

GOVT. ARTS COLLEGE FOR WOMEN, SALEM – 8.
DEPARTMENT OF COMMERCE.

AUDITING

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AUDITING

UNIT-I

Auditing – meaning and object of audit- difference between auditing and accountancy- kinds of audit- advantages and limitation of audit- audit programme and working papers.

UNIT-II

Internal control- meaning and object- internal check- meaning & object- internal check regarding cash, purchase, sales, payment of wages.

UNIT- III

Vouching- meaning- objects – features of good vouchers- procedure and importance- vouching of cash transaction- verification of assets and liabilities.

UNIT- IV

Auditor –qualification, appointment, disqualification, removal, duties, powers, liabilities and remuneration.- share capital and share transfer audit – audit report – contents and types.

UNIT -V

Specialized audits- charitable institutions, club, cinema theatre, educational institution, hospital and hotel – Electronic Data Processing Audit (EDP)

TEXT BOOK:

1. PRACTICAL AUDITING: TANDON

UNIT-I
AUDITING

INTRODUCTION:

The word “audit” is derived from the Latin word “audire” which means “to hear”. In olden days also it was customary to appoint a person to check the accounts. During “Egyptian era “fiscal receipts were recorded by two officials.”Greeks” also used to appoint checking clerk to scrutinize the accounts of public officials. “Romans who designed an effective system of financial administration.

MEANING:

Auditing is an examination of books of accounts, documents and vouchers of a business in order to verify the financial position as disclosed by the balance sheet and profit and loss account of the undertaking.

DEFINITION:

“Auditing is such an examination of books, accounts and vouchers of a business as shall enable the auditor to satisfy himself whether the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the business, according to him and as shown by the books and if not in what aspect he is not satisfied or the balance sheet is untrue or incorrect”.

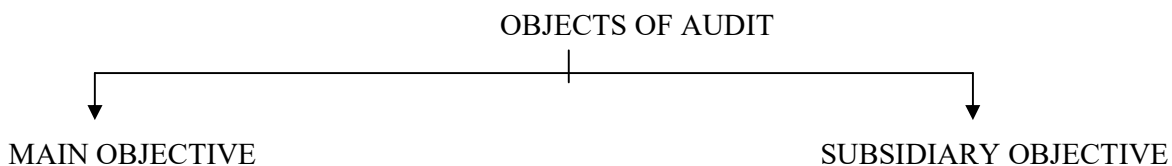
- Spicer and Peglar.

“Auditing is a systematic and independent examination of data, statement, records, operations and performance of an enterprise for a stated purpose. In any auditing situation the auditor understands and recognizes the proposition before him for examination, collects evidence, evaluates the same and on this basis, formulates his judgment which is communicated through his audit report”.

- Institute of Chartered Accountants of India.

OBJECTIVES OF AUDITING

As per sec 227 of the company’s act 1956 the main object of auditing is to state whether the accounts give a “true and fair view” in case of balance sheet of the financial state of affairs of the company at the end of financial year and in case of profit and loss account for its financial year.



I. MAIN OBJECTIVES

The main object of an audit is to verify and establish that at a given date of balance sheet present true and fair view of financial position of the business and profit and loss account gives the true and fair view of profit or loss for the accounting period.

The auditor has conducted an independent review of financial statement about their reliability of the firm. The auditor must examine the system of internal control and internal check, arithmetical accuracy of books of accounts; validity of transaction entered in the books and confirms the existence of and value of assets and liabilities. To judge the accuracy of the books of account the auditor must

- ❖ Assess the system of internal control.
- ❖ Verify the accuracy of posting, balancing etc.
- ❖ Confirm the validity of transaction with supporting documents.
- ❖ Ascertain whether distinction has been made between capital and revenue items.
- ❖ Confirm existence of assets and liabilities.
- ❖ Ascertain all statutory requirements of maintenance of bulks and records has been complied with.

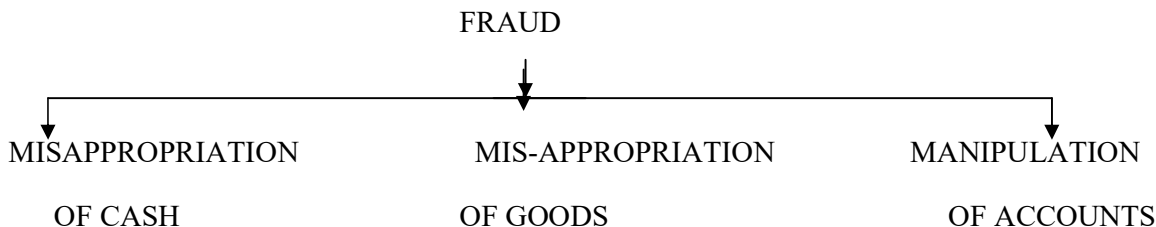
II. **SUBSIDIARY OBJECT:**

A. **DETECTION AND PREVENTION OF FRAUD:**

According to ICAI (institute of chartered accountant of India) fraud refers to intentional misrepresentation of financial information by one or more individuals among management employees or third parties. Fraud may involve

- manipulation, falsification or alteration of records or documents
- misappropriation of assets
- Suppression or omission of effect of transaction from records or documents.
- Misapplication of accounting policies.

Detection of fraud is one of the important functions of the auditor. Fraud may be divided into following categories.



a. **Misappropriation of Cash**

Misappropriation of cash is usually done by theft of cash receipts, petty cash, cheque, negotiable instruments; showing fictitious payment to workers, creditors, purchases etc. Misappropriation of cash is easy number of examples of misappropriation of cash can be as follows.

- ✓ Recording factious purchases and thereby cash involved is misappropriated.
- ✓ showing payment of wages to dummy workers in wage sheet

- ✓ Various receipts like bad debt recovered, sale of scrap or rejected stock may conceal.
- ✓ The credit sales may not be recorded and money received from customers pocketed.
- ✓ cash sales may not be recorded at all

- ✓ “Teeming and lading” methods may be adopted in which money received from a customer is pocketed and later on money received from another person may be shown as received from the former customers. This process may be continued for a long time till the fraud is detected.

b. Misappropriation of Goods

Again fraud may be in respect of goods that is misappropriation of goods. This type of fraud is very difficult to find out especially when the goods are less bulky and are of high value proper methods of keeping accounts in regard to purchase and sales, stock taking, periodical checking of stock etc.

c. Manipulation of Accounts

This type of fraud is committed by upper level of management with the different objectives to mislead certain parties within or outside the business.

This type of fraud is usually committed by managers, directors, and board of directors etc.

B. DETECTION AND PREVENTION OF ERRORS

Generally errors are the result of carelessness on the part of the person preparing the accounts. Sometimes errors may be the result of fraudulent manipulation of accounts.

Classification of Errors;

i. Error of Principle

When principle of book keeping and accountancy are not followed in the treatment and recording of items of a transaction, it is known as error of principle.

ii. Error of Omission

When a transaction is omitted fully or partially from books of accounts, such type of errors is known as error of omission. Usually it arises due to mistake of clerks.

iii. Error of Commission

The entries made in the books of original entry or ledger is incorrect wholly or partly such errors are errors of commission. Usually these errors arise due to negligence in recording of some business transaction.

These errors may or may not affect the trial balance, balance sheet, profit and loss accounts.

iv. Error of Duplication

When a transaction is recorded twice and also posted twice in the ledger such error will not affect the trial balance.

Sometimes supplier sends the invoice in duplicate and both the copies of the bill are recorded respectively. It is more difficult to locate such errors.

v. Compensating Error.

When an error offsets the effect of another error such errors are known as compensating errors. These errors do not affect the agreement of trial balance, hence cannot be located.



KINDS OF AUDIT

The following are the some kinds of audit. Those are;

- 1) On the basis of scope
- 2) On the basis of nature of activity
- 3) On the basis of forms of organization
- 4) On the basis of relation of auditor vs. management
- 5) On the basis of legal necessity
- 6) On the basis of periodicity
- 7) On the basis of matter of checking

A. ON THE BASIS OF SCOPE

An audit examination can be general or specific. A general audit will cover all the area of business. On the other hand specific audit concentrate on a particular area or object or may be period. On the basis of emphasis it can be further classified as

- | | |
|--------------------|---------------------|
| ✓ Partial audit | ✓ Performance audit |
| ✓ Occasional audit | ✓ Standard audit |
| ✓ Interim audit | ✓ Audit in depth |
| ✓ Cost audit | ✓ Cash audit |
| ✓ Management audit | |

B. ON THE BASIS OF NATURE OF ACTIVITY

▪ Commercial audit

The nature of activity will determine the scope and approach of the audit. While the audit of profit motive organization can be called commercial audit.

- **Non-commercial audit**

The audit of non-profit organization will fall under non-commercial audit, example for non-commercial audit are govt audit, audit of organization involved in promotion of education, health or environment etc.

C. ON THE BASIS OF FORMS OF ORGANISATION

- **Private audit**

When the audit is not statutory requirement, but is conducted at the desire of owner, such audit is private audit. This audit is conducted primarily for their own interest. At the same time the private audit may become a requirement under tax law, if the turn over exceed a specified limit. Private audit is of the following types.

- audit of sole trader account
- audit of accounts of partnership firm

- **Govt audit**

Audit of govt offices and dept is covered under this heading. A separate dept is maintained by govt of India known as accounts and audit departments. This department is headed by comptroller and auditor general of India.

D. ON THE BASIS OF RELATION OF AUDITOR Vs MANAGEMENT

- **External audit**

The audit is said to be external if the appointment of auditor is made by person other than those whose performance is evaluated by auditor. The statutory auditor is said to be external auditor, because he is appointed not by the management but by shareholders. The external auditor is an independent person.

- **Internal audit**

It implies the audit of accounts by the staff of the business. The staff may or may not have professional qualification for audit of accounts. The internal audit is permanent nature and helps the business in early detection of errors and prevention of frauds. The objective and functions of internal audit depends on the nature of operations and business

E. ON THE BASIS OF LEGAL NECESSITY

- **Statutory or compulsory audit**

Statutory audit is an audit which is made compulsory by the statute or law. Most of the countries in the world have made it compulsory for the joint stock companies and society. in India also, audit of the following institution has been made compulsory.

- Joint stock companies registered under the company's act 1956.
- Banking companies governed by the banking company's act 1949.
- Insurance companies governed by the respective insurance act.
- co-operative societies registered under the co-operative act

- **Non statutory audit**

Where audit is conducted without any legal necessity or requirement, the audit is called non-statutory audit

F. ON THE BASIS OF PERIODICITY

When the auditor and his staff is constantly engaged in the work during the whole year or period at regular or irregular interval the audit is known continuous audit.

- **Continuous audit**

It is an audit where the auditor or his staff is constantly engaged in checking the accounts during the whole year of financial year and where the auditor or his staff attends the audit program me at regular intervals during the period. It is not so much used to small business, but for the large business concern it is good system of audit.

- **Annual(or) periodical (or) final (or)completed audit**

In this type the auditor takes up his work of audit only at the end of an accounting perished checks the financial transaction at one stretch or in continuous session. He is in possession of the full fact relating to the accounts for the year under review before he undertakes such audit.

G. ON THE BASIS OF MATTER OF CHECKING

- **Balance sheet audit**

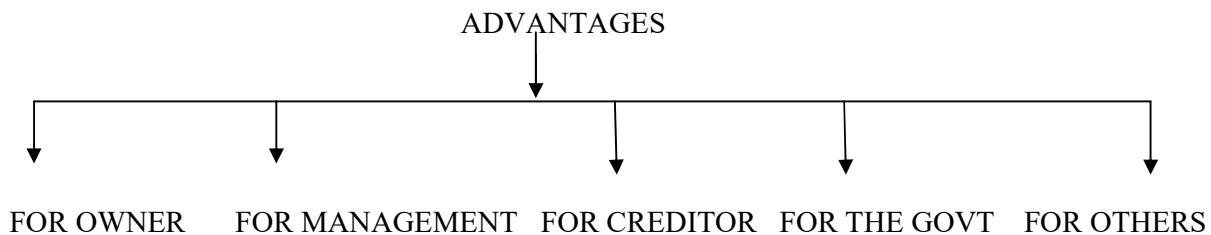
In the balance sheet audit the auditor check the capital, reserve and provisions, creditors and other liabilities. On the other side assets are to be properly verified and valued, which are to be shown in the balance sheet. The work of the auditors is confined to the balance sheet items only.

