios for the company as whole and products under references.

4. **Production -** Registered capacity, installed capacity, enhancement in production capacity if any, actual production in relation to capacity and planned target, percentage production to installed capacity etc.

5. **Process of Manufacturing –**Full details of manufacturing process including flow chart should be given.

6. **Raw Material –** Details of cost of major raw material, quantity of material consumed, standard requirement of material and actual material used, variations in material use and their reasons, material and components not moved since last 12 months etc.

7. **Power and Fuel –** Quantity, rate and cost of major form of power/fuel used in production e.g. coal, furnace oil, electricity etc. compare the same with standard and reasons of difference and measures initiated to conserve energy.

8. **<u>Wages and Salaries –</u>** Direct and indirect wages & salaries, wages & salaries on production, administration, selling and distribution, total man days, labour per unit of production, comment on incentive schemes for labour.

9. **Repairs and Maintenance** -Details & comparative picture of repairs & maintenance for current and previous year, repairs of store & spares, outside contract & repairs etc.

10. **Depreciation** -Method of depreciation, basis of apportioning depreciation amongst different department etc.

11. **Overheads –**
Total amount of overheads pertaining factory, administrative, selling & distribution overheads etc. basis followed for their allocation and apportionment, standard and actual overheads, reasons for their variations.

12. **Sales** – Details of sale in the country, exports , net sales realization, different selling prices as per Govt. policies, packing, delivery charges, etc.

13. **Abnormal nonrecurring costs** – Details of such costs like strikes break downs, lock outs, substantial power cuts, serious accidents and their effect on cost of production.

14. **Auditors observations and conclusions** –To make a report on:
- Matters which appear to him wrong in principle.
- Cases where funds have been used negligently, inefficiently.
- Factors which could have been controlled but not controlled.
- Contracts through undue benefits provided.
- Adequacy of budgetary control system
- Suggestions to over come defects
- Imbalances in production
- Full utilization of capacity
- scope for cost reduction
- Scope for increasing productivity

- Scope for improved inventory policies
- In case of qualified report, its extent
- Reconciliation of profit as per cost & financial accounts
- Details of each factory under production
- Details of each product in specified format by way of annexure
- All cost statements and other statements in respect of intermediate and finished products as prescribed in schedule I
- Cost report is as per format prescribed.

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Multiple Choice Questions

Sub: Theory & Practice of Auditing

(B.Com III Year)

1. Internal check is an arrangement of A-Checking by management, B-Checking by Audit, C- Distribution of work for checking & counter checking

2. Checking of transactions/vouchers daily or with periodical intervals is done in A- Interim audit, B- Periodical Audit, C-Continuous audit.

3. Audit of a partnership firm is A- Private Audit, B- Statutory Audit, C- Govt. Audit.

4. Checking properly of decision taken by management is A-Management Audit, B- Efficiency Audit, C- Propriety Audit.

5. Process of checking entries recorded in books is a part of A-vouching, B- Verification, C- Valuation.

6. Net loss appearing in the balance sheet is a A- Intangible Asset, B-Wasting Asset, C- Fictivious Asset.

7. First auditor or appointment of auditor in a casual vacancy can be done by A- Board of Directors, B- Share holders in AGM, C- Central Govt.

8. Auditor is having a right to receive notice and being heard in A-Board Meeting, B- Annual General Meeting, C- Special General Body Meeting.

9. It is not the duty of auditor to take stock. It was decided in case of A- Irish Woolen Co. 1900 , B- Commissioner of Income Tax V/s. Dandekar 1952, C- Kingston Cotton Mills 1896.

10. "Auditor is not liable towards third parties" was decided in which case of 3 case given in question 9.

11. Under section 619(3) (b), supplementary or test Audit of a company is authorized to be conducted by A- Comptroller & Auditor General, B- Central Govt., C- Investigation team appointed by management.

12. Duty of submitting audit report by auditor is complete when he submits the report to A- Share holders, B- Secretary of the company, C- Board of Directors.

13. For making a false statement in the audit report, auditor can be imposed imprisonment of A- 1 year, B- 2 years, C- 3 years.

14. Dividend in a company can be distributed out of A- Divisible profit, B- Net Profit.

15. It an auditor has not received information required for audit and is dissatisfied on various issues, he can submit A- Qualified report, B- Unqualified report, C- Clear report.

