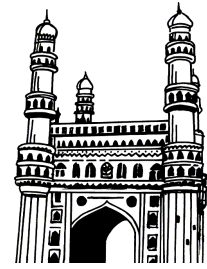


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AUDITING

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UNIT I

INTRODUCTION:

Auditing: Meaning – Definition – Evolution – Objectives – Importance - Types of Audit – Standards of Auditing – Procedure for issue of standards by AASB.

1.1 AUDITING

1.1.1 Meaning – Definition

Q1. Define Auditing.

(OR)

What do you understand by Auditing.

(OR)

What is Auditing.

(OR)

Explain the meaning of Auditing.

Ans : (July-21, Dec.-20, Dec.-19, July-19, Dec.-18)

Meaning

The word Audit is derived from Latin word "Audire" which means 'to hear'. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

Definitions

- (i) **According to L.R.Dicksee** "Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate."

- (ii) **According to R.K. Mautz** "Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports."

- (iii) **According to R.E.Schlosser** "Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement."

- (iv) **According to A. W. Hanson**, "An audit is an examination of such records to establish their reliability of statements drawn from them".

- (v) **According to R.B Bose**, "Audit may be said to be the verification of the accuracy and correctness of the books of accounts by an independent person qualified for the job and not in any way concerned with the preparation of such accounts".

Q2. Explain the scope auditing.

Ans :

The following points merit consideration in regard to scope of audit:

1. The audit should be organized to cover adequately all aspects of the enterprise relevant to the financial statements being audited.
2. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements.

3. In forming his opinion, the auditor should also decide whether the relevant information is properly disclosed in the financial statements subject to statutory requirements, where applicable.
4. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
 - (a) Making a study and evaluation of accounting systems and internal controls and
 - (b) Carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.
5. The auditor determines whether the relevant information is properly disclosed in the financial statements by:
 - (a) Comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein; and
 - (b) Considering the judgments that management has made in preparing the financial statements accordingly, the auditor assess the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.
6. The auditor is not expected to perform duties which fall outside the scope of his competence. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.
7. Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.

1.1.2 Evolution

Q3. How did Auditing Evolve?

(OR)

State the evolution of Auditing.

(OR)

Write in detail about the evolution of Auditing.

Ans :

(July-19)

The system of accounting and auditing is believed to have existed in our country under the Mauryas, Chandragupta and other Hindu Kings. Kautilya, in his Arthashastra had mentioned about the accounting and auditing of state finances. He stated that, "all undertakings depend on finance. Hence, foremost attention should be paid to the treasury." He also listed various kinds of frauds and embezzlements and prescribed punishments to deal with them. However, the growth of the Accounting profession in India is a recent development.

The first company legislation in India, the Joint Stock Companies Act of 1857, contained regulations for the annual audit of company accounts. But adoption of these regulations were entirely optional as there was no legal obligation on the part of a company to have the audit of their annual accounts.

The growth of accounting profession was an outcome of the Indian Companies Act 1913, which for the first time prescribed the qualifications for an auditor. The qualification was obtained by passing the Government Diploma in Accountancy which was conducted by Provincial Governments.

Subsequently an Indian Accountancy Board was established under the Auditors certificates Rules, 1932.

On passing of the Chartered Accountants Act 1949 substantially the entire regulation, Control Management of the Profession passed from the Central Government to the profession.

The Companies Act of 1956 replaced the Act of 1913 and its subsequent amendments further elaborated various provisions regarding the procedure of appointment of company auditors as well as their powers and duties. The Act also enlarged the scope of annual accounts and the audit

report. The insertion of Section 233-B in the Companies Act 1956, has empowered the Central Government to order compulsory cost audit in the case of specified companies. The Cost and Works Accountants Act of India (1959), now permits its practising members to carry out Cost audit as contemplated by Section 233-B of the Companies Act 1956.

In the year 1985, the Reserve Bank of India (RBI) issued a circular to commercial banks advising them to ask their potential borrowers to get their accounts audited. The Income Tax Act, which was amended in 1984 also provided for the compulsory audit of accounts of certain assesses.

1.1.3 Objectives

Q4. Explain the Objectives of Auditing.

(OR)

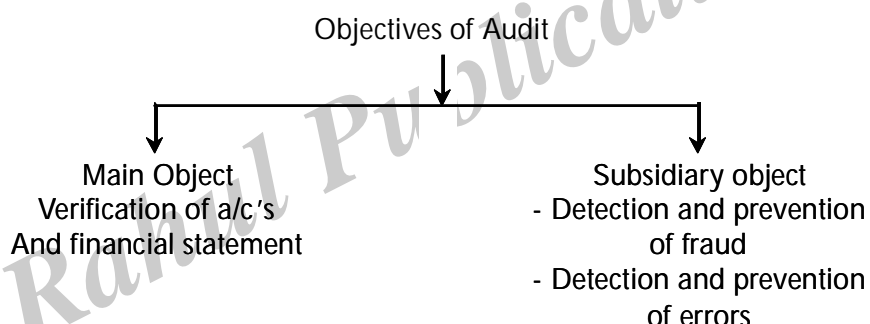
What are the Objectives of an Audit.

Ans :

(July-19, Dec.-19, Dec.-18)

Introduction

The principle objectives of auditing are changing with the advancement of business techniques. Earlier it was only to check the correctness of receipts & payments which was extended to detection of fraud. The method of auditing of accounts have been improved the detection of fraud is simply an incidental object. The main object of audit is to find the reliability of financial position and P & L A/c statement. The objects of an audit are divided into two



I. Main Object of Audit

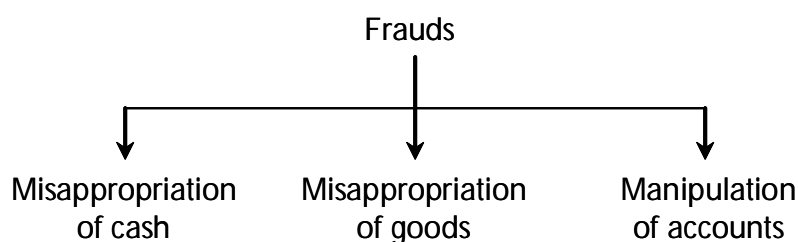
The main object of an audit is to verify and establish that at a given data. Balance sheet presents true and fair view of profit or loss for the accounting period. The auditor must examine the system of internal control, internal check, the arithmetical accuracy of books of a/c's existence and values of Assets & Liabilities.

According to the Companies Act, it is essential to verify as to whether the books of accounts are in accordance with the act and check whether they exhibit a true and fair view of the company's financial position. The auditor needs to carry out a separate review of the reliability of the financial statements and in order to do so, the auditor is supposed to scrutinize the internal control system and carry out internal check of mathematical accuracy of books of accounts, transaction's validity which is entered in the books and gives assurance about the prevalence of the values of assets and liabilities.

II. Subsidiary Objectives

(A) Detection & Prevention of Fraud

According to SAP (Standard Auditing Practices) issued by ICAI Fraud refers to intentional misrepresentation of financial information by one or more individuals among management, employees or third parties. Frauds are further divided into three



1. **Misappropriation of Cash** : It is usually done by theft of cash receipts, petty cash, cheques, negotiable instruments, purchases etc., It is very easy particularly in large scale business where contact between the owners and the employee's is not very close.

Ex:- Cash sales not recorded in the books. Recording fictitious purchases and their by cash involved is misappropriated.

2. **Misappropriation of Goods** : This is easy in case of business which produces or deals in goods of high value and less bulky. This is done generally by the employees of the company.

Example :

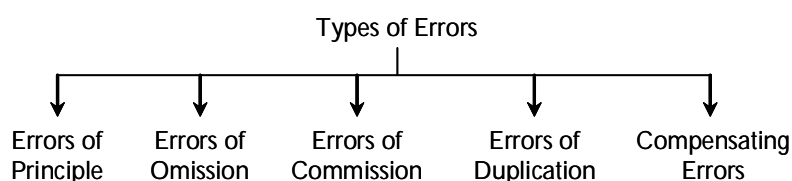
- a) Goods stolen by employees from the godown.
- b) Issuing false credit notes customers for sales return & goods missappropriated.

3. **Manipulation of Accounts** : This type of fraud is generally done by upper level of management. Usually, falsification of accounts is done by altering the accounts, omission of accounts, over valuation or under valuation of accounts.

Ex:- (1) Showing low profit than the actual ones
(2) Assets or liabilities may be over or under charged.

(B) Detection & Prevention of Errors

Generally, errors are the result of carelessness on the part of the person preparing the a/c's sometimes errors may be the result of fraudulent, manipulation of a/c's according to SAP 4 issued by ICAI an error is an unintentional mistake or misrepresentation in the books of accounts or records. The classification of errors are as follows.



1. **Errors of Principle** : When principles of book keeping & accounting are not followed in the treatment and recording of items of a transaction it is known as error of principle.

Example :

- a) Item of income posted to a personal a/c like rent received it will reduce the profit & increased creditors in the Balance Sheet.
- b) Providing inadequate depreciation or excess depreciation.

2. **Errors of Omission** : When a transaction is omitted fully or partially from books of accounts such types of errors are known as errors of omission. Usually, it arises due to mistake of clerk. If the transaction is fully omitted from the books of accounts it will not effect Trial Balance.

Example :

- a) Omission of purchases from purchase day book.
- b) Rent paid only for eleven months and the remaining amount that is balance sheet has not been recorded in the books.

3. **Errors of Commission :** When entries made in the books of original entry or ledger are incorrect fully, or partially such errors are called "errors of commission". These arise due to negligence in recording the transaction.

Example :

- a) Wrong recording in the books like goods purchased Rs. 100 recorded in purchase day book as Rs. 100 from M & Co. recorded as from N & Co.
- b) Wrong posting to the wrong a/c's like sales of Rs. 1000 posted to customer's account Rs. 100

4. **Error of Duplications :** When a transaction is recorded twice & posted twice in the ledger accounts it is called error of duplication. Such errors don't effect Trial Balance.

Example : Purchased goods Rs.100 entered twice in the accounts and twice in the ledger.

5. **Compensating Errors :** When an error offsets the effect of another error such error is known as compensating error. These errors do not effect agreement of trial balance. Hence, it cannot be located.

Ex:- (a) X a/c is debited with Rs. 90 short and credit side of his account is under totalled by Rs. 90.

1.1.4 Importance**Q5. Explain the Importance of Auditing.**

Ans :

(July-21, Dec.-19, Dec.-18)

Importance of auditing can be judged from the fact that even those organizations which are not covered by Companies Act get their financial statements audited. It has become a necessity for every commercial and even non-commercial organization.