- **Standard audit**

Under this audit a few transaction are picked up for the detailed checking and the rest of the transaction are left for “test-checking” in practice this system of audit is adopted in any business or industrial undertaking

ADVANTAGES AND DISADVANTAGES OF AUDIT

ADVANTAGES:



1. FOR OWNER OF BUSINESS OR SHARE HOLDERS

- a) In case of sole trader, he can depend on the audited accounts for the purpose of sale of business or for admitting a new partner he can value his business on the basis of audited accounts.
- b) In case of partnership firm audited accounts will be useful in valuing goodwill and business on admission of partner, retirement of a partner.
- c) Shareholders who do not know about day to day administration of the company can judge the performance of the management from audited accounts.
- d) Share holders can value their shares on the basis of audited financial statement.

2. FOR THE MANAGEMENT

- a) It helps the management in deducting and preventing errors and frauds.
- b) It keeps the accountant and staff vigilant while preparing accounts.
- c) Claims due to fire, theft and accident can be estimated from audited accounts.
- d) It helps in reviewing the system of internal control and internal check.
- e) The audited accounts are uniformly prepared over the year, comparison of such statement become easy.

3. FOR THE CREDITOR

Long and short term creditors can depend on audited financial statement while taking decision to grant credit to business houses.

4. FOR THE GOVT BODIES.

- a) Tax authorities depend on audited statement in assessing the income tax, sales tax and wealth tax liability of the business.
- b) Audited accounts can be produced in the court to provide evidence.
- c) Audited accounts are useful for the govt while granting subsidies etc.

5. FOR OTHERS.

- a) Audited accounts can be used by insurance companies to settle the arising on account of loss by fire.
- b) It safeguard the interest of the workers because the audited accounts are useful for settling trade disputes for higher wages or bonus..
- c) In case of amalgamation and absorption the purchasing company can calculate purchase consideration on the basis of audited accounts.

DISADVANTAGES / DEMERITS OR LIMITATION OF AUDIT.

The audit of accounts suffers from several limitations also. Some of the limitation is as follows.

- a) The audit may not give complete picture. If the accounts are prepared with bad intentions and for that fraud is committed. Auditor may not be able to fully rely them.
- b) Sometime the auditor has to depend on explanation, clarification and information from staff and client. He may or may not get correct or complete information.
- c) Under the law shareholders appointed an auditor but in fact directors appoint him. Under such situation he may not be an independent auditor.

- d) Auditing is a post mortem examination. What is the use of such examination when events have already happened?
- e) It is very difficult to verify certain items, for example stock in trade.

DIFFERENCE BETWEEN ACCOUNTANCY AND AUDITING

ACCOUNTANCY -

“ACCOUNTANCY BEGINS WHERE BOOK KEEPING ENDS”.

Accountancy involves the preparation of final accounts to show the result of the business at the end of the financial period. The man who is interested with this work is called accountant.

AUDITING -

“AUDITING BEGINS WHERE ACCOUNTANCY ENDS”.

Auditing is a careful and critical examination of books of accounts to find out their accuracy whether the profit and loss account and the balance sheet have been properly drawn up and whether they exhibit a true and fair view of the state of affairs of business.

S.No	Basis	Accountancy	Audit
1	Nature	In accountancy we prepare final accounts and make proper adjustment and rectification entries from the books of original records.	Auditing aims at examination of the correctness of these accounts prepared by the accountants.
2	Object	The primary object of accountancy is to ascertain the trading result of a business during a financial year.	The object of auditing is to certify the correctness and justification of the financial statement prepared by the accountant.
3	Commencement	Once book keeping records are completed they become available for commencement of work of accounting.	Auditing starts only after the completion of the work of accounting.
4	Scope	The scope of accounting is the preparation of various financial statements and their analysis.	The scope of auditing however is defined by an agreement between the owner and the auditor
5	Qualification	An accountant needs no formal qualification.	But an auditor must be an associate fellow member of the institute of chartered accountant of India which he becomes only after passing the

			required examination
6	Reporting	Accountant does not submit any separate report of the financial statement prepared by him.	The auditor have to prepare and append a statement report along with their certificate that the balance sheet and profit and loss account gives true and fair picture of the business.
8	Remuneration	The accountant is paid monthly salary	The auditor gets a fixed amount as per agreement with his client
9	Duration	The accounting work is conducted throughout the year.	The audit may be conducted at the end of the year or throughout the year.

AUDIT PROGRAMME

An audit program is an essential for an efficient audit. It is the auditor's plan of actions. It is a detailed plan of the auditing work to be performed. It specifies the procedures to be followed in verification in each and every item in the financial statement, the allotment of work, among the audit staff, and the estimated time required.

Definition:

According to Megis "A detailed plan of auditing work to be performed, specifying the procedure to be followed in the verification of each item in the financial statement and giving the estimate time required".

Auditing program involve mainly three things, they are,

- a. How much work is to be done
- b. who is doing a particular portion of the work
- c. what is the duration of time by which the work is to be finished.

Advantages of audit program

The following are the advantages of audit program.

- i. It facilitates the completion of audit work without omitting any portion.
- ii. It facilitates the allocation and distribution of work among the audit staff.
- iii. It facilitates to watch the progress made by the audit staff in the audit.
- iv. It gives guidance to junior clerk to perform the work allotted to him.
- v. It fixes responsibility for the work done.

Disadvantages of audit programme

The following are the disadvantages of an audit programme.

- i. An audit program makes the clerk mechanical and specialized in only one work. They cannot be assigned in other work.
- ii. It discourages initiative and interest of the efficient staff.

- iii. Even a well prepared audit program may not include all important points as it so drawn before the commencement of audit.
- iv. It is unnecessary for small business concern.
- v. Work may be hurried up to complete a required time schedule.

WORKING PAPER

The term audit working paper means the files of analysis, summaries, comment and correspondence built up by and auditor during the cause of the field work of an auditor during the cause of the field work of an audit engagement. These papers contain essential fact about account which is under audit.

Definition:

Arnold w.johnson defines that “audit working papers are the written, private materials which an auditor prepare for each audit. They describe the accounting information which he received from his client, the method of examination used, his conclusion and financial statement.”

Classification of working paper.

- Permanent file paper
- Audit administrative paper
- Audit evidence paper

1. Permanent file paper;

The permanent file contains papers of continuing interest over many years audit of the same client. The matter contain shall be suitably indexed. These should normally include

- a) Memorandum and Articles of Association and other statutory documents. For example partnership deed.
- b) Copies of other documents and minutes of the meeting having a continuing importance.
- c) A short description of the types of business carried on and places of business.
- d) The client internal accounting instruction and internal audit instructions or stock taking instruction.
- e) A brief history of the company, its product and marketing.
- f) Copies of balance sheet of earlier years.

2. Audit administrative papers.

Generally the following items may appear in the print of each year’s current file.

- a) Appointment letter.
- b) Memoranda of meeting with the management
- c) Memoranda of meeting with audit committee of the client.
- d) Audit time budget.
- e) Internal control questionnaire
- f) Internal control system and flowchart.
- g) Audit programme
- h) A working trial balance of general ledger accounts.

3. Audit evidence paper

The current year audit evidence working papers contain the records of the procedure followed, the test performed, the evidence obtained and the decision made in the course of audit. These papers themselves are communication of the quality of audit. Therefore these must be clear, complete, well indexed and informative.

Merits (or) purpose of working paper.

The following are some of the merits of the working paper.

- 1) They represent the volume of work performed by the auditor and his staff which held in preparing a reports.
- 2) They show the extend of follow the accounting principle and accounting standard.
- 3) They are useful as evidence against the charge of negligence.
- 4) They act as guide for subsequent examination.
- 5) They assist the auditors in co-coordinating and organizing the work of audit clerk.
- 6) They assist in planning and performance of audit work.
- 7) They enable the auditor to know the weakness of the internal check system.

AUDIT NOTEBOOK

Audit notebook is a diary or register maintained by audit staff to note errors, doubtful entries etc. The purpose is to note down various point which need to be either classified with the client or the chief auditor. The audit notebook is also used for recording important points to be included in the auditor's report. It is a complete records of doubts and their clarification.

Contents of an audit note book.

An audit notebook usually contains the following information about the audit work performed by the audit staff.

- ✓ A list of books of accounts maintained
- ✓ The name, duties and responsibilities of officers.
- ✓ The particulars of receipts and vouchers.
- ✓ Mistake and errors detected
- ✓ The points calling for clarification and explanation
- ✓ Various totals and balances.
- ✓ Extracts from the minutes and contract.
- ✓ Date of commencement and completion of the audit.

Advantages of audit note book

- ❖ It ensures uniformity and helps in knowing the amount of work performed.
- ❖ Important matters relating to the audit work may be easily recalled.
- ❖ Facilitate the preparation of audit report.
- ❖ It ensures that the audit program has been sincerely followed, deviation can be noticed.
- ❖ It is reliable evidence in the court of law.



QUESTION BANK

1. Define auditing and explain the objectives of an audit.
2. Explain the different kinds of audit
3. Define auditing? Explain the advantages and disadvantages of auditing
4. What is an audit programme? State its advantages
5. What are the contents of an audit note book?
6. What is meant by fraud? What are the types of fraud?
7. What are the difference between accountancy and auditing?

UNIT- II

INTERNAL CONTROL

As the size of the operation of the business firm increase and nature of activities became complex, it is difficult for the manager to control the firm by his direct and close supervision. The management in such a circumstance is interested to introduce a system of internal control.

MEANING

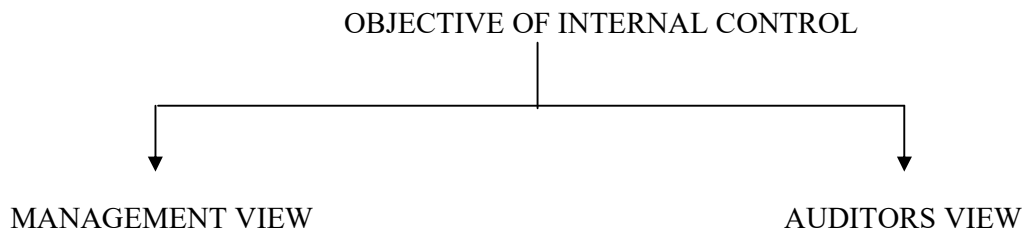
Internal control is a wider term. It includes all type of control namely financial control, managerial control and organizational control. As a matter of fact it covers even the internal check and internal audit. It help the organization to meet its goal more effectively.

DEFINIITON

According to Spicer & Peglar, “internal control is best regarded as indication as the whole system of control, financial and otherwise established by the management in the conduct of a business, including internal check, internal audit and other forms of control”.

OBJECTIVES OF INTERNAL CONTROL (OR) WHY TO HAVE INTERNAL CONTROL

Before introducing a proper system of internal control, businessman must know the objectives or purpose for which it is to be introduced. The objectives of internal control can be studied in two phases.



I. FROM MANAGEMENT POINT VIEW

1) PROVIDING RELIABLE DATA

Business decision required accurate information to run the business activities efficiently. For example management required reliable information for fixation of selling price etc.

2) SAFEQUARDING ASSETS & RECORDS

The physical assets of a company be stolen, misused or accidently destroyed, if not properly protected by adequate controls. The safe guarding of certain assets and records has become increasingly important since the introduction of computer system.