16. Investigation Officer appointed by Govt. under section 235 of companies Act is known as A- Investigator, B- Inspector, C- Enquiry Officer.

17. Propriety audit and efficiency audit are two important components of A-Statutory Audit, B- Cost Audit, C- Internal Audit.

Answer Key:

1- C, 2-C, 3- A, 4- C, 5- A, 6- C, 7-A, 8- B, 9-A, 10- B, 11-A, 12-B, 13- B, 14- A,
15- A, 16- A, 17- B

Key Terms

1. **Accountancy**- After book-keeping the work of accountancy starts which includes preparing profit & loss account and analyzing the final accounts for decision making.

2. **Articles of Association**- A set of internal rules and regulations framed in accordance's with companies Act regarding various aspects like raising of capital, management of company, loans advances etc.

3. **Audit-** Is examination of books & accounts by an independent agency with the help of relative documentary evidences to ascertain true and fair view on a particular date and submit report thereof.

4. **Audit certificate**- After completion of audit and preparing audit report, auditor also attaches his certificate below the balance sheet expressing his opinion about the true and fair view about the affairs of company.

5. **Audit Programme**- Programme prepared in detail indicating work to be done by audit staff for timely completion of Audit. It should be flexible so that it could be changed as and when required.

6. **Audit observations**- Points noted by auditor which are to be incorporated by the auditor in final audit report to be complied by the management.

7. **Auditor's working papers**- Are personal papers which are prepared by the auditor with regard to audit and information he required and his observation to accounts and other aspects. These working papers help in preparing audit report.

8. **Audit report**- Is a report of collected and considered facts observed by auditor during audit and his remarks/views on the working of company. It is sum and substance of job performed by the auditor. This report may be a clean report or qualified report.

9. **Capital Profit**- Is profit earned on the sale of fixed assets. Such capital profit is not credited in the Profit & Loss Account but shown as capital reserve in liability side of balance sheet.

10. **Capital Reserve**- The profit earned on fixed asset, premium on issue of shares are credited in to reserve which is known as capital reserve. Such reserve is shown in the liability side of balance-sheet.

11. **Complete Audit-** When accounts are fully/completely examined by the auditor, it is called complete audit. This examination may be six monthly or annual.

12. **Continuous/Concurrent Audit**- When the auditor visits his client daily or with certain interval and checks accounts up to this date of visit, it is known as continuous audit. Such audit is followed in big organizations.

13. **Cost Audit**- Refers to audit which aims at ascertaining and ensuring that cost of the unit has been correctly work out. Auditor examines correctness of all three elements of cost i.e. material, labour and overheads.

14. **Depreciation**- Decrease in the value of fixed assets due to use, lapse of time, deminiton is called depreciation. Reserve in the form of depreciation reserve is provided on fixed assets.

15. **Divisible Profits**- That part of net profit which is available for distribution/appropriation for declaring dividend. Such divisible profit is arrived at after providing current and past depreciation, pass losses and transfer to general reserve.

16. **Errors**- Are mistakes which commonly occur in preparing accounts. Such mistakes/errors are classified as errors of principle, duplication, clerical, omission and commission. An auditor is required to detect such errors in audit.

17. **Efficiency Audit**- Refers to checking efficiency of the organization which depends upon optimum utilization of all available resources such as financial, human, technological resources, effectiveness and profitability.

18. **Financial Audit**- Means audit based on the financial books summried in the form of trial balance, profit and loss account and balance sheet.

19. **Fixed Assets**- Are assets which are acquired for permanent use in business and not meant for sale such as land, building, plant & machinery, furniture and fixtures etc.

20. **Floating Assets**- Are assets in which organization deals and are purchased for resale and converting in to cash such as raw material, goods purchase, bills receivable and debtors.

21. **Fictitious Assets**-Are assets which are not assets in real scene but shown in assets side of balance sheet such as preliminary expenses to be accounted for in future, net loss etc.

22. **Frauds**- Are mistakes committed intentionally with the purpose of embezzling cash, manipulations of goods and properties and a amenities manipulation of labour and manipulation of accounts. Such frauds are punishable under law.

23. **Govt. Audit-** Mean audit of Govt. departments and organizations. Highest authority for this is Comptroller & Auditor General (CAG) of India who is appointed by The President of India. Under him are various offices such as office of Account General in States.