The importance of auditing can be summed in following points:

- (a) Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.
- (b) Dispute over correctness of profits can be avoided.
- (c) Shareholders, who do not know about day today administration of the company can judge the performance of management from audited accounts.
- (d) It helps management in detecting and preventing errors and frauds.
- (e) Management gets advice on financial affairs from the auditors.
- (f) Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.
- (g) Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.

- (h) Audited accounts are useful for the government while granting subsidies etc.
- (i) It can be used by insurance companies to settle the claims arising on account of loss by fire.
- (j) Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.
- (k) It safe guards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

Q6. What are the features of Auditing?

Ans :

The features of auditing are as follows,

1. Accounting Control

Auditing is a tool used for accounting control. The auditing activities will manage and verify the accuracy of the accounting data.

2. Safeguard

Auditing activities protects the proprietors from fraud and carelessness of the agents or servants in using proprietor's money or other assets.

3. Assurance

Auditing ensures that accounts are prepared accurately and expenses are incurred carefully.

4. Assessment

Auditing determines the effectiveness of an accounting system in maintaining company's accounting records.

5. Review

The financial statements are reviewed by audit inorder to understand whether the accounting records are in accordance with financial statements or not.

Q7. State the functions of Auditing.

Ans :

Following are some of the important functions of auditing :

1. Reviewing systems and procedures of business.

2. Examining documentary evidence to establish the accuracy of recorded transactions.
3. Reviewing the system of accounting and internal control.
4. To verify the valuation and existence of assets.
5. To examine the mathematical accuracy of accounting statements.
6. To see whether the statutory require-ments have been complied with.
7. Reporting as to what extent, accounts exhibit truth and fairness.
8. To make recommendations for improvement in internal control and accounting system.
9. To verify the distinction between capital and revenue items.

Q8. What are the basic principles of auditing?

Ans :

1. Integrity, Objectivity and Independence

The auditor must be open-minded and he must be honest, sincere and straight forward towards his professional work.

2. Skills and Competence

A well trained, experienced and competent individual must carry out auditing with due care.

3. Confidentiality

The auditor must maintain the secrecy of data which is obtained during the process of audit.

4. Documentation

Inorder to prove that the audit was performed as per the legal obligations, the documents must be maintained by the auditor.

5. Audit Evidence

Adequate proof must be acquired by the auditor to interpret the financial information.

6. Planning

An auditor must plan his auditing work to carry out auditing in an effective way and on time.

7. Accounting System and Internal Control

The auditor must ensure himself that the accounting system is appropriate and the accounting data which must be recorded has been recorded.

8. Audit Conclusions and Reporting

An auditor must analyze the interpretations drawn from the audit evidence and his view on the company's financial information must be submitted in a report format.

Q9. "Auditing begins where accountancy ends". Comment distinguishing between accounting and Auditing.

(OR)

Explain the difference between accounting and Auditing.

(OR)

What are the differences between Auditing and accountancy.

Ans :

(Dec.-19)

S.No.	Basis of Distinction	Accounting	Auditing
1.	Nature	Accounting refers to preparation of Accounts.	Auditing refers to examination and checking of financial records.
2.	Objective	The primary object of Accounting is to find out the trading results of business during a financial year and show the financial position of the concern on a particular date.	The primary object of Auditing is to certify the correctness and justification of the financial statements prepared by the accountants.
3.	Qualification	The accountant need not be a Chartered Accountant.	The Auditor must be Chartered Accountant.
4.	Appointment	The accounting work is done by an employee of the concern and works directly under the control of management.	The auditor is not an employee. He is an independent person. Professionally competent, appointed by the proprietor with specific purpose.
5.	Status	The accounting work is done by a permanent employee of the concern.	The audit work is done by an outsider.
6.	Scope	Its scope is restricted to preparation of financial statements and their interpretation.	It is determined by the agreement between auditor and his client.
7.	Commencement	It starts where book-keeping ends.	It starts where accountancy ends.
8.	Remuneration	The accountant is paid monthly salary.	The Auditor gets a fixed amount as per agreement with his client.
9.	Knowledge	The accountant may or may not have any knowledge of auditing and its techniques.	The auditor must have thorough knowledge of Accountancy.
10.	Time Period	Accounting work is undertaken throughout the year.	Generally Auditing is taken up at the end of the year.
11.	Regulations applicable	Accounting is governed by any professional regulations.	Auditing is governed by the code of conduct and standards laid down by the ICAL.
12.	Submission of Report	The accountant is not required to submit a report on the Financial Statements prepared by him.	The auditor is required to submit a report to his client on truth and fairness of financial statements.
13.	Compulsion	Keeping of Accounts is a must to know the exact financial position and profitability of the business at the end of the financial year.	Audit is not compulsory except where this is required by the statute.

1.1.5 Types of Audit

Q10. Explain the various types of Audit.

(OR)

Briefly discuss the various types of Audit.

Ans : (Dec.-20, Dec.-18)

It can be classified from different angles. Following is the broad classification of audit:

- (I) Audit based on Ownership or Organizational Structure of an Enterprise.
- (II) Based on Time or Scope of Audit procedure.
- (III) Based on objectives of each type of audit.

I) Audit based on Ownership (or) Organization structure

1. Audit of sole proprietary concern.

Sole proprietors are not required by any law to have their accounts audited. Despite this fact, many of them who derive their large incomes from different sources i.e., from property and shares etc. and whose expenditure is vast and varied, get their accounts audited. In such cases, the auditor also acts as an accountant and prepares the final accounts besides auditing the accounts. As he is appointed by an individual, he must get clear instructions from his client in writing regarding the nature of work he is expected to do. The scope of work, nature of duties and responsibilities will depend upon the agreement that he has entered into with the client. Any ambiguity in respect to his duties may create problems for him. In case the auditor is asked to prepare the accounts and also do the full audit, he must see that the accounts are properly prepared, the balance sheet is properly drawn-up and the audit is done as per the terms of the agreements in order to avoid his responsibility. It is,

therefore, of greatest importance both for the independent accountant and the client, that each party should be clear about the nature of the work to be undertaken.

2. Audit of Partnership Firms.

Nowadays, a majority of agreements of partnership provide for the accounts of the partnership firm to be audited by an independent auditor. However, the Partnership Act of 1932 does not require it. In case, the partners decide to get the accounts of the partnership firm audited, then an auditor is appointed by an agreement and his rights and duties are determined by a mutual agreement between the auditor and his client. He should always bear in mind that all the partners jointly and severally are his clients, though he might have been appointed by only one of them, if so authorised under the partnership deed. Before starting the audit, he should always obtain a copy of the partnership deed in order to acquaint himself about the terms and conditions of the partnership. In a larger number of cases, he is called upon to act as an accountant also and he is asked to prepare the final accounts of the firm besides auditing the accounts. Under such circumstances, it will be in the interest of the auditor to get in writing the nature and scope of his work, which is to be carried out and particulars of limitations, if any, under which he would have to function to avoid any dispute later on. The auditor should carefully complete his work and produce a written report in turn which can leave no doubt as to the nature of duties undertaken. In case the auditor is charged for negligence in the performance of his duties, he can produce a copy of the agreement and of the report to defend himself.

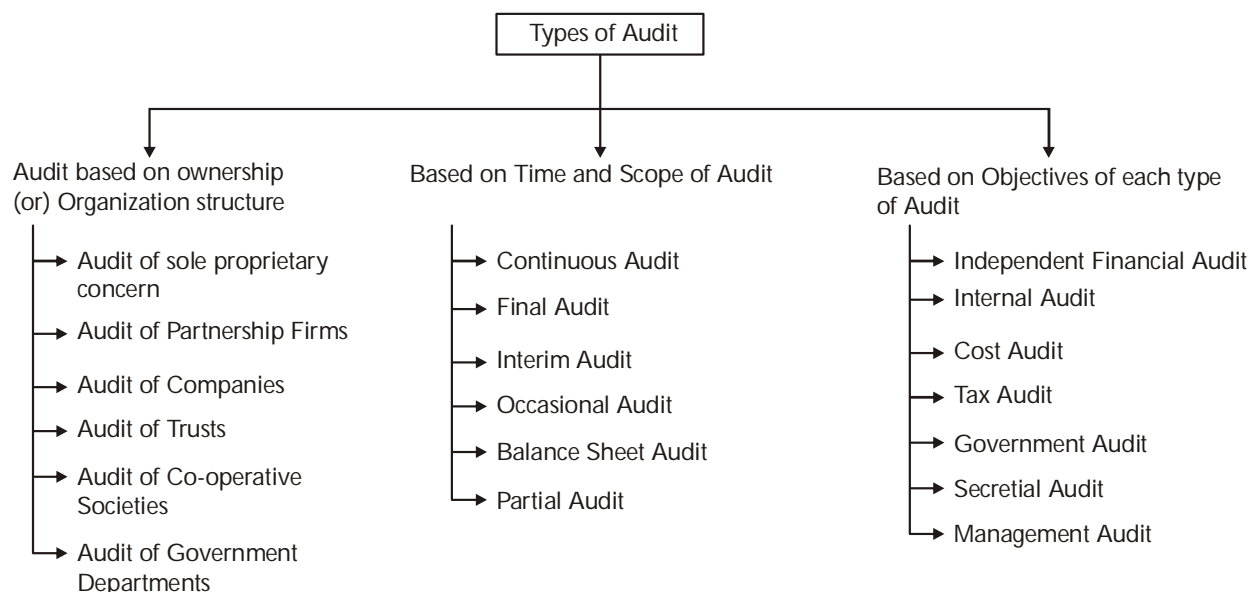


Fig.: Types of Audit

Following are the advantages to be derived by a partnership firm by getting the accounts of a firm audited by a qualified auditor :

- (i) Disputes among partners may be avoided.
- (ii) In the case of admission, retirement or death of partner, the adjustments arising on admission, the valuation of goodwill and the settlement of accounts on death or retirement may become very easy.
- (iii) Audited accounts will be more reliable for the purpose of the assessment of income- tax.
- (iv) Negotiations for loan from different sources become easy, and
- (v) An auditor can suggest better ways of keeping accounts of the firms.

Besides the above-mentioned advantages, all the usual advantages common to all forms of audit i.e., verification of accounts and detection of errors and frauds shall also be derived by partnership firms by getting their accounts audited.

3. Audit of Companies.

A unique feature of company form of organization is that the ownership and Management lie in the hands of different people. Therefore it is mandatory for companies to get their books of accounts audited. The financial statements are prepared by the management. The owners need assurance that the financial statements prepared by the management are reliable. Among different types of audit company audit is the most common. Therefore in India and in other countries there are legal requirements for audit of financial statements of companies.