3) TO ENCOURAGE THE SUPPORT OF PRESCRIBED POLICIES

The system of internal control is meant to provide reasonable assurance that procedures and rules of the various institutes are followed by company personnel.

II. FROM AUDITORS POINTS OF VIEW.

The study and evaluation of the management system of internal control is important to auditors. The auditor must have a thorough understanding of the system. Simply by asking certain questions, reviewing of organizational chart and studying a few procedure manuals to obtain an understanding of the system is not sufficient.

ELEMENTS (OR) CHARACTERISTICS (OR) PRINCIPLES OF INTERNAL CONTROL

An effective or a good system of internal control should have the following characteristics;

1) COMPETENT AND TRUST WORTHY PERSONNEL

Personnel are the most important elements of any system of internal control. If employee are competent and trust worthy some of the other characteristic can be absent and reliable financial statement can be still result.

2) RECORDS FINANCIAL AND OTHER ORGANISATIONAL PLAN

Documents perform the functions of transmitting information throughout the organizations and between different organizations. The document must be adequate to provide reasonable assurance that all assets are properly controlled and all transactions correctly recorded.

3) SEGREGATION OF DUTIES

- Segregation of operational responsibility from record keeping responsibility.
- Separation of the custody of assets from accounting.

4) SUPERVISION

Directors should review the company's financial statements and positions at regular and frequent intervals. Comparison with result for previous period indicates problems that call for further examination.

5) AUTHORISATION

If control is to be satisfactory every transaction must be properly authorized. Authorization can be of two namely,

- General
- Specific

6) INTERNAL AUDIT

Internal audit is a part of the whole system of internal control. It is the examination of accounts of a business concern by its employee specially appointed for the purpose.

7) ARITHMETIC & ACCOUNTING CONTROLS

Chart of accounts in balance sheet and income statement is an important control because it provides information to management and other financial statements users. Chart of accounts or financial statement should be prepared in accordance with the generally accepted principles.

SCOPE (or) AREA OF INTERNAL CONTROL

A) GENERAL FINANCIAL CONTROL

It is concerned with an efficient system of accounting, adequate supervision, recording and duplicating system etc.

B) CASH CONTROL

It includes proper control for receipts, payment and balance held. Due safe guard must be exercised to avoid misappropriation of cash.

C) CONTROL OVER TRADING TRANSACTION

This area deals with an efficient system of control over both purchase and sales transaction. Proper procedures should be laid down for handling and accounting of goods purchased and also for recording and handling of goods sold

D) CONTROL OVER EMPLOYEES REMUNERATION

This area concerned itself with the preparation and maintenance of records for remuneration to employees, method of payment etc. proper control must be exercised over this aspect so as to avoid misappropriation of cash payment to be made to the employees.

F) OTHERS

These includes,

- ✓ Maintenance of staff relationship

- ✓ Stock maintenance
- ✓ Control over investment.

INTERNAL CHECK

MEANING

Internal checks are also called inner check or inter check system. It is a system of accounts keeping. It is an arrangement of duties of members of the staff in such a manner that the work performed by one person is automatically and independently checked by another. For example, in cash sales the sales man will not be allowed either to deliver the goods to the customers or receive money from him.

DEFINITION

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

THE SYSTEM OF INTERNAL CHECK INVOLVE 4 THINGS

- ✓ The work is divided in such a way that all the duties are assigned to different clerk.
- ✓ The clerk gets the work load according to their capabilities and qualification.
- ✓ Only one clerk does not perform any single task from the beginning to the end.
- ✓ The work done by one clerk is independently and automatically checked by another person.

OBJECT OF INTERNAL CHECK

- To exercise moral pressure over staff.
- To ensure that the accounting system produce reliable and adequate information
- To provide protection to the resourced of the business against fraud, carelessness and inefficiency.
- To allocate duties and responsibilities of each clerk in such a way that he may be held responsible for particular fraud or errors.
- To minimize the chance of errors, fraud or irregularities in the business.

CHARACTERISTICS (OR) PRINCIPLES OF A GOOD SYSTEM OF INTERNAL CHECK

1) FIXED RESPONSIBILITY

Responsibility of each individual must be properly defined and fixed. There should be a schedule of duties of every employee in the entire department.

2) STANDARD FORMS

There should be standard rules and arrangement of fraud and accounting records with numbering etc.

3) SEPERATION OF ACCOUNTING & CONTROL

No person should be able to establish accountability over his own operation.

4) ROTATION OF EMPLOYEES

Where the employees are in large number, the auditor should suggest the rotation of the various employees so that they should not develop same work within the staff of the concerned department.

5) USE OF MECHANISED METHODS

As far as possible and keeping in view the requirement of the undertaking, the mechanized systems of accounting should be adopted so that the erases or over writing can be avoided.

6) SAFE QUARD

Adequate safeguard should be prescribed to keep unused receipts, cheque book etc.

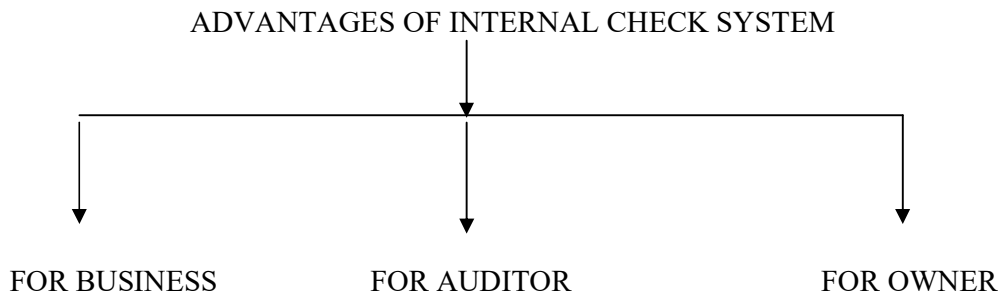
7) REVIEW

The system of internal check should be reviewed from time to time to introduce improvement.

ADVANTAGES & DISADVANTAGES OF INTERNAL CHECK SYSTEM

ADVANTAGES

Some of the widely accepted advantages of an efficient system of internal check are as follows.



1) FOR THE BUSINESS

A) PROPER DIVISION OF WORK

Internal check system gives a proper and rational distribution of work among the members of staff of the enterprises keeping in view their individual qualification, experience and area of specialization.

B) DETECTION OF ERRORS & FRAUDS

Since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the others.

This helps in the early detection and discovery of errors and frauds and the possibilities of commission of errors and frauds can be minimized.

C) INCREASED EFFICIENCY COUPLED WITH ECONOMY

A good system of internal check increases the efficiency of work among the staff and leads to overall economy.

2) FOR THE AUDITOR

A) QUICK PREPARATION OF FINAL ACCOUNTS

The profit and loss account and balance sheet are prepared without any loss to time.

B) CONVENIENCE

Where an organization is operating a system of internal check the statutory auditors may conveniently avoid detailed checking of the transactions.

3) FOR THE OWNERS

A) INCREASE IN PROFIT

Overall efficiency and economy in operation result in more profit. Thus ensuring large dividend for the owners or shareholders.

B) ACCURACY OF THE ACCOUNTS CAN BE RELIED UPON

If there is a good system of internal check the owner of the concern may rely upon the accuracy of the accounts.

INTERNAL CHECK FOR CASH RECEIPT AND CASH PAYMENT

There is a great scope for misappropriation of cash if there is no well organized system of internal check. The following system of internal check may be adopted for receipt of cash.

RECEIPT SIDE

- Every receipt of cash should be entered in a rough cash book or diary in the presence of a responsible person.
- All cheques received should be immediately cashed

- All cash receipt should be acknowledged by the issuing printed receipt which should have counterfoil or carbon copies.
- The receipt should be signed by a responsible officer of the concern. The cashier also should counter sign them.
- The receipt should be serially numbered
- Unused receipt should be kept under lock and key
- Spoiled receipts should be cancelled and should be presented along with counterfoils. If some alteration is made in the receipt already written it should be properly initialized
- No blank counterfoils should be accepted
- All receipt of cash should be banked daily
- The cashier should not have access to the ledger
- Bank reconciliation statement (BRS) should be prepared periodically by a person other than cashier.

✓ PAYMENT SIDE

- ✓ All payment as far as possible except the petty expenses should be made by crossed cheque.
- ✓ Before issuing cheque to trade creditors his ledger account must be checked with the statement received from him.
- ✓ Vouchers should be obtained for all payment
- ✓ All the vouchers are to be numbered consecutively and properly filed.
- ✓ The number of cash voucher should be entered in the cash book against the respective entry.
- ✓ All cheque should be signed only by authorized persons. The same person should also initial the counter foils of the cheque book.
- ✓ Unused cheque book should be kept under lock and key.

INTERNAL CHECK REGARDING PURCHASES

Purchases are a very important part of the activity of a business. Thus it is necessary to have a proper system of internal check regarding purchase. The following steps are suggested to secure an effective control over credit purchase.

1. REQUISITION

The procedure for issuing purchases requisiting should be specified. The head of the dept which needs of goods should fill in a requisition slip duly signed and then should send it to the purchase department. The details about quantity, quality and the time by which the goods must be supplied be clearly mentioned in the requisition slip.

2. ENQUIRY

Purchase department makes a enquiry about the terms and conditions of purchase from different suppliers. For this purpose tender are generally invited but who shall open and accept the tender should be clearly specified. As a rule the lowest tender should be accepted and accordingly a decision should be taken.

3. PURCHASE ORDER

The purchase department places orders which should be recorded in the “purchase order book”. For this purpose four copies of purchase order should be prepared. One copy will be sent to vendor, second to the store department, third to the accounts department and fourth one will be retained by the purchase department itself. A responsible officer should sign the purchase order.

4. RECEIPT OF GOODS

On receipt of goods the purchase department should properly inspect them and after an entry in the “goods inward book”. The same should be sent to the store.

5. MAKING THE PAYMENT

The purchase department should thoroughly check the invoice and send the same to the accounting department for payment. The accounts department compares the invoices with the purchase order and should also verify the calculation. A good system of internal check with regards to purchase will prevent the following types of irregularities, error and frauds.

- **FICTITIOUS**

It may be recorded in the purchase book and payment with drawn may be misappropriated.

- **DOUBLE PAYMENT**

Some invoices may be recorded twice and double payment made may be misappropriated.

INTERNAL CHECK REGARDING TO SALES

Sales are the most important sources of revenue in a business. In most of the business concern it is only sources of revenue. Therefore the system of internal check regarding sales should be extremely efficient otherwise the following type of frauds may be committed.

- a) Sales may be omitted from recording in the sales book
- b) Fictitious sales may be recorded in the sales book.
- c) Goods actually sold may be treated as sent on approval basis or by value payable by post
- d) Sales of fixed assets may be treated as sale of goods
- e) Sales of the next year may be recorded as the sales of the current years
- f) Thus to avoid such type of frauds the whole system of credit sales should be kept under proper control and supervision

INTERNAL CHECK SYSTEM TO SALES

- ✓ All order received should be entered in the “order received book”
- ✓ Only authorized person should accept the order
- ✓ Only senior official should have authority to grant credit facility.

- ✓ The person having authority to examine and record the dispatch of goods should not be from among those who are in charge of stock maintenance or invoice duties.
- ✓ There should be a well established procedure for regular comparison of records of goods dispatched with original order, dispatch memo and invoice.
- ✓ Invoice should be prepared in triplicate.
- ✓ Two copies of invoice should be sent to the customers concerned who should be asked to return a copy there off with his signature as a proof of receipt of goods mentioned there in. From the third copy of the invoice particular of the sales should be recorded in the “goods outward book”.
- ✓ A proper procedure to follow the goods sent on approval, sales or return, free of charge etc.
- ✓ Goods returned by customer should be entered in a separate register. For example “goods inward book” and the reason for the return.
- ✓ Authority to deals with customer’s enquiries, overdue accounts and writing of bad debts should rest with a senior person.