24. **Interim Audit**- Complete audit for an interim period say 3 months or 6 months for a specific purpose. Generally it is conducted for declaring interim dividend.

25. **Internal Audit**- Audit done by specifically appointed person to internally check accounts so that least possible errors/mistakes are observed by statutory/external auditor.

26. **Internal Check**- Is distribution of book-keeping & accounting work in such a way so that work of one person is checked and counter checked by other persons so as to avoid occurrence of errors and frauds in books.

27. **Intangible Assets**- Assets which are not legible and do not have a form or shape such as goodwill, patent, copyright etc.

28. **Investigation**- It is an intensive examination of books, transactions for a specific purpose. Its objective is to expose actual facts in such a way that a party/person for whom investigation is done may draw conclusions and take decisions on that basis.

29. **Local Fund Audit**- In Govt. there is local fund audit department which conducts audit of local bodies such as municipal boards, panchayast samities, village panchayats etc.

30. **Overheads**- Are one of the three elements of cost after material and labour. These indirect expenses required to be apportioned on some specific criteria to arrive at cost of unit.

31. **Private Audit**- When getting accounts audited is optional and not statutory and audit is got done by a person under an agreement. The rights & duties of auditor are not governed by any statute.

32. **Partial Audit**- When only parts of accounts are examined by auditor, it is called partial audit such as audit of cash transactions only.

33. **Periodic Audit**- When audit is conducted at the end of year after final accounts are ready and audit continues till completion of audit work, it is known as periodic audit. It is also known as final audit or balance sheet audit.

34. **Performance Audit**- Refers to audit of actual performance of organization with reference to predetermined targets, it is known as performance audit.

35. **Propriety Audit-** Checking of propriety of decisions taken by the management i.e. decisions have been taken wisely, in good faith and decisions leads to economy in expenditure.

36. **Provisions-** Means amount set aide to meet specific needs in future e.g. provision for bad & doubtful debts, provision for fluctuation in the investment. Generally such provisions are created by way of charge on profits & loss account.

37. **Qualified Audit Report-** When auditor is not satisfied with various points to be mentioned in the audit report, he submits a qualified report and mentions in the report/certificate why he was not satisfied during audit.

38. **Qualifications of an auditor-** A qualified auditor for a company is one who possesses at least one of the following two qualifications i.e. (i) he is a chartered accountant, (ii) He is a certified auditor.

39. **Reserves-** Mean setting aside part of profit to meet future contingencies or to strengthen financial position of the organization.

40. **Secret Reserve-** is a reserve which exists but not visible in balance sheet and hidden behind assets & liabilities. It is created by undervaluation of assets, overvaluation of liabilities, making excess provisions than required etc.

41. **Social Audit-** Audit which evaluates social good to the society in general. It is generally examination of such schemes which has been prepared and implemented for social up lift ment of population such as audit of NAREGA.

42. **Statutory Audit**- When getting accounts audited is statutorily compulsory, it is known as statutory audit such as audit of companies, banks, trusts etc. Auditor's duties and responsibilities are governed under law.

43. **Supplementary or Test Audit-** Under section 619(3) (b) CAG is authorized to perform supplementary or test audit of accounts of companies which is also known as efficiency even propriety audit to see some specific points such as whether board of directors, directors worked in the best interest of company, chief executive exercised his powers properly and company is being run economically and efficiently.

44. **True and Fair-** Concept of "true and fair" is very fundamental in auditing. It explain that the results shown in accounting statement present on accurate financial position of the company.

45. **Valuation of assets-** Means enquiry in to the true and fair value of assets shown in the balance sheet. For this purpose different types of values are considered for different assets.

46. **Verification of Assets-** Implies on enquiry in to the value, ownership and title, existence & possession and presence of any change on the asset.

47. **Voucher-** Is documentary evidence in support of a transaction entered in books and accounts. These vouchers may be original vouchers or collateral vouchers which support the correctness of original vouchers.

48. **Vouching-** is a process of reconciling/checking documentary evidences in support of transaction entered in books. Vouching is considered as an essence of audit.

49. **Wasting Assets-** Are assets which exhaust due to depletion such as mines, queries, oil wells etc. Such assets are valued at cost price less nominal depreciation.

50. **Window dressing-** Preparing final accounts in such a way that they reflect financial position much better than what actually it is. It is resorted to attract share capital, creditors and loans from financial institutions. Auditor has to be careful in this regard.