It assures the owners about the reliability of financial statements. The other users of these statements are potential investors, creditors, banks, financial institutions, tax authorities etc., they also place greater reliance on the audited accounts.

4. Audit of Trusts

Private trusts are often created by philanthropists for the benefit of some religious or charitable purpose such as temples and educational institutions. In some cases, trusts may be created for the benefit of minors and widows who cannot look after them properly themselves. A board of trustees

is created to look after the property left by the testator. They receive money from different sources and distribute the income among beneficiaries as per the terms of the trust deeds. In many cases, these trustees may lack the essential knowledge of maintaining accounts, or may not always use the income of the trust for the benefit of the party for which it has been created. In other words, they may misappropriate the trust funds without the knowledge of the beneficiaries. Generally, to avoid such a thing, a provision is made in the Trust Deed for the audit of accounts by a qualified auditor. If the accounts are audited, it helps both the trustees and beneficiaries. Trustees will be benefited because there will be no unnecessary criticism against them and the nature of beneficiaries will be assured about the correctness of the accounts. It should be noted that in some of the states in India, the Public Trust Acts have been brought into force, which provide for compulsory audit of a Trust by a qualified auditor, i.e., under the Bombay Public Trust Act, 1950, the accounts of a Public Trust must be audited by a chartered accountant in accordance with the provisions of the Act.

5. **Audit of Co-operative Societies.**

In case of co-operative societies also there is a separation of ownership from management. The capital of a cooperative society is contributed by all the members, whereas the management of its affairs is done only by some members who are elected for this purpose. Therefore, an independent financial audit of accounts is required for cooperative societies. Many large cooperative societies also have system of internal audit.

6. **Audit of Government Departments**

Public utilities and government departments like Electricity boards are also subject to audit. These departments also have system of internal audit. The constitution of India makes the requirements for such audit.

II) **Based on Time and Scope of Audit Procedure**

1. **Continuous Audit**

A continuous audit is one in which the external auditor's staff is occupied in a detailed examination of the books of accounts of the client the whole year round or at regular intervals, say weekly, monthly and quarterly. It is a system of audit in which the audit work is carried on almost simultaneously with the recording of transactions.

Continuous audit becomes imperative in the following types of business:

- (i) Where it is desired that audited final accounts should be ready immediately after the close of the accounting period.
- (ii) Where business is very large and there are numerous transactions to be checked.
- (iii) Where there is no satisfactory and effective system of internal check in force, and
- (iv) Where monthly final accounts are required.

2. **Final Audit**

Periodical or Final or Annual Audit: A system where the auditor takes up his work of checking the books of accounts and other related documents, only at the end of the accounting period when the transactions for the whole financial year are completely recorded, balanced, the trial balance is then drawn out and the final accounts have been prepared, is known as periodical or final or annual audit. The auditor will normally start routine checking of the books and other audit procedures only after the close of the financial year. He would complete his audit work in one continuous session or without any interval. In other words, the auditor visits his client only once a year and goes on checking the accounts and other related documents until the audit work for the whole period is completed.

3. Interim Audit

An audit which is conducted in between the two annual audits for interim purpose is called interim audit, for instance, to enable a company to declare an interim dividend or to get the periodical data of the turnover or gross profit etc. This kind of audit involves a complete checking of accounts prepared by a company for a part of the accounting year. It is a kind of audit which is done between the two balance sheet audits. The work of the final audit becomes much easier if there has been an interim audit.

4. Occasional Audit

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

5. Balance Sheet Audit

The term balance-sheet is not of common use but this class of audit is mainly followed in the USA. It is an audit which starts with the verification of the items appearing in the balance-sheet. Here the audit operates in the opposite direction of the normal audit procedures. It commences with the detailed examination of the balance-sheet and works back to the books of original entry and related evidences. This is essentially a 'partial audit' since it verifies the items appearing in the balance-sheet mainly and does not start the work of verification with the books of prime entry. The underlying idea of this audit is that by comparing the balance sheets at two successive dates, the profit of the year can be ascertained. However, the auditor will check the accounts in the general ledger and will also check those items of profit and loss account which are directly related to assets. In this audit, the work can be successful in those business houses where an efficient system of internal control in the real sense exists.

6. Partial Audit

When an auditor is asked to carry out the audit of the records and books of a particular work only, it is called partial audit. For example, the client may ask the auditor to audit only the payment side of the cash book because he himself receives cash and cheques on behalf of his business and there are no chances of misappropriation of cash. The liability of the auditor in such a case will also be different from his liability for the complete audit. It is advised that the auditor should get instructions in writing as to the scope of his work so that no dispute can subsequently arise as to the extent of his responsibility. This kind of audit is not permitted in case of a private or public limited company.

III) Based on Objectives of each type of Audit**1. Independent Financial Audit.**

Independent financial audit is generally conducted to ascertain whether the balance sheet and the profit and loss account present a true and fair view of the financial position and working results, respectively, of the enterprise under audit. It is conducted by a professionally qualified and competent person who is independent of the enterprise which is hiring his services for the purpose. In most countries, such audits have been made compulsory by law in the case of companies, corporations etc., In India for example, the Companies Act 1956 lays down that only practicing Chartered accountants or persons holding certificate under the Restricted Auditor's Certificate Rules 1956, can be appointed as auditors of a company.

The objective of an independent financial audit is to ascertain whether the financial statements of an enterprise are reliable. The financial statements contain representations or assertions of the management as regards the profitability and the financial position of the enterprise. The auditor's opinion as regards the truth and fairness of the assertions imparts credibility to financial statements in the eyes of those for whom these statements

are meant, e.g., investors, creditors, owners, banks and financial institutions, government authorities and so on.

2. Internal Audit

Internal Audit is an audit conducted on behalf of the management of a concern or enterprise, with the aim of providing assistance to the management for effective discharge of responsibilities. It involves an examination and evaluation of various activities of an enterprise and reporting on the same to management.

Objectives

- (a) To ascertain the degree of compliance with pre determined plans, policies and procedures.
- (b) To ascertain the authenticity of accounting and other related information.
- (c) To examine whether the resources of an enterprise are being used efficiently and economically.
- (d) To examine whether the assets of the enterprise are properly safeguarded from losses.

3. Cost Audit

According to Sec. 233B which was added by the Amendment Act of 1965, necessary directions were issued for audit of cost accounts of companies which are engaged in production, manufacturing, processing and mining activities. Under Sec 209(1) (d) the central government is given a power to require such companies to give particulars relating to use of material or labour or any other items of cost as may be prescribed. Such audit should be conducted by an auditor who shall be either a Cost Accountant within the meaning of cost and works Accountant Act 1959 or Chartered Accountant or any other person who has the prescribed qualifications. The cost audit as per Sec 233 B is in addition to the usual audit under Sec 227. such auditor will have the same powers and duties as a company auditor has under Sec 227(1). He shall make

his report to the Company Law Board in such form and within such time as specified.

4. Tax Audit

The Income Tax Act of 1961 provides for compulsory audit of accounts of certain assesses. The purpose of such audit is to assist the tax authorities to make correct assessment of tax. The Act also contains various provisions where the tax audit reports are required to be submitted to avail certain deductions and exemptions.

5. Government Audit

Government Audit is conducted to ensure that the financial transactions of the government are executed with proper sanction, correctly recorded and confirm with the rules of financial propriety. In India the Comptroller and Auditor General of India is authorized to conduct the Audit of central and state governments. The reports of the CAG which are relating to accounts of the union shall be submitted to the president who shall cause them to be laid before the Parliament. In case of States they are to be submitted to the Governors of respective states who shall cause them to be laid before the state legislature.

6. Secretarial Audit

Many companies have a department called secretarial department which performs a number of services. The department ensures that the company complies with the provisions of the companies Act of 1956 and other applicable laws. An audit conducted to verify whether a company has complied with the provisions of the Companies Act and other related laws is termed as secretarial audit. The basic objective of secretarial audit is to ensure compliance with company law. It helps the authorities responsible for enforcement of the law like Registrars of Companies, but also provides assistance to the companies themselves in avoiding any unintended violation of law.

7. Management Audit

Management Audit means the audit of management processes and functions. According to W.P. Leanard "The Management audit may be defined as a comprehensive and Constructive examination of an organisational structure of a Company institution or branch of government, or of any component objectives, its means of operation and use of human and physical facilities". Thus the auditor examines the policies and the actions of the management to ensure that there is a proper and maximum utilization of available resources. It facilitates to ascertain whether sound management prevails from the highest level to downward or not and helps in creating most effective relationship with the outside world and smooth running of the internal organisation.

Q11. Distinguish between Interim Audit and Internal Audit.

Ans :

The following are the differences between interim audit and internal audit.

S.No.	Interim Audit	S.No.	Internal Audit
1.	Interim audit can be carried out at any time in an year.	1.	Internal audit is carried out across 365 days.
2.	The auditor of interim audit is an external party.	2.	The auditor of the internal audit is an employee of the organisation.
3.	It is undertaken on a specific date.	3.	It is not conducted on a specific date. It is a continuous process.
4.	The audit is carried out for a specific purpose according to the situation.	4.	This audit is an administrative process.

Q12. Differentiate between audit of joint stock company and audit of partnership firm.

(OR)

Explain the differences between partnership firm and company/organization audits.

Ans :

The following are the differences between partnership firm and company/organization audits,

S.No.	Point of Distinction	Partnership Firm Audit	Company Audit
1.	Legal Requirement	As per the Partnership Act, partnership firm audit is not mandatory.	As per the Companies Act, company audit is mandatory.
2.	Auditor's Qualification	No qualification is prescribed for an auditor of a partnership firm.	An auditor of a company must be a chartered accountant with a full time certificate of practice.
3.	Area of Audit	The nature and area of the audit relies upon the terms of appointment.	In case of the company audit, the nature and area of the audit is based on the provisions of the Companies Act 1956.

Q13. Distinguish between cost audit and financial audit.*Ans :*

The following are the few differences between cost audit and financial audit.

S.No.	Cost Audit	S.No.	Financial Audit
1.	Cost audit is not mandatory.	1.	As per Companies Act, 1984, financial audit is mandatory.
2.	In cost audit, the auditor has to verify the cost details.	2.	In financial audit, the auditor will not check cost records.
3.	In this, the auditor should check whether the materials are issued as per the program or not.	3.	In this, the auditor may not focus on the issuance of materials as per the program.

Q14. What is continuous audit? State its advantages and disadvantages.*Ans :***(Dec.-18)****Meaning**

A continuous audit is one in which the external auditor's staff is occupied in a detailed examination of the books of accounts of the client the whole year round or at regular intervals, say weekly, monthly and quarterly. It is a system of audit in which the audit work is carried on almost simultaneously with the recording of transactions.