INTERNAL CHECK REGARDING TO WAGES

The system of internal check for wages should be devised in a careful and planned way especially the manufacturing concern. In big manufacturing concern huge amount will have to be disbursed to number of workers periodically as wages. There are greater possibilities of frauds in such concern. Efforts therefore should be made to prevent them with the help of some suitable arrangement of internal check.

It should be actively enforced and supervised by some responsible officers. The objects are,

- To avoid inclusion of dummy or ghost workers in the wage list
- To avoid incorrect time and piece work record
- To avoid fraudulent manipulation of wage sheet and misappropriation of money etc

SYSTEM OF INTERNAL CHECK.

To minimize such risk of fraud the following system of internal check may be adopted.

- ❖ Wage department should be headed by a responsible official other than the cashier.
- ❖ The time of arrival and the time of leaving of every worker must be recorded by the gate keeper
- ❖ All apportionment, removal and fixation or alteration of wage rate should be in writing and authorized by a responsible officials.
- ❖ In respect of time workers the time records maintained by the gate keeper and the foremen must be compared and checked to deduct dummy or ghost worker if any
- ❖ Each worker should be given a card bearing his name and numbers. The worker should write the time of his arrival and leaving from the factory, the job number and the department in which he works and the terms of employment. The foreman in charge should initial the entries on the card. These cards will be collected from the workers and sent to the wage office at the end of each week
- ❖ Overtime must be recorded separately and passed and approved by the foreman and work manager.
- ❖ The workers should not be allowed to leave the factory without written permission before the scheduled time.

- ❖ Wage sheet should be prepared for piece worker separately by person not connected with the recording of attendance and work of the employees. Each person who took part in the preparation of wage sheet should initial it for the work performed.
 - ❖ A cheque should be drawn for the exact amount payable.
 - ❖ Wages should be paid by a person not connected with the preparation of wage sheet. But in the presence of foreman and work manager.
 - ❖ Wages should be paid only the workers who are present and not to their nominees.
 - ❖ A statement of “unpaid wages” should be prepared and which should be signed by the cashier and concerned foreman.
 - ❖ Advances should be discouraged. If unavoidable advances should be given through the petty cashier. Later on they should collect from the wages of the respective.
 - ❖ If casual workers are also employed in the factory a separate record should be maintained about them. Such records should e examined periodically by responsible officers.
 - ❖ There should be specific instruction with regards to the procedure will be followed for dealing with unclaimed wages. These should include of preparation list of unclaimed amount and immediate deposit of the sum in the bank in a separate accounts
 - ❖ Senior officer should do surprise checking of wage sheet and wage payment to ensure that,
 - ✓ Fake dummy names are not shown in the wage sheet
 - ✓ Wage rate are not over stated or deduction are not under stated
 - ✓ False over time payment are not recorded
-

QUESTION BANK

1. What are the objectives of internal control
2. What is internal check? State the objectives of internal check
3. Suggest a sound internal check system as regard cash receipt and cash payment in cash book
4. Explain the advantages of internal check system
5. State the essential characteristics of a good system of internal check
6. Suggests a sound internal check system as regard credit purchase of a company
7. Suggest a sound internal check system as regard
 - Sales of a company
 - Wages of a company
 - Inventory of a company

UNIT – III

VOUCHING

MEANING OF VOUCHING

Vouching is an important aspect of auditing. Audit without vouching shall be incomplete. It enables testing the truth of items appearing in the books of original entry.

Vouching does not mean only comparing the cash receipt with the counterfoils of the receipt book or the bank pay in slip, but it includes proper examination with reference. Thus the act of establishing the accuracy and authenticity of entries in the accounts book is called “vouching”.

DEFINITION

According to Ronald A. Irish, “vouching is a technical term which refers to the inspection by the auditor or documentary evidence supporting a transaction”.

OBJECT OF VOUCHING

The main objectives of vouching are as follows.

- 1) All the transaction which is connected with the business have been recorded in the books of accounts properly.
- 2) To verify that all transactions recorded in the books of accounts are supported by documentary evidence.
- 3) The vouchers which support the entries are legally valid from the view point that they are authentic and properly dated.
- 4) To verify that no fraud or errors has been committed while recording the transaction in books of accounts.
- 5) The vouchers have been processed carefully through various states of internal check system.
- 6) Every transaction recorded has been adequately authenticated by a responsible person.
- 7) While recording the transaction whether distinction has been made between capital and revenue items.
- 8) Whether accuracy has been observed while totaling, carrying forward and recording an amount in the accounts.

PROCEDURE OF VOUCHING

The auditor must be taken the following procedure while vouching the transaction.

- 1) While vouching a transaction auditor must verify the authenticity of transaction, accuracy of amount recorded and proper classification of accounts.

- 2) Auditor should see that all the vouchers are numbered serially and dated.
- 3) The voucher which has been checked by the auditor should be stamped or tick marked with a special sign, so that it may not be used again for a fictitious transaction.
- 4) The amount in the receipt must be shown in words and figures. If the two differ then it should be investigated.
- 5) If the voucher is in the personal name of the partner, manager, director or any other person, it should be seen that proper treatment for such transaction has been provided in the books.
- 6) If any voucher is doubtful the auditor should proceed cautiously and use special tick for such voucher.
- 7) It should be seen that every voucher is certified by the responsible of the business.
- 8) For missing voucher the auditor should ask for explanation from the concerned official. If no satisfactory reply is received then it should be further investigated.
- 9) While vouching the auditor should not take any help from client staff.
- 10) While vouching the auditor should keep in mind that distinction is made between capital and revenue items.
- 11) For certain transaction auditor may refer the resolution passed at the meeting of share holders or directors
- 12) When purchases are made on cash basis, auditor should see that such transaction are not recorded twice, once in the cash book and then in the purchase book.
- 13) As far as possible vouching of books of accounts of a particular period must be completed in one continuous sitting.
- 14) Auditor should use specific tickets for vouching cash payment, receipts, purchase, sales etc.

IMPORTANCE OF VOUCHING

“VOUCHING IS THE BACKBONE OF AUDITING”

Vouching is considered to be the essence of auditing or backbone of auditing due to the following reasons.

1. PRIMARY STEP IN AUDITING

Vouching is the preliminary step in the audit of accounts. If an auditor completes this work carefully, he can proceed further in his task easily.

2. ACCURACY OF BOOKS OF ACCOUNTS

The main aim of audit is to check the books of accounts to ascertain their accuracy. This object of audit is fulfilled by vouching since it establishes the accuracy and authenticity of transaction.

3. BASIS FOR THE VERIFICATION OF ASSETS AND LIABILITIES

Vouching is the basis of verification of assets and liabilities which is the next step in auditing. The auditor has to certify the correctness of assets and liabilities appearing in the balance sheet for which vouching is helpful to him. Let us take an example of cash at bank stated in a balance sheet.

If it is to be certified as correct the auditor has to vouch the pass book counterfoils of the paying in slips, banker's advice note, counterfoils of cheque book and other correspondence with the bank. He should further compare these items with the cash book and check the bank reconciliation statement.

4. DETECTION OF ERRORS AND FRAUDS

During the course of vouching the auditor is able to detect errors and frauds which is the subsidiary object to audit. This possibility of detection automatically prevents the commission of errors and frauds.

5. CERTIFICATION OF STATE OF AFFAIRS OF A BUSINESS

The auditor has to certify that the profit and loss account and the balance sheet exhibits a true and correct view of the state of affairs of a business. In order to certify like this or otherwise the vouching is of much use of an auditor since it reveals the correctness of accounts and forms the basis of verification.

VOUCHERS

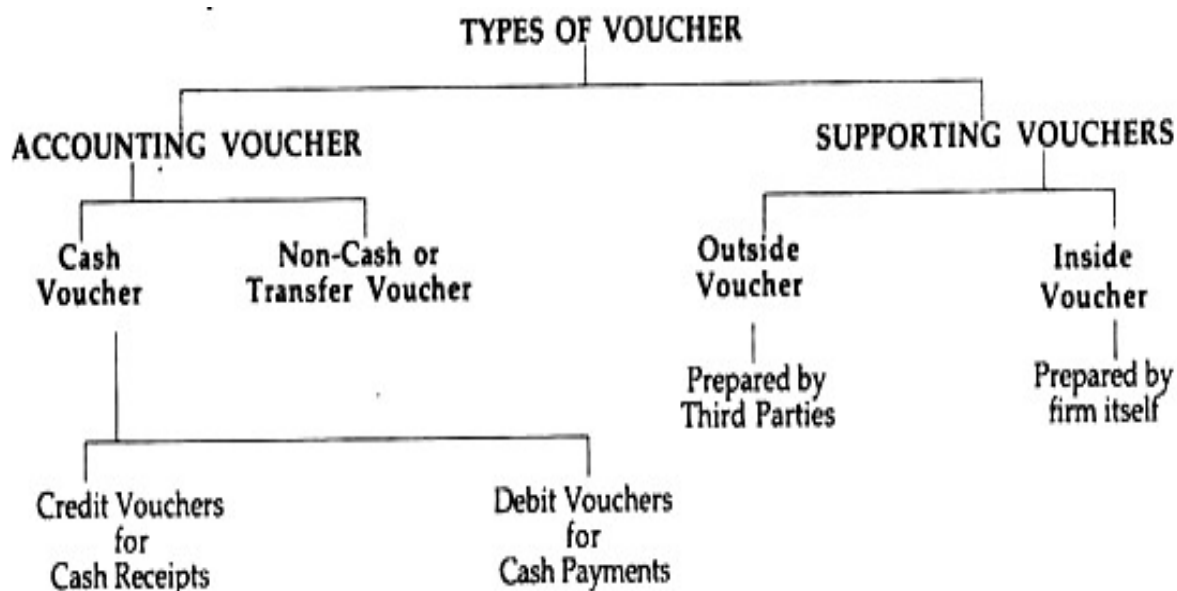
MEANING OF VOUCHER

A voucher may be defined as any documents which evidences a transaction or an entry in a book of accounts. It may be in the form of a money receipts, invoice, cash memo, bank pay in slip, agreement of contract, a resolution passed at a meeting of the board of directors of shareholder, the minutes of a meeting, correspondence with parties and so on.

KINDS OF VOUCHERS

A voucher may be

1. Primary or Accounting Voucher
2. Collateral or Supporting Voucher



FEATURES OF GOOD VOUCHER (OR) REQUISITIES OF A VOUCHER

1. ADEQUATE

Adequacy is not to be confused with the number of vouchers which the auditor is able to collect in support of a transaction or an entry. The important thing is the relevance and authentic of a voucher.

2. REALICBILITY

Reliability of a voucher is to be determined with reference to the manner of preparation and maintenance of the voucher, for example whether the voucher is addressed to the firm at its normal business address, and whether it is properly dated, authorized and filed.

3. COMPETENCY

Competency of a voucher will largely depend on the place of its origin. Vouchers originating outside, such as written confirmations obtained from debtors or creditors, may be safely treated as competent evidence. But vouchers originating outside but held by the client e.g. purchase invoices or bank statement cannot be so treated because these can be easily forged or altered. Vouchers processed through an effective internal control system can also be relied upon.

VOUCHING OF CASH TRANSACTION

INTRODUCTION

Vouching of cash transaction is a very important part of the auditor's duty as there are greater chances of fraud and misappropriation. The auditor should carefully examine the system of internal check. He should enquire about the right and duties of the cashier, who should not have any access to the ledger, books of original entries etc, otherwise there are greater chance of fraud and misappropriation.

A) VOUCHING OF RECEIPT SIDE (OR) DEBIT SIDE OF CASH BOOK

While vouching the debit or receipt side of the cash book, the auditor must remain alert to the following errors.