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University of Rajasthan Exam 2009
B.Com. (Part –III) Examination, 2009
(10+2+3 Pattern)
(Faculty of commerce)
ACCOUNTANCY AND BUSINESS STATISTICS
First Paper: Theory and Practice of Auditing
OBJECTIVE PART-I

Time: One Hour **Max. Marks: 40**

Attempt all Questions.

1. **Answer the following in not more than 20 words each.**
   (i) What is audit programme?
   (ii) Give two object of vouching.
   (iii) What is meant by verification of assets?
   (iv) Explain the basic difference between Provision and Reserve.
   (v) In how many parts can be liability of statutory auditor be divided? Name them.
   (vi) What is meant by interim dividend?
   (vii) What are divisible profits?
   (viii) What is investigation?
   (ix) Explain two advantage of cost audit.
   (x) Who is responsible for "supplementary audit' in a government company?

2. **Answer each of the following in not more than 50 words each. Each question carries 4 marks.**
   (i) What is subject-matter of routing checking?
   (ii) "Vouching is the backbone of auditing". Explain.
   (iii) Explain the difference between vouching and verification.
   (iv) What is basic the difference between negligence and misfeasance?
   (v) What is basic the difference between special audit and investigation.

DESCRIPTIVE PART-II

Time : Two Hour
Max. Marks: 60

Attempt Three questions in all, selection one question from each Section. Each question carries 20 marks.

Section-A

1. "Accountancy is a necessity while auditing is a luxury for a business enterprise." Do you agree? Give reasons for your opinion and examine cortically the role of auditing in the efficient, honest and economical conduct of a business concern.
2. What is internal check? Explain clearly the difference between internal check and internal audit. What is the essential system of internal check? What is the position of an auditor in relation to such a system?

Section-B

3. What will be the position of an auditor acquires any disqualification after his appointment? In what circumstances a company auditor may be appointed by the board of directors?
4. How will you audit the following:
   (a) Issue of shares at a premium;
   (b) Issue of shares at a discount;
   (c) Redemption of redeemable shares; and
   (d) Issue of shares to vendors?

Section-C

5. "An auditor is watchdog and not a bloodhound". In the light of this statement narrate the duties of a company auditor. Also give the concern case also.
6. What is a 'qualified report'? Draft specimen of a qualified report inserting four qualifications.

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ACCOUNTANCY AND BUSINESS STATISTICS
First Paper: Theory and Practice of Auditing
OBJECTIVE PART-I

Time : One Hour **Max. Marks: 40**

Attempt all Questions.

1. **Answer the following in not more than 20 words each**.
   - (i) Give any two limitations of audit.
   - (ii) Give any two similarities between statutory and internal audit.
   - (iii) Give the meaning of routing checking.
   - (iv) Name two vouchers related with Cash Sales.
   - (v) Give two examples of contingent liabilities.
   - (vi) What are the different types of civil liabilities? Name them.
   - (vii) Give the minimum number of directors of vouching of Statutory Report.
   - (viii) Mention any four object of investigation?
   - (ix) Name the two aspects of Cost Audit.
   - (x) What are two basic principles in relation to dividend?

2. **Answer each of the following in not more than 50 words each.**
   - (i) What do you understand by fictions assets? At what value are they valued?
   - (ii) In what situations auditor is appointed by the central government?
   - (iii) What is the basic deference between negligence and misfeasance?
   - (iv) What do you understand by directions under section 619 (3) (a)? Give any two in brief.
   - (v) Explain any two points for cost audit given under section 233B of Companies Act, 1974.

DESCRIPTIVE PART-II

Time: Two Hour

Max. Marks: 60

Attempt three questions in all, selection one question from each Section. Each question carries 20 marks.

Section-A

1. It has been said that two of the object of an audit are the direction of

(i) Technical errors and (ii) errors of principles. Discuss this statement giving examples.

2. "An auditor is not a value and yet he is intimately concern with proper valuation of assets and liabilities." Discuss the statement relating some important legal decision in this respect.

Section-B

3. "An auditor is not an insurer, he does not guarantee correctness of balance sheet." Discuss.
4. Explain how the shares of a company are forfeited. State in detail duties of an auditor in connection with forfeiture of shares.

Section-C

5. Discuss the liability of an auditor towards third parties.
6. Define the term investigation and distinguish it from audit. Mention the circumstances under which investigation is necessary.