Continuous audit becomes imperative in the following types of business:

- (i) Where it is desired that audited final accounts should be ready immediately after the close of the accounting period.
- (ii) Where business is very large and there are numerous transactions to be checked.
- (iii) Where there is no satisfactory and effective system of internal check in force, and
- (iv) Where monthly final accounts are required.

Advantages**(a) Complete checking of all the records**

Since the audit is carried out throughout the year, sufficient time is available for detailed checking. Any enquiry and doubt arising in the course of audit can be tackled in a better way.

(b) Proper planning

Auditor can plan his audit work in a systematic manner. He can evenly spread his work throughout the year. It will improve efficiency of auditor.

(c) Early detection of frauds and errors

The work of auditor becomes easier for detecting frauds and errors, otherwise it will involve more time.

(d) Up-to-date accounts

The efficiency of account staff will increase and their work will be up-to-date and accurate.

(e) Valuable suggestions

Continuous audit will help the auditor to understand the technicalities of business. This will help the auditor to make suggestions for the improvement of business.

(f) Preparation of interim accounts

Interim accounts can be prepared without much delay. It will help the Board of Directors to declare interim dividend.

Disadvantages**(a) Expensive**

It is an expensive system as it may not suit the budget of small organizations.

(b) Dislocation of routine work: Frequent visits by auditor may dislocate the smooth flow of office work.**(c) Alteration of Figures**

after the accounts have been audited, the figures may be fraudulently altered by the staff.

(d) Losing link in the audit work

As the work is not completed continuously, the auditor may lose continuity and certain questions and inquiries may be left unanswered.

3. Final Audit

Final Audit means when the audit work is conducted after the close of financial year. A final audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed.

4. Balance Sheet Audit

Balance Sheet Audit relates to the verification of various items of balance sheet such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

Q15. How can you overcome the disadvantages of continuous audit.

Ans :

Few measures are undertaken to overcome the drawbacks of continuous audit. They are as follows,

1. Audit Notebook

Audit notebooks helps the auditor to record the work which is accomplished by him and his assistants in a particular period of time, material errors which were identified and corrected, the questions which were raised by him and his staff and what explanations were given by the client. This would help the auditor to proceed smoothly by having knowledge about the extent of the work being completed, unanswered queries, any modifications made and so on.

2. Special Tick Marks While Checking

Special tick marks must be used for checking the figures modified prior to audit. These marks must be light and unnoticeable. This would help the auditor to find out as to whether any illegal modifications were made to the audit or not.

3. Audit Staff Must not be Changed

In order to carry out smooth flow of work and to assure the follow-up of unsolved problems, the organizations should not change the duties of the audit staff. Hence for preventing the boredom of the work, nature of duty may be changed after the annual audit.

4. No Change in Audited Figures

The client must be instructed in a detailed manner for not changing any audited figure. If in case the situation demands any changes to be made, then prior permission must be taken from the auditor and such changes must be made with the help of the rectification entry only.

5. Casting in Ink

The periodical totals of different books of accounts must be written down in ink as and when they are being checked.

Q16. What is periodic audit? State its advantages and disadvantages.

(OR)

Explain final audit. State its advantages and disadvantages.

Ans :

Meaning

According to Spicer and Pegler, "A final or complete audit is commonly understood to be an audit which is not commenced until after the end of the financial period and is then carried on until completed".

Advantages

The following are the advantages of final audit,

1. Final audit is less costly when compared to continuous audit.
2. Best suitable to the small scale organisations.
3. It gets completed in less time and very quickly.
4. There are less number of modifications in figures as the auditor accomplishes his work on continuous basis.
5. There is no or minimal disturbance in the daily activities of the business.
6. It helps in easy preparation of audit schedule.
7. There is no need of big establishment.

Disadvantages

The following are few disadvantages of final audit.

1. Final audit is not suitable for large scale organisations.
2. Management would not cooperate with the auditors in certain cases.
3. The audited accounts might not be ready immediately after closure of the financial year.
4. Greater chances of errors and frauds as the auditor would not be able to check all the transactions.
5. Audit report might be submitted lately due to unavailability of all accounts.

Q17. Compare and contrast continuous audit and periodic audit.

(OR)

Distinguish between continuous audit and periodic audit.

Ans :

S.No.	Basis of Distinction	Continuous Audit	Periodic Audit
1.	Time Period	Continuous audit is done throughout the year	Periodical audit is done at the end of the year.
2.	Visit by the auditor	The auditor visits the client's office frequently.	The auditor visits the client's office at the end of the year.
3.	Nature of Business	It is quite suitable of big concerns.	It is suitable for small concerns.
4.	Checking of transaction	Detailed checking of the transactions is possible.	Detained checking is not possible.
5.	Expensive	It is very expensive	It is not expensive
6.	Interim accounts	It helps in preparation of interim accounts	It does not help in preparation of interim accounts.
7.	Detection of Errors and Fraud	It reduces the opportunities for Fraud.	It does not reduce the opportunities of fraud.
8.	Nature of work	Work becomes mechanical and boring.	Work does not become mechanical.
9.	Relationship with staff of the client	There is a possibility for developing unhealthy relationship between the audit staff and the client's staff.	There is no possibility for developing unhealthy relationship between audit staff and client's staff.
10.	Quick submission of accounts	Financial accounts can be submitted immediately after the close of financial year.	Not possible to do so.
11.	Declaration of dividends	It facilitates early declaration of dividend.	It does not facilitate early declaration of dividend.
12.	Moral Check	There will be moral check on the staff of the client.	There will not be any moral check on the staff of the client.

Q18. What are the advantages and limitations of auditing?

Ans :

Advantages

I) For the Owners of Business

1. Greater reliability on the financial statements.
2. Improvement in the efficiency with consequential increase in the overall profitability.
3. In case of a Proprietary concern, audited statement of accounts provide a proof that all business transactions have been duly accounted for and there are no errors or fraud.
4. In case of a Partnership Firm it serves as an evidence of proper management of the affairs of business. Such accounts are also of great help in settlement of accounts in case of admission, retirement or death of partner.
5. In a Joint Stock company, the shareholders rely on the audited statements of accounts to satisfy themselves that the affairs of the company are being run in an efficient manner and there is no misutilization of shareholders funds.
6. In case of co-operative societies, trusts etc., it serves as an evidence that the interest of the beneficiaries and members are being properly looked after.

II) Advantages to the Management

1. Easy dealings with third parties like Banks, creditors, financial institutions and insurance companies, due to credibility of the financial statements which are audited.
2. It ensures compliance with legal requirements.
3. Efficient use of resources through identification of inefficiencies leading to remedial measures.
4. It acts as a moral check on the employees and improves management control.
5. It creates greater confidence of owners in management's integrity.

III) Advantages to employees, investors and creditors

1. It provides a reliable base for taking investment, credit and other decisions.
2. It safeguards the interest of the employees and workers because audited accounts are useful for settling trade disputes e.g., hike in wages or to get higher bonus.
3. Long-term and short-term creditors can rely on audited accounts while taking decisions to grant credit to business concerns.

IV) For Government

1. For determination of liability under sales tax, income tax etc., tax authorities can rely upon the audited statements of accounts.
2. Audited statements of accounts can serve the purpose for taking policy decisions like price fixation, grant of subsidies, reduction of tax rates etc.,
3. Audited accounts can be produced in the court to provide an evidence.

V) For Others

1. Audited accounts can be used by insurance companies to settle the claims arising on account of loss by fire.
2. In case of amalgamation and absorption, the purchasing company can calculate purchase consideration on the basis of audited accounts.

Limitations**1. Postmortem of accounts**

Auditing is a post-mortem examination of accounts. Auditing begins where accountancy ends which means auditor is nowhere around when the accounts are prepared and finalized. Therefore, it may not be possible for him to discover manipulations or fraud in the books of accounts at the preparatory stage.

2. Audit may not provide complete picture

Sometimes the auditor has to depend on explanations, clarifications and information from staff and client. Authenticity of such information is always open to question, if the personnel so providing it have themselves been a party to the manipulation of books of accounts. As a result, the audited statements may not reveal the correct or complete picture.

3. Qualitative aspects ignored

Auditing as a practical subject mainly deals with procedures and techniques of checking, ticking, totaling, vouching etc., As a result several aspects such as business ethics, managerial efficiency and effectiveness are ignored. In such circumstance, it can hardly be expected to do justice to its objects.

4. Inadequate external evidence

Auditor has to seek opinion of experts on certain matters on which he may not have expert's knowledge. For example, a debtor of the business might provide wrong information about the debt owed by him. The valuer of the assets might go wrong in valuing an asset. In such a case, even audited accounts may lack authenticity.

5. Formation of faulty Judgement

The auditor's judgement in relation to correctness and fairness of the propositions in the books of accounts is based on evaluation and critical review of the evidence collected by him through appropriate audit techniques. However, sometimes his personal opinion might cloud his sense of judgement.

so that his report might contain an assessment which is not supported by relevant material evidence. In such circumstance the audited accounts will not show the correct position of the business.

1.2 STANDARDS OF AUDITING

Q19. Explain the concept of Standards of Auditing.

Ans : (July-21, Dec.-18)

In India, the procedures or practices of auditing are issued by ICAI (Institute of Chartered Accountants of India). These procedures were earlier called as AAS. Today, they are known as "Standards on Auditing" (SA). The SA are considered as the standards through which the auditor can measure the audit performance quality and record the attained objectives. These standards help the auditor in determining the professional qualities which are required for effective audit performance. In other words, SA are the standards of auditing which specify the way in which the auditing must be carried out to maintain the quality of audit. If the audit quality is maintained through S A, then it provides an assurance to the related regulatory authority and results in enhanced systems and procedures for the business as a whole and specifically relating to the audit matter. It also gives professional satisfaction to the auditor and acts as a guide to the successor. In brief, it assists in presenting the information in a better manner.

Scope

The SA are useful, when an independent audit is performed i.e., the independent evaluation of financial data of any business, whether profit oriented or not and whatever the size or legal form it has, then such an evaluation is carried out with an objective to express an opinion. SA are also applicable in other functional areas of auditing.

In order to guide the members of the organization, declarations on accepted auditing practices are issued by various professional bodies of accountants in various countries. These pronouncements are related to the financial audit

and also to various other kinds of audit such as internal audit, propriety audit, peer review etc. In India, for independent financial audit, the ICAI has issued a series of SA.

Q20. Explain the importance of standards of auditing.

Ans :

The following points highlight the importance of SA,

1. Codification of Auditing Practices

These professional declarations try to summarize the practices of auditing which are applied while carrying out an audit.