- Receipts may not be entered in the cash book, particularly receipts of a casual and non-recurring nature such as proceeds from sale of assets, recovery of bad debts already written off, or repayment of over payment to suppliers.
- Receipts may be understood by preparing the duplicate receipts for sums less than the original.
- On the counter foils of bank paying in slips, false particulars of cash deposited in bank may be mentioned.
- Discount allowed may be overstated and the excess amount may be misappropriate from cash received.
- A recoverable debt may be shown as bad, and cash received from the party may be misappropriated.

VOUCHING PROCEDURE

The vouching procedure in regard to some of the important items appearing on the debit side of the cash book is given below.

1. OPENING BALANCE

Closing balance of last year becomes the opening cash balance of the current year. Opening balance can be verified from the last years audited balance sheet. In cash book has bank column also it should be ensured that opening balance are not entered in the wrong column.

2. CASH SALES

There are more chances of misappropriation of cash sales. The concerned sales man may make the sales and may not make entry for cash received. In big concern the sales man is not allowed to receive cash from customers, even goods are also delivered by some other person. He is simply to prepare four copies of memo of goods sold of which two copies are handed over to customer and sales man will send one copy along with goods to the delivery clerk.

3. CASH RECEIVED FROM DEBTORS

Apart from the cash sales the goods are mostly sold on credit, the parties to whom the goods are sold on credit are called debtors. In course of time cash is received from debtors, the vouchers in this case will be the counterfoil or the carbon copies of the receipt issued against the payment received from the debtor. The auditor should vouch the debtors considering the following important point.

- **CASH DISCOUNT**

The auditor should give stress upon the discount policy of the business. Cash discount should be verified and it should be according to the agreed terms or usual trade customs.

- **STATEMENT OF ACCOUNTS SENT TO DEBTORS**

In the process of internal check and vouching of cash statement an important point to note is that the person who receives cash from the customers should not be connected with

sending the statement of accounts to the debtors. The auditor should also see that these statements are regularly sent and debtors are asked to confirm the balance as shown by the statement of accounts.

- UNUSED RECEIPT BOOK UNDER SAFE CUSTODY

Due care should be taken in respect of unused receipt books. These should be kept under the lock and key safely in possession of the responsible officers.

- BAD DEBTS

The auditor should pay special attention to the amount written off as bad debts. He should find out as to who is authorized to write off bad debt. Cash received may be misappropriated by writing off the debts wholly or partly.

- DIRECT CONFIRMATION STATEMENT SENT BY AUDITOR

The auditor with the consent of the client can send the confirmation letter so as to confirm that the balance shown in the books are correct.

4. LOANS

All the business concern has to borrow money from banks or other financial institutions. Auditor should enquire whether the client is empowered to borrow. Restrictions are imposed by company act 1956 or limited companies whether the company has with all the legal provision relating to loans. While vouching the loans received, the terms and conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.

6. BILLS RECEIVABLE

Bills receivable book may be verified because the various details regarding bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have been becomes due but no amount is received. A verification of the bills discounted should be made whether the entry for discount had been made.

6. RENT RECIVABLE

The following points regarding rent receivable be examined by the auditor.

- Terms and conditions of agreement and lease deed.
- Rent received should be compared with the list of properties maintained. In case of rent collected by agent, then it should be compare with the accounts submitted by agents.
- Check the counter foils of receipts issued to tenants.
- In case of heavy arrears of rent outstanding, auditor should confirm the arrears from tenant with the consent of client.

7. COMMISSION RECEIVED

The auditor should keep in mind the following points while vouching commission received.

- Study the agreement for receiving commission

- Verify the commission received with counterfoil of receipt
- Check the calculation of commission according to the terms of agreement
- List of names of the parties should be verified from whom the commission is receivable.

8. INCOME FROM INTEREST & DIVIDEND

While vouching dividend auditors should check dividend warrant counterfoils and covering letter received along with the cheque. If the dividend received through bank amount should be verified with the bank statement.

9. INSURANCE CLAIMS

Insurance claims can be vouched with the copy of insurance claim lodged, correspondence with the insurance company counterfoil of the receipt issued. It should be verified that insurance claim recovered has been recorded in the proper account

10. ROYALTY RECEIVED

Royalty received can be examined from the following.

- Terms and conditions of royalty payment.
- Correspondence with the lessee
- Calculation of royalty
- Counterfoil of receipt issued

VOUCHING OF THE MORE IMPORTANT ITEMS APPEARING ON THE PAYMENT SIDE SHOULD BE DONE AS FOLLOWS:

1) OPENING BALANCE

Cash book may have credit balance in the bank column. This balance can be verified from the previous year balance sheet.

2) CASH PURCHASE

In emergency cash purchase of goods may be made. Purchase of stores and stationery are made usually on cash basis. An adequate internal control system will be helpful in controlling manipulation of cash purchase. It should be seen that goods purchased are actually received by the store keeper. Cash memo can be compared with "GOODS INWARD BOOK" to verify the goods received.

3) PAYMENT TO CREDITORS

Payment to creditors should be examined with the receipt issued by the creditors. Receipt should indicate the purpose for which the payment has been made. If the payment is made in full and final settlement of accounts. The balance should be accounted for as discount received. Where the payment is made in excess of bill, either the excess payment is in advance or the payment is made by mistake, which should be recovered back from the creditor.

4) BILLS PAYABLE

Bills payable on the date of maturity and is return by the payee after receiving payment. Those bills should be cancelled after being paid. Bills payable paid can be vouched with bill. If the payment is made by bank, bank statement or pass book can be examined to verify the payment of bill.

5) WAGES

Payment of wages involves large amount. There are many chances of fraud and misappropriation in wage payment. The auditor should study the system of internal control in operations. Fraud and misappropriation in wage payment can arise in the following ways.

- Inclusions of dummy workers in the workers register.
- Payment of wages at higher rate than allowed.
- Including the records the name of those workers who have left the organization

6) PAYMENT OF SALARIES

To vouch payments on account of salary to staff the auditor should begin by a review of the last years audit working papers and see whether the salaries register show any increase or decrease in the number of salaried persons or nay variation in the amount payable and ascertain the reasons for the same. In casa of the variation are due to annual increments granted to employee's authorization for the same in the form of a resolution of the board or other competent authority should be examined.

7) LOAN

Auditor should see that the loan voucher should be supported by the receipt given by the party. Further details regarding terms and conditions of loan can be verified from the loan agreement. It should see that installments of loan along with interest are received in time. Mortgage deed and other document should also be examined.

8) PURCHASE OF INVESTMENT

The auditor should compare the investment purchased with "BROKER BOUGHT NOTE". If possible physical verification of investment should be made. Investment must be in the name of the company.

9.) PLANT & MACHINERY

The auditor can vouch the purchase of machinery with invoice received from the suppliers. The expenses incurred on the purchase and installation of machinery is to be capitalized by debiting the concerned assets account. In case of imported machine the import duty and clearing charges should also be debited to the assets account.

10) PURCHASE OF LAND & BUILDING

Land may be purchased or acquired on long term lease. Buildings may also be constructed. To vouch payments made on this account the auditor should first ascertain that there is proper authority for the expenditure. This may be in the form of resolution of board in the case of a company. If the

expenditure on purchase exceeds the amount authorized, the reason and approval for the excess should be examined.

11) DIRECTOR'S FEES

Directors received fees for attending board of directors meeting. Provision for the payment of fees to directors is made in Articles of Association. Director's attendance register will provide the name of directors, who attend the meeting. Directors signature on receiving fees is obtained on the receipt book and the signature of directors attend the meeting.

12) RENT PAID

Auditor should verify the payment of rent from the agreement. The rent voucher should be supported rent receipt from the landlord. It should be seen that payment of rent is sanctioned by responsible officers.

13) INSURANCE PREMIUM

The auditor should examine the following for the vouching of insurance premium.

- Insurance policy or the cover note issued by the insurance company.
- Insurance policies in case of policies are more than one.
- Insurance premium receipt.

14) TRAVELLING EXPENSES

The staff of the company is paid travelling expenses according to the rules and regulations. It will be framed by the board of directors, partners etc. in the absence of such rules, vouching should be on the basis of the expenditure incurred.

15) INCOME TAX

The payment of income tax can be verified from the demand notice and receipt chalan. The auditor should see the proper entries are made in the accounts keeping in view advance tax, previous year tax and current year tax payment. If any penalty is also paid, separate entry shall be made in the concerned account.

16) PETTY CASH BOOK

Petty cash book is an important book. It records petty cash payment. It is usually maintained on the basis of "IMPRIEST SYSTEM". In many cases the petty cash payment is considered as unimportant.

But in fact there are lot of opportunity for committing fraud and misappropriation. Before commencing the vouching of petty cash book the auditor should check the system of internal check in regard to the petty cash transaction and adopt the following force of action.

VERIFICATION

MEANING OF VERIFICATION

Verification in the case of an audit is concerned by means of physical examination, legal and official documents and expert opinion as to existence, ownership, possession, classification and valuation of assets and liabilities of the entity as disclosed in the balance sheet.

DEFINITION

According to Spicer and Pegler, “verification of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets”.

OBJECTIVES OF VERIFICATION

- ❖ Correct valuation of assets & liabilities
- ❖ Whether the balance sheet exhibits a true & fair financial position
- ❖ Finding out the existence of assets
- ❖ Finding out the ownership & title of the assets
- ❖ Deduction of fraud & irregularities
- ❖ Certification of the arithmetical accuracy of the accounts

DISTINCTION BETWEEN VERIFICATION & VOUCHING

BASIS FOR COMPARISON	VOUCHING	VERIFICATION
Meaning	Vouching means checking the accuracy of the transactions recorded in the books of accounts.	Verification means a process to substantiate the validity of assets and liabilities appearing in the Balance Sheet.
Basis	Documentary Evidence	Observation and Documentary Evidence
Examination of	Items of Profit & Loss account	Items of Balance Sheet
Carried out by	Audit clerks	Auditor
Time Horizon	Year-round	At the end of the financial year.
Objective	To examine the correctness, validity and completeness of the transactions.	To confirm the ownership, possession, existence, valuation and disclosure of the items appearing on the Balance Sheet.

VERIFICATION OF DIFFERENT ASSETS

For the purpose of convenience we may divide the assets into the following four categories.

1] INTANGIBLE ASSETS

A) GOODWILL

It is an intangible asset. It is more or less reputation of a business valued in terms of money. Its value depends upon the earning capacity of the business. Its value increases with raise in profit and decreases with the fall in profit. Thus goodwill cannot have a permanent value. Goodwill is not usually brought into account books. It is brought into account books only when it is actually purchased or in the case of partnership firm when there is an admission, retirement or death of any one of the partners. The auditor should examine the purchase agreement or the partnership deed to ascertain the cost of goodwill. He should also see that the goodwill is never overvalued.

B) PATENTS

Patents normally should appear in the balance sheet at their cost price there were purchased from others. The auditor should examine the patents and should see that they are registered in the clients' name. Auditor should also obtain the last renewal certificate. The normal legal life of patents is sixteen years.

C) TRADE MARK

Trade mark is a legal right when registered to be used for the production. The auditor should examine the certificate issued by the registrar. In case they have purchased from others the auditors should vouch the expenditure incurred in connection with their acquisition for example registration fees, payment made to designers etc, should be capitalized. Auditor should see that they are written off over their useful life.

D) COPY RIGHT

Copy right is a sole right to produce or reproduce a book or an article. The life of a copy right is considerable longer than the patents. In general it lasts for the life time of the author and a period of 50 years after his death. It is purchased the auditor should check the written agreement and vouch the price paid off for it. The copy right will appear in the balance sheet at cost and shall be written off over a short period.

2] FIXED ASSETS

A) LAND AND BUILDING

Land and building are the common premises found in almost all the business or industrial undertakings. It may be i) free hold or ii) lease hold

B) PLANT AND MACHINERY

This asset forms a considerable part of capital expenditure of a business. It is very difficult to verify this asset because it is not at one place but scattered here and there, so complete verification is not possible. The auditor will vouch the expenditure incurred on each period on plant and machinery. Where a “plant register” is maintained verification of the plant and machinery may be done by comparing the register with the plant and machinery installed. If the plant and machinery is purchased then the auditor should vouch expenditure with the invoice and receipts.

C) FURNITURE AND FIXTURE

This asset is fixed assets. It is not intended for sale. So it is shown in the books at cost price less depreciation. The auditor should certify the price of furniture with invoice and receipts. He should examine carefully any additions or sale during the year. He should also verify the physical existence of furniture by personal inspection. He should see the proper depreciation is provided on furniture and fittings.

3) FLOATING ASSETS

A) CASH IN HAND & CASH AT BANK

The figure of cash in hand and cash at bank shown in the balance sheet is extracted from the cash book of the clients. As a part of the routine work the pass book or the statement of account will be examined to see that the balance sheet shown its final balance as shown by the cash book. The verification should be completed by a certificate furnished direct to the auditor by the bank in which the firm is maintaining the accounts. The certificate is issued for the various types of deposits, saving and current bank accounts. Where the firm is maintaining its accounts in a foreign bank it should be seen that the balance is stated after conversion into home currency at the exchange rate at the date of the balance sheet.

B) BILLS RECEIVABLE

The auditor should examine the “bills receivable book” with the bills in hand. Bills on hand should be verified by actual inspection of the bills. The auditor should see that they are properly drawn, stamped, duly accepted and are not overdue. Bills discounted are to be checked up with the entries in the cash book and bank pass book. Bills sent to bank for collection should be checked with the entries in the “bills receivable book” regarding their due dates and amount. He should also check them with the certificates obtained from the bank.

C) STOCK IN TRADE

The correctness of profit and loss account of a concern depends to a great extent upon the correctness of the value of stock of goods at the close of the period so the auditor has to verify it very carefully. The verification of stock involves verification of physical existence and verification of the value of stock.

D) SUNDRY DEBTORS OR BOOK DEBTS

The auditor must obtain a schedule or list of all the debtors. The schedule should be compared and checked with the sales ledger. The sales ledger is also called debtor ledger or customer ledger. The debtor ledger may also be checked with the outward invoices, debit notes, goods outward book, return inward book, cash book and bills receivable books. He should see that the trade discount and goods sent on approval. The opening debit balance should also check with the help of the previous audited balance sheet. The auditor should obtain a list of such bad and doubtful debts from the clients duly certified. He should see that bad debts are written off and adequate provision is made against doubtful debts.

E) INVESTMENTS

If there is a large number of investment and auditor should ask for a list of investment. The list should show the details of investment. The list should show the details of investment i.e. face value, market value, book value, date of purchase etc. investment may be made in

- Registered stock and shares
- Bearer shares or debentures or bonds

VERIFICATION OF LIABILITIES

Verification of liabilities is an important as the verification of assets. If liability are not properly verified and valued the balance sheet will not reveal a true and fair view of the state of affairs of a business concerns. Verification of liability is aimed at ascertaining that all the business liabilities are properly disclosed, valued, classified and presented in the balance sheet. The auditor should see that liabilities are not over stated or even deliberately omitted. He should obtain a certificate from some responsible officers as to their correctness. Now we discuss the verification of various liabilities.

1) CAPITAL

It is not a liability in the strict sense of the world. Never the less it is a liability popularly known as internal liability. The auditor is required to verify it so as to certify the correctness of the balance sheet. In case of firm the auditor should verify the liability on account of capital with the help of partnership deed, cash book and the pass book. He should see that it has been properly recorded in the books of account. In case of a company the auditor job may be grouped under 2 heads namely first audit and subsequent audit.

2) DEBENTURES

The auditor should note the following points while verifying debentures.

- The auditor should refer to the memorandum and articles of association to find out whether the company has got power to issue debentures and that limits if any has not been crossed.
- “Debenture trust deed” should be inspected and with its help the debenture account in the ledger should be examined.
- The debenture are may be issued at par or at a premium or at a discount.

3) TRADE CREDITORS

The auditor must obtain a schedule or list of all creditors. The schedule must include all details about trade creditors. The schedule should be compared and checked with the purchases ledger or credit ledger.

The credit ledger may also be checked with the purchase invoices, credit note, goods inwards book, return outward book, cash book, bills payable book etc. he has to satisfy himself with the help of the goods inward book that all the purchases during the year has been duly recorded in the books and there is no omission of invoices.

4) BILLS PAYABLE

The auditor should take following steps to verify this liability,

- With the permission of his client the auditor should obtain confirmatory statement from the drawers directly.
- The auditor should obtain a list of outstanding obligation on account of bills payable. This should be checked with the bills payable book and bills payable account.
- The bills paid after the balance sheet date should be verified with the entries passed in the cash book.
- He should ensure that the bills which have been paid are not recorded as outstanding.

5) LOANS

The auditor should examine the loan agreement in order to ascertain the terms of loan, amount of loan, period and nature of loan etc. with the permission of his client he should confirm the balance of unpaid loans directly from the creditors of the company.

In case of loans or over draft have been taken from a bank an agreement with the bank should be obtained from a bank. The auditor should see whether the interest due has been paid it or not. If the interest is due but not paid till date of the balance sheet, the same should be clearly shown as liability therein

6) OUT STANDING LIABILITIES FOR EXPENSES

The auditor should obtain a certificate from a responsible officer of the company stating that all outstanding liabilities for expenses incurred have been brought into account.

The auditor can verify those items of expenses which usually constitutes outstanding liabilities. For example salaries payable, legal expenses, rent, wages, audit fees etc.



QUESTION BANK

- 1) Vouching is the essence of auditing? Elucidate
- 2) Explain the meaning of the term vouching? what are its objectives
- 3) What is voucher? What consideration should an auditor keep in mind while examining a voucher
- 4) Explain the importance of vouching
- 5) How will you vouch payment side of wages
- 6) How will you verify the following items?
 - Free hold property
 - Trade creditor
 - Loans (as a assets)
 - Plant and machinery
 - Copy rights
 - Book debts
 - Investment
 - Good will
 - Opening cash
 - Cash sales
 - Cash received from debtor
 - Sale of investment
 - Petty cash

UNIT –IV

APPOINTMENT OF AUDITORS

Audit is voluntary to sole trading concerns and partnership firms. But it is legally compulsory to all joint stock companies. Every company must appoint a qualified auditor to audit the accounts. Auditors are appointed and not elected. Sec 224 of the Companies Act 1956 contain provision relating to the appointment of a company auditor

1. First auditor

Sec 224 (5) provide for the appointment of first auditor by the board of directors within one month of the date of registration of the company. The auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. The company may however at a general meeting, remove any auditors and appoint in their place any other person. Appointment of the first auditor should be by a valid resolution at the board meeting. Merely naming them in the article will not be recognized as appointment under the act. The first auditors is also not required to inform the registrar about his acceptance or refusal of the said appointment.

2. Subsequent auditors

Subsequent auditor or auditors of a company are appointed every year by the share holder in annual general meeting by passing an ordinary resolution. According to Sec 224(1) “ every company shall at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting, and shall within 7 days of the appointment give intimation to every auditor so appointed”.

3. Appointment by central government

According to Sec 224 (3) where at an annual general meeting no auditors are appointed or re-appointed, the central government may appoint a person to fill the vacancy. In such case the company is required within 7 days of its failure to appoint or reappoint an auditor to whom the central government’s power to appoint an auditor in such an event has been delegated under sec 637.

4. Appointment in case of casual vacancy

According to sec 224(6), board of directors may fill any casual vacancy in the office of an auditor before the annual general meeting of the share holders. However casual vacancy called by the resignation of an auditor shall be filled only by the company in general meeting. The auditor appointed to fill a casual vacancy shall hold office till the next annual general meeting.

5. Appointment by special resolution (sec 224 (a))

Sec 224-A of the amendment act 1974 specified the cases in which the appointment by the auditor which require a special resolution. In case of company which is not less than 25% of subscribed share capital is held by a public financial institution or govt or nationalized bank or general insurance company the appointment or reappointment shall be made by a special resolution.

6. Auditor of government companies.

Special provision has been made by sec 619 of the company's act 1956, regarding the auditor of a govt company. The auditor of such a company shall be appointed or reappointed by central govt on the advice of the comptroller and audit general of India.

7. Restriction on the number of auditor ship

Companies act 1974 has introduced certain radical changes with regard to the appointment of the company auditor. Two new sub-sections have been added to sec 224. Subsection 1B empowers the central govt to specify the number of companies in which a person can be appointed as an auditor. An auditor cannot hold the audit of more than 20 companies, out of which not more than 10 companies where, paid up share capital Rs.25 lakhs or more.

QUALIFICATION & DISQUALIFICATION OF AN AUDITOR

Audit is optional to sole trading concerns and partnership firms. But it is compulsory to joint stock companies. The accounts of sole trader and partnership firm can be audited even by unqualified auditors. But according to the joint stock companies can be audited only by qualified auditors. Sec 226 of the company's act 1956 contains provisions relating to the qualification and disqualification of a company auditor.

QUALIFICATION OF AN AUDITOR;

1. PROFESSIONAL QUALIFICATIONS:

- ❖ Wide and thought knowledge in the taxation commercial law, principles of auditing and companies act etc.,
- ❖ Considerable knowledge in economic also

2. PERSONAL QUALIFICATION:

- ❖ He must be honest & tactful
- ❖ He must be vigilant
- ❖ He must be systematic/methodical
- ❖ He must be courage & integrity
- ❖ He must be sincere in profession

- ❖ He must have sound common sense
- ❖ He must have the ability to draft the effective audit report

DISQUALIFICATION OF AN AUDITOR

Sec 226 (3) provide the disqualification. According to it following are disqualified to be appointed as auditor of a company.

- ❖ A body corporate
- ❖ An officer or employee of the company
- ❖ A partner or employee of an officer or employee of the company
- ❖ **A person indebted to the company for an amount exceeding Rs 10000**
- ❖ **A surety or guarantee of a debt exceeding Rs 10000 taken by a third person from the company**
- ❖ **A director or member of a private company or a partner of a firm, which is the managing agent or secretaries and treasurers of the company.**
- ❖ **An un-discharged insolvent or insanity persons.**

REMOVAL OF THE AUDITORS

Provision regarding removal of the auditor

According to sec 224(7) of the Indian companies Act an auditor may be removed from office before the expiry of his term. The law permits the removal of an auditor under certain circumstances. The directors of a company however have no power under any conditions to remove an auditor from office.

- ❖ The first auditor appointed by the director may be removed from office before the expiry of his term by the company at a general meeting, provide at least 14 days notice before holding the meeting has been given to him. The approval of the company law board is not necessary.
- ❖ Any other auditor may be removed from office before the expiry of his term by the company at a general meeting after obtaining the previous approval of the company law board.

Procedure for removal

Sec 225 lays down the procedure that is to be followed for removal of an auditor.

- If any shareholder wishes to nominate another person in place of the existing auditor he must give a special notice of 14 days to the company.
- The company must send a copy of such notice to the retiring auditor.
- The retiring auditor has got a right to make written representation to the company.
- He got a right to ask the company to circulate his written representation among its members.
- The auditor is also entitled to attend the meeting where his removal is being discussed.
- He also has a right to speak at such meeting.

REMUNERATION OF THE AUDITORS

Sec 224(8) of the companies act deals with the remuneration of the auditor of a company. The remuneration of the auditor of a company shall be fixed by the appointing authority. According to the provision of sec 224(8) the remuneration may be fixed as under.