2. Ensure Effective Auditing Practices

Generally, these professional auditing methods and principles are considered as standard. The purpose of specifying these instructions is to make sure that the auditing practices are sound and effective.

3. Guidance to the Auditors

The professional bodies of accountants provide these guidelines to the accountants for organizing the audit. These bodies have specified the auditing principles and techniques which are to be followed by the auditors at the time of conducting an audit.

4. Uniform Presentation of Accounts

Auditing is an inexact science. It is a matter of interpretation to a certain extent. Although the various concepts, conventions, traditions, customs and practices have created confusion, they are found to be significant in checking the free, fair and smooth flow of auditing activities. It ensured consistency in the concepts, conventions and practices of auditing.

5. Prevention of Accounting Scandals

Accounting scandals are often the result of confusion, ambiguity and inexactness in the evaluation and meaning of 'criminology'. This leads to the failure in business. So, standardization is required in auditing terminology in order to secure it from misuse.

Q21. Discuss in detail the standards of auditing*Ans :***(Dec.-18)**

**Audits & Reviews of Historical Financial Information
New/Revised Standards (Auditing, Review and Others)**

S.No.	S.A.NO.	Particulars	Description	Date from which Effective
1	SA 200	Overall Objective of the Independent Auditor and the Conduct of Audit in Accordance with Standards on Auditing.	This standard develops the complete responsibilities of auditors while performing an audit of financial statements as per SAs.	1 April 2010
2	SA 210	Agreeing the Terms of Audit Engagement	This standard deals with the responsibilities of auditor to meet the terms of audit engagement along with management.	1 April 2010
3	SA 220	Quality Control for an Audit of Financial Statements	This standard deals with the auditors specific responsibilities relating to quality control procedures for an audit of financial statements.	1 April 2010
4	SA 230	Audit Documentation	It manages an auditor's responsibility to make documentation for an audit of financial statements.	1 April 2009
5	SA 240	The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements	This standard generally takes up a risk related approach to auditor's responsibility to deal with the fraud in an audit of financial statements.	1 April 2009
6	SA 250	Consideration of Law and Regulations in an Audit of Financial Statements	This standard is concerned about the auditors responsibilities to consider the law and regulations while conducting an audit of financial statements.	1 April 2009
7	SA 260	Communication with Those Charged with Governance	This standard is related to the auditor's responsibility to communicate properly with whoever are entrusted with the governance related to the audit of financial statements.	1 April 2009
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	This standard is related to auditor's responsibility to communicate the short comings in internal control to the ones who are entrusted with governance and management.	1 April 2010
9	SA 299	Responsibility of Joint Auditors	This standard is concerned with the professional responsibilities which are undertaken by auditor to accept appointment as a joint auditor.	1 April 1996

300 - 499 Risk Assessment and response to Assessed Risks

10	SA 300	Planning an Audit of Financial Statements	This standard deals with planning and auditing of financial statements.	1 April 2008
11	SA 315	Identifying and evaluating the risks of material misstatement through understanding the entity and its environment.	The standard is concerned about the auditor's responsibility to have an understanding of the business and its environment, which helps in identifying and evaluating the risks of material misstatement.	1 April 2008

12	SA 320	Materiality in Planning and Performing an Audit	The standards is related to the auditor's of responsibility of applying the materiality concept in planning and conducting an audit of financial statements.	1 April 2010
13	SA 330	The Auditor's Responses to Assessed Risks	It deals with the responsibility of auditor to develop and implement the responses for the risks of material misstatement, which are evaluated by the auditor as per SA 315.	1 April 2008
14	SA 402	Audit Considerations Relating to an Entity Using Service Organisation	It is related to the auditor's responsibility to receive proper audit evidence whenever the services of one or more organizations are used by a user entity.	1 April 2010
15	SA 450	Evaluation of Misstatements Identified the Audit	This standard helps in identifying and assessing the effect of misstatements on audit and also the effect of uncorrected misstatements on the financial statements.	1 April 2010

500 - 599 Audit Evidence

16	SA 500	Audit Evidence	This standard helps in designing and performing audit procedures to get required audit evidence and as to draw appropriate conclusions on which the opinion of the auditor is based.	1 April 2009
17	SA 505	External Confirmations	This standard is related to the use of external confirmation procedures by auditor to get audit evidence as per the requirements of SA 330.	1 April 2010
18	SA 510	Initial Audit Engagements – Opening Balances	This standard develops the principles relating to the audit of opening balances in initial engagements i.e., when the auditing of the financial statement is done for the first time.	1 April 2010
19	SA 520	Analytical procedures	It is concerned with the analytical procedures used by auditor as substantive procedures and as the procedures at the end of audit which helps the auditor in drawing the conclusion on the financial statements.	1 April 2010
20	SA 530	Audit Sampling	This standard is applied when the auditor wants to use audit. Sampling in carrying out the audit procedures.	1 April 2009
21	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures	It is related to the responsibilities of auditor with respect to accounting estimates and related disclosures in an audit of financial statements.	1 April 2009
22	SA 550	Related Parties	This standard deals with the responsibility of the auditor concerning the related parties and transactions while conducting an audit of financial statements.	1 April 2010

23	SA 560	Subsequent Events	This standard deals with the responsibilities of auditor concerning the subsequent events while conducting the audit of financial statements.	1 April 2009
24	SA 570	Going Concern	This standard describes the responsibility of an auditor in the audit of financial statements relating to the use of concern assumption by management for preparing and presenting the financial statement.	1 April 2009
25	SA 580	Written Representations	It is related to the items of duties and aims of auditor relating to the acknowledgement by the management.	1 April 2009

600 - 699 Using Works of Others

26	SA 600	Using the Work of Another Auditor	This standard details the procedures to be used when the independent auditor preparing the financial statement of an entity, makes use of an independent auditor concerning to the financial statements of one or more units of the business.	1 April 2002
27	SA 610	Using the Work of Internal Auditors	This standard deals with responsibilities of external auditors towards internal auditors.	1 April 2010
28	SA 620	Using the Work of an Auditor's Expert	This standard deals with the use of an individual work in a field of expertise except auditing or accounting only when the work helps the auditor's in getting appropriate audit evidence.	1 April 2010

700 - 799 Audit Conclusions and Reporting

29	SA 700	Forming an Opinion and Reporting on Financial Statements	This standard is about the auditor's responsibilities to make an opinion on the financial statements, the form and content of the auditors report given as a result of an audit of financial statements.	1 April 2010
30	SA 705	Modifications to the Opinion in the Independent Auditor's Report	This standard details the responsibility of an auditor to provide suitable report while forming an opinion as per SA 700 (Revised). The auditor makes a conclusion that it is important to have modification to the opinion of auditor on the financial statements.	1 April 2011
31	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	This standard is related to the additional communication in the report of the auditor when the auditor finds it important to draw attention of users towards a matter paragraphs and other matter paragraphs in the financial statements.	1 April 2011
32	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements	This standard explains about the auditors responsibilities towards comparative information in an audit of financial statements.	1 April 2011

33	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements	This standard is about information in documents that includes audited financial statements and auditors report. This also includes the requirement related to reading other information material inconsistencies and misstatements of fact.	1 April 2011
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800 - 899 Specialized Areas

34	SA 800	Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks	It deals with the special consideration while applying the standards to an audit of financial statements made as per the special purpose framework.	1 April 2011
35	SA 805	Special Considerations-Audits of Single Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	This standard is related to the special considerations in the application of the standards to an audit of a single financial statement of a particular element, account or item of a financial statements.	1 April 2011
36	SA 810	Engagements to Report of Summary Financial Statements	This standard deals with the responsibilities of an auditor to take up an engagement to prepare summary financial statement.	1 April 2011

2000 - 2699 Standards on Review Engagements (SREs)

37	SA 2400	Engagements to Review Financial Statements	Engagements to review financial statements.	1 April 2010
38	SA 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity	Review of interim financial information conducted by the independent auditor of the business.	1 April 2010

1.2.1 Procedure for issue of standards by AASB**Q22. Explain the Procedure followed by AASB to issues audit standards.****(OR)****Explain the Procedure for issue of standards by AASB***Ans. :***(July-21, July-19)**

Broadly, the following procedure is adopted for formulating Accounting Standards:

The ASB determines the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof. In the preparation of Accounting Standards, the ASB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.

The draft of the proposed standard will normally include the following :

- Objective of the Standard,
- Scope of the Standard,
- Definitions of the terms used in the Standard,
- Recognition and measurement principles, wherever applicable,
- Presentation and disclosure requirements.

The ASB will consider the preliminary draft prepared by the Study Group and if any revision of the draft is required on the basis of deliberations, the ASB will make the same or refer the same to the Study Group. The ASB will circulate the draft of the Accounting Standard to the Council members of the ICAI and the following specified bodies for their comments:

- i) Department of Company Affairs (DCA)
- ii) Comptroller and Auditor General of India (C and AG)
- iii) Central Board of Direct Taxes (CBDT)
- iv) The Institute of Cost and Works Accountants of India (ICWAI)
- v) The Institute of Company Secretaries of India (ICSI)
- vi) Associated Chambers of Commerce and Industry (ASSOCHAM), Confederation of Indian Industry (CII) and Federation of Indian Chambers of Commerce and Industry (FICCI)
- vii) Reserve Bank of India (RBI)
- viii) Securities and Exchange Board of India (SEBI)
- ix) Standing Conference of Public Enterprises (SCOPE)
- x) Indian Banks' Association (IBA)
- xi) Any other body considered relevant by the ASB keeping in view the nature of the Accounting Standard.

The ASB will hold a meeting with the representatives of specified bodies to ascertain their views on the draft of the proposed Accounting Standard. On the basis of comments received and discussion with the representatives of specified bodies, the ASB will finalize the Exposure Draft of the proposed Accounting Standard.

The Exposure Draft of the proposed Standard will be issued for comments by the members of the Institute and the public. The exposure Draft will specifically be sent to specified bodies (as listed above), stock exchanges, and other interest groups, as appropriate. After taking into consideration the comments received, the draft of the proposed Standard will be finalized by the ASB and submitted to the Council of the ICAI.

The Council of the ICAI will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with the ASB. The Accounting Standard on the relevant subject will then be issued by the ICAI. For a substantive revision of an Accounting Standard, the procedure followed for formulation of a new Accounting Standard, as detailed above, will be followed. Subsequent to issuance of an Accounting Standard, some aspect(s) may require revision which is not substantive in nature. For this purpose, the ICAI may make limited revision to an Accounting Standard.