- a) The remuneration shall be fixed by board of director when the auditors are appointed by the board.
- b) The remuneration shall be fixed by the central government.
- c) In all other case remuneration shall be fixed by the company in general meeting or in such manner as the company in general meeting may be determined.
- d) Any sum paid by the company in respect of the expenses of an auditor shall be deemed to be included in the terms of remuneration.**
- e) If the auditor is asked to do any other work like preparation of final accounts or filling of income tax returns he or entitled to extra remuneration for such services rendered by him.**

DUTIES OF AN AUDITOR

1. To report on the accounts audited by him.

An auditor is appointed by the shareholder to examine the accounts maintained by the directors. It is the primary duty of an auditor to make a report to members on the accounts qualified by him and on the balance sheet and profit and loss of the company. If in his opinion the accounts do not give a true and fair view he must qualify his report. He has to keep the interest of the share holders in his mind while submitting his report.

2. To assist inspections

Under sec 240 auditor are regarded as the agents of the company. Hence it is their duty to give all assistance to an inspector appointed to immediate into the affairs of a company.

3. Suggestions for altering the system of account keeping

If the auditor is not satisfied with the system of account keeping, he must suggest to the directors to alter the system .If the director refuse to accept the suggestion, he must state the fact in his report.

4. Certification of prospectus.

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

5. Certification of statutory reports.

An auditor has to certify the statutory report are correct according to sec 165(4)

6. Certification of interim financial statement

An auditor has to certify interim profit and loss account and balance sheet prepared by board of directors and the managing agents or secretaries and treasurers.

7. To certify declaration of solvency.

In case of members voluntary winding up auditors is required to certify the directors declaration about the solvency of the company.

8. Duty as to report under voluntary winding up

When a company has been wound up voluntary and the required number of its directors has made declaration as to its solvency. Then the auditor is under a duty to prepare such report as far as circumstance admits in accordance with the provision of the companies act.

Powers (or) Rights of Auditor

1. Right of access of the books of accounts (sec 227(1))

Auditor has a right to access at all time to the books and vouchers of the company, whether kept at the head office or elsewhere. He is free to go surprise visit and check books. The term 'Book' not only include financial record but also all the statistical and costing books. Similarly vouchers include all type of documentary evidence recorded in the books of accounts.

2. Rights to obtain information and explanation. (sec 227(1))

Auditors have the right to ask the directors and officers of the company to give any information and explanation which are necessary for the preparation of his duties satisfactorily.

3. Rights to visit branches

Auditors have a right to visit the branches and audit the account maintained by them. However if qualified auditor are appointed to audit the account of the branches he cannot exercise the right.

4. Right to receive notices etc (sec 231)

Under sec 231 an auditor is entitled to receive and other communication relating to any general meeting of the company in the same way as a member of the company is entitled to receive them. He is also a right to attend any general meeting.

5. Right to attend the meeting of share holders. (sec.2321)

The auditor has the right to attend every general meeting of the share holders. He also has the right to speak at such meeting where the accounts are being discussed. However he has no right to attend the meeting of directors.

6. Right to make a statement.

The auditor has the right to make any statement at a meeting where his certified account discussed if he so desires. He is not found to make any statement or answer question unless he is asked to do so by the chairman of the meeting. He should answer only those questions which affect the accounts.

7. Right to correct any wrong statement.

The auditor has a right to correct the wrong statements made by the directors relating to accounts.

8. Rights to refuse to start the audit work

The auditor has a right to refuse to start the audit work until the management balance the book.

9. Right to take legal & technical advice

Auditor has the right to take legal expert or technical advice any matter relating to the business in order to perform his work satisfactory. But he must give his opinion in the report and not that of experts, lawyer etc.

10. Right to receive the remuneration

Auditor has a right to get remuneration on the completion of the agreed audit work.



LIABILITY OF AUDITORS

The auditor of a private business is not appointed under any statute. He is appointed by an agreement with his client. His duties, powers and liabilities therefore, depend upon the agreement. In

other words his liability is contractual liabilities. His liability may arise on two accounts namely breach of contract or negligence in the performance of his duties.

Company auditor is however different. He is appointed under the companies act. His duties and liabilities are determined by statutes. Under Indian companies act and other act the auditor has civil and criminal liabilities.

A. CIVIAL LIABILITIES

- Negligence of duty
- Breach of trust or misfeasance
- Liabilities towards misstatement

B. CRIMINAL LIABITIES

- According to companies act
- As per income tax act
- Other enactments

A. CIVIAL LIABILITIES

Liabilities of an auditor to pay damages are known as civil liabilities. Liability may arise in the following cases.

1. Negligence of duty

Auditor is appointed to perform certain duties. He is the agent of shareholders. He has to verify assets and liabilities. He has to perform his duties according to the accepted professional standard. He has to exercise reasonable care and skill in the performance of his duties. If he acts negligently, he may be used in a civil court damages. He has to make good the loss suffered by the company on account of his negligence.

Case study

[London oil Storage Company limited vs. sear Hasluck co.]

In this case auditors failed to verify the existence of the petty cash. As a result company suffered loss. It was held that an auditor committed breach of duty by omitting to verify petty cash and hence liable to pay damages.

2. Breach of trust (or) misfeasance

Misfeasance means breach of duty imposed by law. If an auditor does something wrongfully in the performance of his duties resulting in a financial loss to the company he is guilty of misfeasance.

Case study- 1

[THE KINGSTON COTTON MILL CASE (1986)]

In this case accounts of the company has been falsified by the over valuation of stock in trade for a number of years. As a result dividends were paid out of capital. Auditor relied upon the stock sheets certified by the manager of the company. It was held that “it was not a part of his duty to take stock or to act as valuer. In the absence of suspicious circumstance auditor could rely on the stock sheet certified by a responsible officer”.

Case study-2

[THE WESTMINSTER ROAD CONSTRUCTION & ENGINEERING CO.LTD (1932)]

Auditor has held liable to refund to the company the amount of dividend wrongly declared by it on the faith of auditor’s qualified balance sheet, which did not disclose all existing liabilities.

3. Liabilities towards misstatements in prospectus.

The auditor of a company has to make certain reports in the prospectus as an expert under sec 62 of the companies act. If he makes misstatements in prospectus he is liable as per law. Auditor is liable for misstatement in prospectus to third persons who purchased share and debentures of the company on the faith of the prospectus and suffered loss or damages. However he cannot held liable if he prove that,

- He withdraws his consent in writing before delivery of prospectus for registration.
- He withdraws his consent before allotment of shares or debentures and had given public notice stating the reason of such withdrawal.

B. CRIMINAL LIABILITIES.

Criminal liability means responsibility for a crime. The criminal liability arises because of offences against the statutory provisions specially laid down. In case of criminal liabilities an auditor is punished with fine or imprisonment or both or might be provided in the relevant act.

❖ **ACCORDING TO COMPANIES ACT**

1. PENALTY FOR DELIBERATE ACT OF COMMISSION OR OMISSION (SEC 628)

According to sec 628 of the companies act an auditor is liable to criminal prosecution if he makes false statement in any certificate, return, report, balance sheet, prospectus or other documents knowing it to be false or deliberately omits any material fact he shall be punishable with imprisonment for a term which may extend to two years and also be liable to fine.

2. PENALTY FOR FALSIFICATION OF BOOKS (SEC.539)

If with intent to defraud or deceive any person, any officer (including auditors) of a company which is being wound up: Destroys, mutilates, alters, falsification of any books, paper or securities etc he shall be punishable with imprisonment for 7 years and shall always be liable to fine.

3. FAILURE TO ASSIST INVESTIGATION (SEC.240)

According to Sec 240 if the auditor of the company does not give the required assistance to an inspector appointed by the Central Govt to investigate the affairs of the company he is punishable with imprisonment up to 6 months or with a fine up to Rs.20,000 or both.

4.MIS-STATEMENT IN PROSPECTUS (SEC.68)

According to sec 68 if an auditor induces a person fraudulently to invest money in the company by making a false or misleading statement he may be punished with imprisonment up to 5 years and a fine up to Rs.10,000 or both.

❖ AS PER INCOME TAX ACT

Liability of a professional accountant under the Income Tax has been prescribed under sec 278, sec 288, and Rule 12A of the Income Tax act rule.

A.) ABETTING OR INCLUDING THE FILLING OF FALSE ACCOUNT (sec.278)

Any person who is guilty of abetting or inducing another person to file a false account, statement or declaration, is punishable with rigorous imprisonment for a minimum period of 3 months and a maximum of 3 years with fine.

B.) FALSE INFORMATION IN RETURN (RULES 12 A)

If a chartered accountant in his capacity as an authorized representation, prepare the return to be filed by the assessee contains any information which is false and which the chartered accountant with known's or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to 7 years and fine.

C.) CONVICTION OF AN OFFENCE AS TO TAX PROCEEDING (SEC.288)

If a person has been convicted of an offence connected with any income tax proceeding or if a penalty imposed on him under the income tax act he will be disqualified from representing an assessee. The period of disqualification of such person will be determined by the chief commissioner or commissioner of income tax. Further if a chartered accountant is found guilty of misconduct in his

professional capacity by the council of institute of chartered accountants of India he cannot act as an authorized representative for such time that the order of the council disqualifies him from practicing.

❖ LIABILITY UNDER OTHER ACT

Apart from various directives and regulations of companies act and income tax act, chartered accountant is subject to punishment of the provision of other enactment of the country.

INDIAN PENAL CODE (SEC. 197)

Six months simple imprisonment or fine of Rs 10,000 or both for false declaration amounting to fraud or fraudulently furnishing false information.

INDIAN PENAL CODE (SEC. 477-A)

The auditor is similarly liable to be punished for deliberate and fraudulent falsification of any books, paper, writing, valuable security or account, which belongs to or is in the possession of his employer.

LIABILITIES FOR PROFESSIONAL MISCONDUCT

“Professional misconduct” is defined as including any act or omissions, specified in the First and the Second schedule to the chartered accountants act as also any other misconduct. The liability for professional misconduct will be removal of the name of the accountant from the Register of Members for five years or more.

QUALITIES OF AN AUDITOR

An auditor is required to perform a wide variety of functions and to be able to do so, he must possess several qualities, some tangible, others not so tangible. Some of these qualities may be acquired through formal educational and training, while for the others he will have to depend on his experience in the school of life.

The various qualities required of him are as follows.

A. PROFESSIONAL EXPERTISE

- Knowledge of accounting
- Knowledge of cost accounting
- Knowledge of accounts of business under audit
- Knowledge of business laws
- Knowledge of production system
- Knowledge of economics
- Knowledge of mathematics and statistics

- Knowledge of general management
- Knowledge of financial management
- Knowledge of marketing management

B. GENERAL QUALITIES

- Honesty and integrity
- Tactfulness
- vigilance
- judgment
- responsibility
- diligence
- communication
- common sense



QUESTION BANK

- ✓ explain the various modes of appointment of a company auditor
- ✓ explain the civil and criminal liabilities of a company auditor
- ✓ explain the rights of a company auditor
- ✓ State the provision of the Company's act 1956, with regard to qualification and disqualification and appointment.
- ✓ explain the duties of a company auditor

UNIT- V

SPECIALIZED AUDITS

AUDITORS DUTY

DUTIES OF AN AUDITOR

- 1) Compliance with Audit Standard
- 2) Duty to Report Fraud
- 3) Duty not to render certain services
He can not render "consulting and specialized services" which means any one or combination of-
 - Accounting and Book keeping services
 - Internal Audit
 - Design and implementation of any financial information system
 - actuarial services
 - investment advisory services
 - investment banking services
 - management services
 - any other kind of consultancy services

- 4) Duty to sign audit reports etc.
- 5) Duty to attend General meeting
- 6) Duty to Report
Under section 143 of the Act the auditor has a duty to report to the members of the company on:
 - accounts examined by him
 - every financial statement laid before a general meeting during his tenure
- 7) Duty to Enquire-
 - Secures loans and advances
 - transactions represented merely by book entries
 - personal expenses
 - issue of shares for cash
 - loans and advances made by the company etc.

1. CHARITABLE INSTITUTION

Charitable institutions are usually registered as societies under Societies Registration Act, 1960. Charities may be public charity or private charity. The Trustee of the charity is responsible for maintaining proper books of accounts.