The procedure followed for the limited revision will substantially be the same as that to be followed for formulation of an Accounting Standard, ensuring that sufficient opportunity is given to various interest groups and general public to react to the proposal for limited revision.

Q23. What are the objectives and functions of AASB?

Ans :

(Dec.-20)

Objectives

The following are the objectives of the Accounting Standards Board:

- (i) To conceive of and suggest areas in which Accounting Standards need to be developed.
- (ii) To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
- (iii) To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same.
- (iv) To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.

- (v) To provide, from time to time, interpretations and guidance on Accounting Standards.
- (vi) To carry out such other functions relating to Accounting Standards.

Functions

1. The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India.
2. While formulating the Accounting Standards, the ASB will take into consideration the applicable laws, customs, usages and business environment prevailing in India.
3. The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board's (IASB) pronouncements in the country with a view to facilitate global harmonisation of accounting standards.
4. Accordingly, while formulating the Accounting Standards, the ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standards Committee (predecessor body to IASB) or International Financial Reporting Standards (IFRSs) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
5. The Accounting Standards are issued under the authority of the Council of the ICAI. The ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements.
6. The ASB will provide interpretations and guidance on issues arising from Accounting Standards.

Short Question and Answers

1. Define Auditing.

Ans :

Meaning

The word Audit is derived from Latin word "Audire" which means 'to hear'. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

Definitions

- (i) **According to L.R.Dicksee** "Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate."
- (ii) **According to R.K. Mautz** "Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports."
- (iii) **According to R.E.Schlosser** "Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement."
- (iv) **According to A. W. Hanson**, "An audit is an examination of such records to establish their reliability of statements drawn from them".
- (v) **According to R.B Bose**, "Audit may be said to be the verification of the accuracy and correctness of the books of accounts by an independent person qualified for the job and not in any way concerned with the preparation of such accounts".

2. Balance Sheet Audit

Ans:

The term balance-sheet is not of common use but this class of audit is mainly followed in the USA. It is an audit which starts with the verification of the items appearing in the balance-sheet. Here the audit operates in the opposite direction of the normal audit procedures. It commences with the detailed examination of the balance-sheet and works back to the books of original entry and related evidences. This is essentially a 'partial audit' since it verifies the items appearing in the balance-sheet mainly and does not start the work of verification with the books of prime entry. The underlying idea of this audit is that by comparing the balance sheets at two successive dates, the profit of the year can be ascertained. However, the auditor will check the accounts in the general ledger and will also check those items of profit and loss account which are directly related to assets. In this audit, the work can be successful in those business houses where an efficient system of internal control in the real sense exists.

3. Explain the Importance of Auditing.

Ans :

Importance of auditing can be judged from the fact that even those organizations which are not covered by companies Act get their financial statements audited. It has become a necessity for every commercial and even non-commercial organization.

The importance of auditing can be summed in following points:

- (a) Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.
- (b) Dispute over correctness of profits can be avoided.
- (c) Shareholders, who do not know about day today administration of the company can

judge the performance of management from audited accounts.

- (d) It helps management in detecting and preventing errors and frauds.
- (e) Management gets advice on financial affairs from the auditors.
- (f) Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.
- (g) Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.
- (h) Audited accounts are useful for the government while granting subsidies etc.
- (i) It can be used by insurance companies to settle the claims arising on account of loss by fire.
- (j) Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.
- (k) It safe guards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

4. Continuous Audit.

Ans :

A continuous audit is one in which the external auditor's staff is occupied in a detailed examination of the books of accounts of the client the whole year round or at regular intervals, say weekly, monthly and quarterly. It is a system of audit in which the audit work is carried on almost simultaneously with the recording of transactions.

Continuous audit becomes imperative in the following types of business:

- (i) Where it is desired that audited final accounts should be ready immediately after the close of the accounting period.
- (ii) Where business is very large and there are numerous transactions to be checked.
- (iii) Where there is no satisfactory and effective system of internal check in force, and
- (iv) Where monthly final accounts are required.

5. Government Audit

Ans :

Government Audit is conducted to ensure that the financial transactions of the government are executed with proper sanction, correctly recorded and confirm with the rules of financial propriety. In India the Comptroller and Auditor General of India is authorized to conduct the Audit of central and state governments. The reports of the CAG which are relating to accounts of the union shall be submitted to the president who shall cause them to be laid before the Parliament. In case of States they are to be submitted to the Governors of respective states who shall cause them to be laid before the state legislature.

6. What are the features of Auditing?

Ans :

The features of auditing are as follows,

1. Accounting Control

Auditing is a tool used for accounting control. The auditing activities will manage and verify the accuracy of the accounting data.

2. Safeguard

Auditing activities protects the proprietors from fraud and carelessness of the agents or servants in using proprietor's money or other assets.

3. Assurance

Auditing ensures that accounts are prepared accurately and expenses are incurred carefully.

4. Assessment

Auditing determines the effectiveness of an accounting system in maintaining company's accounting records.

5. Review

The financial statements are reviewed by audit in order to understand whether the accounting records are in accordance with financial statements or not.

7. State the functions of Auditing.

Ans :

Following are some of the important functions of auditing :

1. Reviewing systems and procedures of business.
2. Examining documentary evidence to establish the accuracy of recorded transactions.
3. Reviewing the system of accounting and internal control.
4. To verify the valuation and existence of assets.
5. To examine the mathematical accuracy of accounting statements.
6. To see whether the statutory requirements have been complied with.
7. Reporting as to what extent, accounts exhibit truth and fairness.
8. To make recommendations for improvement in internal control and accounting system.
9. To verify the distinction between capital and revenue items.

8. Final Audit

Ans :

Periodical or Final or Annual Audit: A system where the auditor takes up his work of checking the books of accounts and other related documents, only at the end of the accounting period when the transactions for the whole financial year are completely recorded, balanced, the trial balance is then drawn out and the final accounts have been prepared, is known as periodical or final or annual audit. The auditor will normally start routine checking of the books and other audit procedures only after the close of the financial year. He would complete his audit work in one continuous session or without any interval. In other words, the auditor visits his client only once a year and goes on checking the accounts and other related documents until the audit work for the whole period is completed.

9. Management Audit

Ans :

Management Audit means the audit of management processes and functions. According to W.P. Leanard "The Management audit may be defined as a comprehensive and Constructive examination of an organisational structure of a Company institution or branch of government, or of any component objectives, its means of operation and use of human and physical facilities". Thus the auditor examines the policies and the actions of the management to ensure that there is a proper and maximum utilization of available resources. It facilitates to ascertain whether sound management prevails from the highest level to downward or not and helps in creating most effective relationship with the outside world and smooth running of the internal organisation.

10. Secretarial Audit

Ans :

Many companies have a department called secretarial department which performs a number of services. The department ensures that the company complies with the provisions of the companies Act of 1956 and other applicable laws. An audit conducted to verify whether a company has complied with the provisions of the Companies Act and other related laws is termed as secretarial audit. The basic objective of secretarial audit is to ensure compliance with company law. It helps the authorities responsible for enforcement of the law like Registrars of Companies, but also provides assistance to the companies themselves in avoiding any unintended violation of law.

11. Advantages of final audit.

Ans :

The following are the advantages of final audit,

1. Final audit is less costly when compared to continuous audit.
2. Best suitable to the small scale organisations.
3. It gets completed in less time and very quickly.

4. There are less number of modifications in figures as the auditor accomplishes his work on continuous basis.
5. There is no or minimal disturbance in the daily activities of the business.
6. It helps in easy preparation of audit schedule.
7. There is no need of big establishment.

12. Disadvantages of final audit.

Ans :

The following are few disadvantages of final audit.

1. Final audit is not suitable for large scale organisations.
2. Management would not cooperate with the auditors in certain cases.
3. The audited accounts might not be ready immediately after closure of the financial year.
4. Greater chances of errors and frauds as the auditor would not be able to check all the transactions.
5. Audit report might be submitted lately due to unavailability of all accounts.

13. Standards of Auditing.

Ans :

In India, the procedures or practices of auditing are issued by ICAI (Institute of Chartered Accountants of India). These procedures were earlier called as AAS. Today, they are known as "Standards on Auditing" (SA). The SA are considered as the standards through which the auditor can measure the audit performance quality and record the attained objectives. These standards help the auditor in determining the professional qualities which are required for effective audit performance. In other words, SA are the standards of auditing which specify the way in which the auditing must be carried out to maintain the quality of audit. If the audit quality is maintained through S A, then it provides an assurance to the related regulatory authority and results in enhanced systems and procedures for the business as a whole and specifically relating to the audit matter. It also gives professional satisfaction to

the auditor and acts as a guide to the successor. In brief, it assists in presenting the information in a better manner.

14. What are the objectives and functions of AASB?

Ans :

Objectives

The following are the objectives of the Accounting Standards Board:

- (i) To conceive of and suggest areas in which Accounting Standards need to be developed.
- (ii) To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
- (iii) To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same.
- (iv) To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
- (v) To provide, from time to time, interpretations and guidance on Accounting Standards.
- (vi) To carry out such other functions relating to Accounting Standards.

Functions

1. The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India.
2. While formulating the Accounting Standards, the ASB will take into consideration the applicable laws, customs, usages and business environment prevailing in India.
3. The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board's (IASB) pronouncements in the country with a view to facilitate global harmonisation of accounting standards.

4. Accordingly, while formulating the Accounting Standards, the ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standards Committee (predecessor body to IASB) or International Financial Reporting Standards (IFRSs) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
5. The Accounting Standards are issued under the authority of the Council of the ICAI. The ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements.
6. The ASB will provide interpretations and guidance on issues arising from Accounting Standards.

15. Statutory audit.

Ans :

It is an audit which is conducted by the qualified persons and is a mandatory requirement as per law. Statutory audit includes the following,

- (a) Company audit
- (b) Bank audit
- (c) Audit of trust organizations
- (d) Audit of co-operative society
- (e) Audit of government departments
- (f) Electricity company audit
- (g) Specified entities according to income tax act
- (h) Audit of clubs, societies etc
- (i) Insurance audit.