2. CLUB

Generally a club is set up as a company ltd by guaranteed in which case the provision of the companies act relating to the Companies Act relating to the maintenance and audit of company are applicable to club. A club may also be registered under the Societies Registration Act 1960.

The auditor should take the following steps while auditing the accounts of a club and he should evaluate the system of internal check and control and select the audit procedure accordingly.

AUDIT OF INCOME:

- 1) Auditor should vouch the entrance fees with the application received from members, counterfoils of receipts issued to them and the minutes of the managing committee approving the membership.
- 2) Subscription from members should be vouched with the counterfoils of receipts issued to them and the register of members.
- 3) He should test check the receipts for a selected period with the entries passed in the Register of Members.
- 4) He should see the arrears of subscriptions pertaining to the previous year are duly brought forward.
- 5) He should verify whether necessary steps have been taken for the recovery of arrears of subscription and whether the amount deemed as irrecoverable has been duly written off.
- 6) He should see whether there is an adequate internal checks as regards charging the members for foodstuff, wines, cigars etc supplied to them and their guests.

AUDIT OF EXPENDITURE

- 1) He should examine the procedure relating to purchases, custody and issue of foodstuff, sports goods, crockery etc and see that all purchases and issues are properly authorized and recorded in the respective stock register.
- 2) He should test check vouchers for a selected period.
- 3) In case wine and liquors served in the club are not the property of the club but of outside dealers, he should see that records as to the receipts, consumption and unsold stock are properly maintained.
- 4) In case of club owns or hires any machine for amusement for its subscribers it should be seen that there is a proper check over the removal of coins from them.
- 5) Salary and yearly increments to staff should be verified by reference to service contracts, salary register and minutes of the meeting of the managing committee
- 6) He should as far as physically check the stock of furniture, sports goods, china glass, foodstuff, wine etc with the respective stock register or inventory sheets prepared at the end of the year.
- 7) He should ascertain the rate of depreciation being applied to furniture, fixtures, fitting, linen, china glass etc and satisfy himself that it is adequate.

3. CINEMA THEATRE

The auditor should conduct the audit of a cinema along the following lines.

PRELIMINARY STEP

- He should examine the letter of his appointment to see the scope of his responsibilities.
- He should carefully go through the documents relating such as partnership deed, memorandum of association and articles of association.
- He should ascertain if there is an effective system of internal check and control.

AUDIT OF INCOME

- 1) He should ascertain whether the entrance to the cinema hall during the shows is only against printed tickets which are serially numbered and uniformly found into books.
- 2) He should verify the entries made in cash book in respect of total of the daily returns of sale of tickets and cash collected for the same.
- 3) All the capital expenditure must be dealt correctly in the accounts
- 4) He should see that all the receipts from advertisement on the screen and slides are accounted in the books and verify the amount received with contacts and other documentary evidence.
- 5) He should see that the amount of entertainments tax collected is duly reconciled with the total number of tickets sold for each class.
- 6) He should see that there is a proper record of the issue of free passes and that there are duly authorized by a responsible officials.
- 7) Receipts from restaurants or bars run by the cinema management should be vouched with the daily summary of takings.

AUDIT OF EXPENDITURE

- 1) Auditor should satisfy himself that a proper distinction is maintained between capital and revenue items of expenditure.
- 2) Salaries to staff should be vouched with the individual agreements, money receipts, counter foils of cheque etc.
- 3) Payment to advertisers should be vouched with the contracts with advertisers and bills and statements submitted by them.
- 4) Expenditure on repairs and maintenance of a routine nature should be checked with the bills and money receipts.
- 5) Payments on accounting of renting of films which is generally based on percentage of the taking, should be vouched with the agreements with distributor bills submitted by them.
- 6) In case of advance payment to distributor, the auditor should enquire whether the same are good and recoverable.

OTHERS

- Adequate depreciation should be provided on furniture and equipment
- Unused tickets must be kept under lock and key.
- Stock of various items such as maintenance of materials, stationery etc should be verified.

4. EDUCATIONAL INSTITUTIONS

[SCHOOLS & COLLEGES & UNIVERSITIES]

The auditor should conduct the audit of an educational institution whether a school or colleges or university along the following lines.

PRELIMINARY

- He should see that the letter of his appointment as auditor in the order.
- He should examine the charter, trust deed or regulations in the case of school or college and note all the provisions.
- In case of a university he should go through the act of legislature.
- He should see, study and evaluate the internal check and control.

AUDIT OF INCOME: A.) FEES

- Fees constitute an important source of income of an educational institution. The auditor should check the students fees register for each month or term with the respective class register showing names of the student on roll.
- He should vouch the fees received with the counterfoils of money receipts issued to students as also with the entries in the cash book and the fees register.
- He should check the fees collection for the month or term with the aggregate total in the fees register.
- In the case of free student ships or other concessions as to fees the auditor should examine the authorization by a responsible officer.
- He should check late payment of fees along with fines if any with the entries of arrears in the fees register and authorization for the payment by a responsible official.
- He should see that the receipts of capital nature such as admission fees, building fund contribution etc are credited to separate account.
- He should ascertain if all the arrears of fees including hostel dues are recovered before the students are closed.

AUDIT OF INCOME: B.) GRANTS-IN-AID AND MISCELLANEOUS INCOME

- He should vouch the income by way of grants-in-aid from the government or local body on the basis of the memorandum of association or other correspondence with regard thereto.

- He should examine the original documents or to endowments and legacies and vouch the income there from by reference to the relevant vouchers and investments.
- Income from donations and subscription should be checked with the counterfoils of money receipts, cash book and list of donors/ subscribes published with the annual report.
- He should vouch income by way of rent from landed property with reference to the rent rolls and see that rent in advance or rent in arrears is disclosed in the annual statements.
- He should ascertain whether items of capital and revenue expenditure are properly distinguished in accordance with sound accounting practice.
- When expenditure on any item exceeds the budgeted sum, he should ascertain that the managing committee has duly authorized the same or that it is within its knowledge.
- He should test check the efficiency of the procedure to purchase, custody and issue of materials.
Example :- provision, foodstuff etc
- He should see whether purchase invoice are duly passed for payment
- Stock of furniture, stationery, foodstuff and other equipment should be physically verified.

5. HOSPITALS

While auditing the accounts of a hospital, the auditor should pay attention to the following.

PRELIMINARY

- He should examine the letter of his appointment and ascertain whether it has enlarged in any way the scope of his responsibilities.
- He should carefully go through the charter or trust deed under which the hospital has been set up.
- He should check the system of internal check and control system.

AUDIT OF INCOME

- He should vouch entries in the patients bill register with copies of bills issued
- In case of income by way of interest / dividend he should vouch it with shares and securities as recorded in the Investment Register and dividend and interest warrant.
- The dividend / interest have accrued but not yet received he should verify the appropriate entries have been passed in the book.
- The rental income from landed property settled on the hospital as shown in the property register he should vouch the rent rolls and counterfoils of rent receipt.
- In case of arrears or advance payment of rent, he should confirm whether appropriate entries have been made.
- In case of donations received for a specific purpose. He should ensure that these amount are properly utilized for that specific purpose or not
- Actual collection of subscription should be checked with subscribers register.
- Grants in aid received from the govt or a local body should be verified by reference to the correspondence and entries in the cash book

AUDIT OF EXPENDITURE

- He should ascertain whether a clear distinction has been made between capital and revenue items of expenditure.
- He should see that the system of internal check as to purchase and issue of stores, medicines, linen, clothing and other apparatus does not suffer from any defects.
- All purchases should be properly classified and recorded in the stock register.
- He should see that all appointment of the staff and payment of salaries and also annual increments are authorized by the trustee or the managing committee.

1. HOTEL

The auditor should conduct the audit of a hotel along the following lines.

PRELIMINARY

- He should go through the documents as regards establishment of the hotel business i.e partnership deed, memorandum of association and articles of association.
- He should examine the system of internal check and control particularly as regard ordering, receiving and payment for provision, wines, spirits, crockery, linen etc.

AUDIT OF INCOME

- 1) He should vouch the receipts from the sale of food stuffs, wine, cold drinks etc from the copies of cash memos and summary of daily taking prepared by the cashier.
- 2) Receipts on accounts of boarding and lodging should be checked with the individual accounts of customers as also number of days the room were occupied.
- 3) Receipts on account of holding of conference, marriage, reception etc should be checked with the agreements.
- 4) In case of receipts from advertising the vouching should be by reference to contracts and correspondence with the advertisers and money receipts issued to them.

AUDIT OF EXPENDITURE

- 1) He should be ensured that a proper distinction is made between items of revenue and capital expenditure.
- 2) He should see that purchase of provisions, wines, cigarettes etc are against duly authorized requisition.
- 3) He should verify whether all purchase are duly recorded in the respective stock register.
- 4) Salaries and wages paid to staff should be vouched with the copies of letter of appointment, salaries and wage register.
- 5) It should be seen that annual increments and bonus payments are duly authorized.

MISCELLANEOUS

- 1) He should ascertain the rate of depreciation being applied to furniture, fitting, fixtures, bedding, plates, cutlery etc.
- 2) He should ensure that adequate on hire purchase basis he should ensure that interest account is duly debited or not.
- 3) He should physically verify the several assets of the hotel with the respective ledger accounts, stock register etc.

EDP: Electronic Data Processing

Electronic Data Processing, is nothing but a synonym for IS (Information Services or systems) or MIS (Management Information Services or systems).

It refers to the processing of-commercial data, storing documents, transferring information from paper into digital format with the use of a computer involving electronic communication. It was created with the term DP(data processing). In simple words, it is a process comprising of three stages which are as follows:

- **Input:** The data is entered through input devices like keyboard, digitizer, scanner etc.
- **Processing:** The data is manipulated through software programs that usually include translation, formula, code application, and encryption etc.
- **Output:** The processed data is passed to the user in the form of reports, audio, video etc.



Electronic Data Processing (EDP)

What is EDP audit?

An analysis of an organisation's computer and information system in order to evaluate the integrity of its production system as well as potential security cracks.

Audit Procedures in an Electronic Data Processing Audit

Get Electronic Data

To commence the auditing process. auditors must first retrieve the data stored in the computer. Documents such as sales receipts and supplies invoices are used to verify the data entered into the computer. This ensures that correct information was input into the computer.

Data Conversion

Organizations use different types of software to store their data. This data should be converted from the stored software to the auditing software. This is done using special software programs known as package and utility programs. This ensures that there is no inconsistency when auditing data stored in different software.

Compliance Test

Auditors need to verify that procedures followed when entering data into the data processing system are being applied as prescribed. These procedures act as the underlying evidence of whether the accounting data is correctly fed into the processing system. Obtaining this evidence involves reviewing the accounting journals, ledgers and worksheets. Compliance tests, which are tests used to verify the correct functioning of internal controls, are then carried out to indicate whether such internal controls are working properly. This provides the auditor with the overall picture of the truthfulness of data entered in the processing system.

Substantive Test

Auditors obtain evidence to verify the completeness, validity and accuracy of a client's records. This evidence is an important factor in determining the auditor's opinion on the records. Substantive tests in a merchandising firm would include examining inventory at the end of the period to verify that the levels of such inventory are as indicated in the records. An auditor can also request that suppliers confirm in writing the details of the debts owed by a firm at the end of the trading period.

Reporting

The main aim of an audit is to report to the client. A report should be written and Signed after completing the audit examination: it also should include the auditor's opinion and the basis for it. The date of the report should also be included, along with recommendations for improvements of the entity's reporting system. Finally, reports should be objective, Clear, concise and timely.

QUESTION BANK

- ✓ DRAFT AN AUDIT PROGRAMME FOR THE AUDIT OF THE ACCOUNTS OF
 - ❖ Hospital
 - ❖ Charitable institution
 - ❖ Club
 - ❖ High school
 - ❖ Cinema
- ✓ Explain about Electronic Data Processing Audit (EDP) Audit