Choose the Correct Answers

1. The main object of an audit is _____. [d]
 - (a) Expression of opinion
 - (b) Detection and Prevention of fraud and error
 - (c) Both (a) and (b)
 - (d) Depends on the type of audit
2. The title of AAS2 issued by Council of ICAI is _____. [b]
 - (a) Objective and Scope of the Financial Statements
 - (b) Objective and Scope of the Audit of Financial Statements
 - (c) Objective and Scope of Business of an Entity
 - (d) Objective and Scope of Financial Statements Audit
3. A sale of Rs. 50,000 to A was entered as a sale to B. This is an example of _____. [b]
 - (a) Error of omission
 - (b) Error of commission
 - (c) Compensating error
 - (d) Error of principle
4. 'Goods sent on approval basis' have been recorded as 'Credit sales'. This is an example of _____. [a]
 - (a) Error of principle
 - (b) Error of commission
 - (c) Error of omission
 - (d) Error of duplication
5. As per AAS4 if auditor detects an error then _____. [d]
 - (a) He should inform the management.
 - (b) He should communicate it to the management if it is material
 - (c) The auditor should ensure financial statements are adjusted for detected errors.
 - (d) Both (b) and (c)
6. Which of the following is not a limitation of audit as per AAS4 ? [a]
 - (a) Objectivity of auditor's judgment
 - (b) Selective testing
 - (c) Persuasiveness of evidence
 - (d) Limitations of internal control system
7. The term "Audit" originated from the Latin word [a]
 - (a) Audire
 - (b) Adhere
 - (c) Adhere
 - (d) None of the above

8. The management takes so many decisions on the basis of - [b]
(a) Accounting statement (b) Financial statements
(c) Bank statements (d) None of the above
9. Express an opinion on the financial or non financial areas is the goal of- [c]
(a) Accounting (b) Managing
(c) Auditing (d) None of the above
10. The main object of an audit is- [a]
(a) Expression of opinion (b) Detection and prevention of fraud and error
(c) Both((a) and ((b)above (d) Depends on the type of audit

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Fill in the Blanks

1. _____ is a systematic examination of the books and records of a business
2. Audit done by the employees of the business undertaking is called _____.
3. Management audit otherwise called as _____.
4. A kind of audit conducted for a part of the accounting year is called _____.
5. The audit that is made compulsory under statute is called _____.
6. Audit derived from Latin word Audire which means _____.
7. the audit work performed by employee of the company is _____ audit
8. Statutory audit is also known as _____ audit
9. CBDT stands for _____.
10. Recording a transaction twice in the books of original entry is an error of _____.

ANSWERS

1. Auditing
2. Management audit
3. Efficiency audit
4. Periodical audit
5. Statutory audit
6. To hear
7. internal
8. Compulsory
9. Central board of direct taxes
10. Duplication

One Mark Answers

1. Auditing.

Ans :

According to A. W. Hanson, "An audit is an examination of such records to establish their reliability of statements drawn from them".

2. What is continuous audit?

Ans :

A continuous audit is one in which the external auditor's staff is occupied in a detailed examination of the books of accounts of the client the whole year round or at regular intervals, say weekly, monthly and quarterly. It is a system of audit in which the audit work is carried on almost simultaneously with the recording of transactions.

3. What is periodic audit?

Ans :

According to Spicer and Pegler, "A final or complete audit is commonly understood to be an audit which is not commenced until after the end of the financial period and is then carried on until completed".

4. Write a note on Errors of Principle.

Ans :

Errors which occur due to lack of knowledge about differences of capital and revenue items are called errors of principle.

5. What is Error of Duplication?

Ans :

Error of duplication refers to a case where a transaction is being recorded two times and is also posted two times in the ledger.

UNIT II

AUDITOR AND EXECUTION OF AUDIT:

Appointment – Qualification and Disqualification – Qualities – Remuneration – Removal – Rights – Duties – Civil and Criminal Liabilities of Auditors – Commencement of Audit – Engagement Letter – Audit Program – Audit Note Book – Audit Workbook – Audit Markings.

2.1 AUDITOR

Q1. Define the terms.

- (a) Auditor
- (b) Company Auditor

Ans :

(a) **Auditor**

An auditor is a person or a company of chartered accountants who have expertised knowledge in the field of audit and accounts. If a person wants to become an auditor in India, then he/she must be the member of the Institute of Chartered Accountants of India (ICAI). ICAI is an authoritative body in the profession of accounts and audit.

(b) **Company Auditor**

A company auditor is a person appointed to carryout an independent examination of books, accounts and supporting vouchers to check the fairness and reliability of both profit and loss account and balance sheet. The company auditor is a professional individual with expertised knowledge in all branches of accounting.

Q2. Discuss about the auditors for different forms of business.

Ans :

The auditors for different forms of business are discussed as follows,

1. Audit of a Sole Trade Business

Government doesnot make it mandatory for the sole traders to get their accounts audited. Despite this fact, companies go for audit for several vital

reasons. Audit becomes compulsory for the sole traders who operate business at large scale and have no direct control over all the transactions. Although the statute doesnot govern the sole trader for audit, but sometimes the Income Tax Act makes it essential based on the size and nature of the business.

Rights and Duties of a Sole Trade Business

There are no specific rights and duties of an auditor in the sole trade business. If required, he/ she will perform the following functions/roles,

- (a) The auditor performs the audit work with due diligence, identifies the errors and suggests his client to maintain their books in an appropriate manner.
- (b) The auditor has the right to evaluate the books of accounts and seek clarification whenever needed.
- (c) The remuneration of the auditor is decided based on the work assigned to him and it sometimes depends on mutual understanding between auditor and sole trader.

2. Auditor of a Partnership Firm

The Indian Partnership Act 1932, governs the partnership business in India. The Act doesnot make it mandatory for the firms to get their accounts audited. To avoid accounting errors, many Indian firms has made a provision of compulsory audit in their partnership deed.

Appointment of the Auditor of a Partnership Firm

The appointment of an auditor in a partnership firm is similar to the appointment of auditor in the sole trade business. However, in partnership firm, the auditor will be responsible for the whole firm irrespective of whether he/she is appointed by any of the partners. The partnership deed will govern the appointment and other terms and conditions of the auditor if the provisions relating to rights duties appointment and remuneration of auditor are specified in the partnership deed.

Rights and Duties of the Auditors in a Partnership Firm

The following are the rights and duties of an auditor in the partnership firm,

- (a) The auditor performs his work with due diligence, identifies the errors and suggest his client to maintain their books of accounts in an appropriate manner.
- (b) He has the right to evaluate the books of accounts and seek clarification whenever, needed.
- (c) It is the responsibility of an auditor to report any conflict arising in the company and he is not supposed to favour a partner who is involved in any wrong doing.

3. Auditor of a Limited Company/Joint Stock Company

Joint stock company/limited company is the most significant type of business organization. Hence, the auditing profession is directed towards the audit of the accounts of a limited company. The statute make it compulsory for the firm to get their accounts audited. Certain provisions of audit are provided under sections 224 and 233 of Indian Companies Act, 1956. The same provisions were also there in the previous types of Companies Act. These sections clearly specify the qualification, disqualification, appointment, re-appointment, rights, duties, removal and report of the auditor.

2.1.1 Appointment of Auditor

Q3. Discuss the provisions relating to appointment of a company auditor.

(OR)

Explain the appointment of auditor.

(OR)

State the provisions of companies act 2013 regarding appointment of the auditors.

Ans : (Dec.-18, Dec.-19)

Appointment of Auditors

The provisions relating to the appointment of auditors are as follows:

1. Appointment of First Auditor of a Company (Sec 224 (5))
2. Appointment by company i.e., shareholders (Sec 224 -1 (A))
3. Appointment by the Central Government (Sec 224(3))
4. Appointment in case of casual vacancy (Sec 224 (6))
5. Reappointment of auditors (Sec 224(2))
6. Appointment of Auditors of Government or Certain other companies (Sec 619)
7. Appointment of Auditor by Special Resolution (Sec 224 - A)

The above provisions can be explained in the following manner:

1. Appointment of First Auditor of a Company (Sec 224 (5))

The first auditor (s) of a company shall be appointed by the Board of Directors within 1 month of the date of registration of the company. The auditor so appointed shall hold office until the conclusion of the first annual general meeting.

The company may, however at a general meeting remove any such auditors and appoint in their place any other person or persons who have been nominated for appointment by any member of the company.

The notice of such nomination has been given to members of the company at least 14 days before the date of the proposed meeting.

In case the Board does not exercise its power in this regard, the first auditors shall be appointed by the company in its general meeting.

2. Appointment by Company (Sec 224 - 1 (A))

Except in case of the first auditor, every company shall at each annual general meeting, appoint auditors to hold office from conclusion of that meeting until the conclusion of the next annual general meeting. And shall within 7 days of the appointment give intimation thereof to every auditor so appointed.

Within 30 days of the receipt of intimation from the company about his appointment, the auditor shall inform the Registrar of Companies in writing about his acceptance or refusal of such appointment.

3. Appointment by the Central Government Sec 224 (3)

Where at an annual general meeting no auditors are appointed or reappointed, the Central Government appoints a person to fill the vacancy. When a company fails to appoint an auditor at its annual general meeting then within 7 days of its failure to appoint or reappoint an auditor this fact should be intimated to central Government.

In the case of default, the company and every officer of the company who is in default shall be punishable with a fine which may extend to Rs. 500.

4. Appointment in case of casual vacancy (224(6))

Meaning of casual vacancy This term is not been defined in the Act. In its natural connotation, it means vacancy resulting from accidental circumstances such as death, incapacity or disqualification of the auditor.

Any casual vacancy in the office of an auditor may be filled by the Board of Directors.

However, where any casual vacancy is caused by the resignation of an auditor during the term of his appointment, the vacancy shall only be filled by the company at the general meeting.

5. Reappointment of auditor (Sec 224 (2))

- (a) The auditor appointed by whatever authority shall be reappointed at the annual general meeting unless he is not qualified for reappointment.
- (b) If the auditor has given the company a notice in writing about his unwillingness to be reappointed.
- (c) If a resolution has been passed at that meeting appointing some other person instead of him and to provide expressly that he shall not be reappointed.
- (d) If a notice has been given of any resolution proposing the appointment of some other person in the place of the retiring auditor.

6. Appointment of Auditors of Government or Certain other companies (Sec 619)

Supervening the provisions of Sections 224, Section 619 of the Companies Act has laid down that the auditor of a government company shall be appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor-General (CAG) of India.

According to Section 619B, the provisions of Section 619 of the Act shall also apply to a company in which the Central Government or any state government or governments or partly by the Central Government and partly by one or more state governments, and includes a company which is a subsidiary of a government company, any government company or any government corporation, hold either singly or jointly not less than 51 per cent of the paid up share capital. Thus, the auditors of such companies are to be appointed or re-appointed by the Central Government on the advice of the CAG of India.

7. Appointment by special resolution

Under Section 224-A, a company is required to appoint the auditor by special resolution when 25% or more of the subscribed capital is held either singly or in combination by,

- (i) A government company or any state government or a public financial institution.
- (ii) Any financial institution established by any provincial or state act where a state government has not less than 51% of the subscribed share capital.
- (iii) A nationalized bank or any insurance company dealing with general insurance business.
- (iv) A combination of the above three.

2.1.2 Qualification and Disqualification

Q4. Discuss the provisions of companies act regarding qualification and disqualification of an auditor.

(OR)

State the qualification and disqualification of a company auditor.

Ans : (Dec.-20, July-19)

Qualifications

The object of the provisions as to qualification of the auditors is to ensure that only persons of proven worth are appointed as auditors. The following persons will be competent to be appointed as auditors of a company.

- 1. Sec 226(1) of the Company's Act lays down that a person shall not be qualified for appointment as an auditor of a Company unless he is a Chartered Accountant within the meaning of the Chartered Accountant Act 1949.
- 2. In case of a firm, if all its partners are practicing Chartered Accountants in India are qualified for appointment by its firm's name to be auditors of a company. In such a case any of its partners can act as an auditor in the name of the firm.

- 3. Certified auditors (Sec 226 (2)) Apart from the practicing chartered accountants, a person holding a certificate under the Restricted Auditor's Certificate Rules 1956 is also qualified to be appointed as auditor of a Company. (Such certified auditors are subject to rules framed in this behalf by Central Government).

Disqualifications

- 1. A body corporate.
- 2. An officer or employee of the company.
- 3. A person who is a partner, or who is in the employment under an officer or employee of the company.
- 4. A person who is indebted to the company for an amount exceeding Rs. 1000 or who has given any guarantee or provided any security in relation with the indebtedness of any third person to the company for an amount exceeding Rs. 1000.

A person also shall not be qualified for appointment as auditor of a company, if he is by virtue of the above listed provisions disqualified for appointment as auditor of any other corporate body which is that company's subsidiary, holding company or a subsidiary of that company's holding company, or would be so disqualified if the corporate body were a company. [Section 226(4)]

The provisions of Section 226 as stated above, are intended to ensure that the auditors are independent of the companies they are, appointed to audit.

If an auditor, after his appointment, becomes subject to any of the disqualifications specified above, he shall be deemed to have vacated his office as such.

In this connection, Section 8 of Chartered Accountants Act, 1949, is also relevant since the chartered accountant is also subject to the disabilities stated in this Section.

2.1.3 Qualities**Q5. What are the qualities of a good auditor?**

Ans : (July-21)

An auditor is required to perform a wide variety of functions and to do so he must possess certain qualities. Some of these can be acquired through education and training while for the others it depends upon his experience. Some of these are equally necessary for success in any field.

1. Professional Expertise

It means that he should possess requisite knowledge and can apply that knowledge to practical problems. The knowledge of following subjects contributes to the competence of auditor i.e., Accounting, Business law, Taxation, Management accounting, Economics, Mathematics and Statistics, Financial and marketing management.

2. Integrity

It is one of the essential qualities of an auditor. It means he should be honest, sincere and should have straight forward approach towards his work. The functions of an auditor is to express his opinion with due care and skill and do nothing under pressure. If the auditor compromises his integrity due to fear, then the very purpose of audit is defeated.

3. Tactfulness

The auditor should be tactful in his dealings with officers and staff of the client, with his assistants, with his co auditors, and so on. He should exercise utmost care in deciding what is appropriate to do, to say or write while dealing with others.

4. Objectivity

The auditor should be objective which means detached, fair and unbiased. His opinion should be based on objective consideration of facts, rather than on any pre-determined notion. An independent state of mind and an unbiased judgement are the corner stones of the profession of auditors.

5. Independence

It means the auditor should not subordinate his judgement to that of anyone or the client. An auditor should be free of any such interest in the enterprise under audit which may affect his integrity. Unless he is independent, his report would not generate sufficient confidence among the users of audited information.

6. Logical abilities

An auditor must have logical approach towards his work. He should have the capacity to analyse and interpret problems and facts. The auditor is constantly required to make decisions relating to evidence and audit procedures and he should be able to distinguish the relevant information from the irrelevant. He should make logical conclusions about the course of action to be followed.

7. Communication

The auditor should be able to communicate effectively both oral and written communication. Proficiency in oral and written communication is of great importance to an auditor. In case of report preparation he should be able to convey his message concisely, precisely and clearly.

8. Diligence

The auditor is required to work diligently and methodically to accomplish his tasks and also to set an example before his subordinates.

2.1.4 Remuneration**Q6. Explain the remuneration of auditor.**

Ans : (July-21)

- The remuneration of the auditor of a company may either be fixed by the company at its general meeting or can be fixed in any manner determined in a general meeting.
- In case the auditor is appointed by the Board or the Central Government his remuneration may be fixed by the appointing authority.

- The remuneration is inclusive of all expenses allowed to him and he is not entitled to any other payment, whether as expense or otherwise.
- If an auditor is asked to do any other work over and above his normal work of audit he is entitled to get extra remuneration in addition to normal fee for the audit.
- The approval of such remuneration is not obtained in the general meeting of the company.
- Such remuneration is a matter of arrangement between the auditor and the Board of Directors. However, the remuneration paid as fees, expenses or otherwise for such services to the auditor should be disclosed in the profit and loss account. (Schedule VI Part II Clause B). In its statement, on payment to auditors for other services, the Council of the Institute of Chartered Accountants of India has recommended that the remuneration for other services (other than audit work) performed by the auditor should be classified under the following heads in order to give correct information to shareholders and to others who read the accounts of the company :
 - (i) For taxation matters
 - (ii) For company law matters
 - (iii) For management services
 - (iv) For internal auditing and
 - (v) For other services.
- It is also to be noted that any sums paid by the company in respect of the auditor's expenses in carrying out his duties shall be deemed to be included in the expression 'remuneration'.

2.1.5 Removal

Q7. Explain how an auditor of a company can be removed

Ans : (July-21)

1. Removal of First auditors

They are appointed by the Board of directors prior to the first annual general meeting, may

be removed by the members in general meeting. It is immaterial whether or not the auditor has completed his term of appointment.

In the general meeting the company may appoint in his place any other person nominated by any member of the company.

Notice of such nomination must be given at least 14 days before the date of the general meeting.

2. In other cases

Any auditor may be removed from office before the expiry of his term. This can be done only by the general meeting after obtaining prior approval of the Central Government.

Where it is proposed to remove the present auditor, the procedure as prescribed in sec 225 has to be followed

- (i) **Special notice of resolution :** Any shareholder who wants to remove the present auditor has to give a special notice of his intention to move a resolution to the company at least 14 days before the date of the general meeting.
- (ii) **Auditor to be informed :** On receipt of a notice for such resolution, the company shall send a copy thereof to the retiring auditor.
- (iii) **Right to represent:** On receiving such notice the retiring auditor has a right to make a representation in writing, not exceeding a reasonable length to the company. He may request the company to notify such representation to members of the company.
- (iv) **Company to comply :** Where auditor makes a representation to the company then the company will be required to

state in the notice of the resolution that such representation has been made and the company has to send a copy of the representation to every member of the company to whom the notice of the meeting is sent.

- (v) **Right to attend meeting** : The auditor who is proposed to be removed, can attend the general meeting at which his removal is to be discussed. The auditor has a right to make an oral statement at the meeting where his removal is proposed. Such right is given to the auditor by way of safeguard against his improper removal.

3. Removal as per the Chartered Accountants Act

In case of professional misconduct, the auditor may also be removed from his office. The following are few significant clauses of the Chartered Accountants Act, 1949 which state the professional misconduct for which a Chartered Accountant is removed from his office.

As per chartered accountants act, the following are some of the reasons for removal of an auditor,

- (i) If the Chartered Accountant is found to be unprofessional in his conduct.
- (ii) If the Chartered Accountant is involved in some business other than his profession without taking the permission from the Council of the Institute.
- (iii) If the Chartered Accountant takes up the position of an auditor without informing the previous Chartered Accountant in writing.
- (iv) The Chartered Accountant can be removed if he is negligent in discharging his duties.

2.2 RIGHTS – DUTIES OF AUDITOR

Q8. What are the rights and duties of an auditor?

(OR)

Enumerate the various duties of an Auditor.

Ans : (July-21, Dec.-18)

1. Right of access to books, accounts and vouchers (Sec 227 (1))

The auditor has the right of access, at all times, the books of accounts and vouchers of the company, whether kept at the head office of the company or else where.

The right of access to books etc., is an absolute right and it is not subject to any restriction.

The right of access "at all times" refers to the period during which the auditor works in the company. It also means that during the normal, working hours the auditor can undertake examination of the books.

The term "books" includes not only the financial books of the company but also statutory and statistical books.

The term "vouchers" include all documents, correspondence, agreements etc., containing evidence as to any of the transactions or data in financial statements.

2. Right to obtain information and explanation (Sec 227 (1))

The auditor has the right to obtain information and explanations as he may think necessary for the performance of his duties as auditor. The auditor has to determine what information and explanations will be necessary to enable him to perform his duties. If any information is not available from the accounts of the company the officers are under an obligation to provide it. If they refuse to do so, the auditor is entitled to report accordingly to the members.

3. Right to receive notice and to attend general meeting (Sec 231))

The auditor has the right to receive all notices relating to any general meeting of the company irrespective of the fact whether accounts are being discussed or not at such a meeting. He has a right to speak at such meeting when the accounts are being discussed. The right to attend a general meeting and to speak thereat is permissive and not mandatory such right is restricted to general meeting alone and does not extend to meetings of the Board. But the auditor has a duty to attend and take part in the proceedings at the meeting if he has a reason to believe that the directors are likely to present a false picture of the state of affairs of the business or to distort the meaning of any remarks by him in the audit report.

4. Right to report to members (Sec 227(2))

The auditor has the right, to make a report to the members on the accounts examined by him, and to state whether in his opinion and to best of his information and according to the explanations given to him, the accounts of the company are according to the requirements of the companies act. He has to also state whether the financial statements give a true and fair picture of the companies affairs.

5. Right to have legal and technical advice

Where the auditor needs expert advice in respect of any legal or technical matter for proper discharge of his duties, he may seek it at the expense of the company but he must give his opinion in the report and not that of the experts.

6. Right to visit Branch office (Sec 228)

If the accounts of any branch office are audited by a person other than the companies auditor then the company auditor shall be entitled to visit the branch office and shall have the right of access at all times to the books, accounts and vouchers of the company as maintained at the branch office.

If the company is a banking company and has branches outside India, the auditor will have no right to visit such branches but will have the right of access to all the returns sent by the branch to the head office (Sec 228).

7. Right to receive remuneration (Sec 224 (8))

The auditor has the right to receive remuneration for auditing the accounts of the company, though such right accrues only after he has completed the work.

8. Right to Sign Audit Report (Sec 229)

Only the person appointed as auditor of the company can sign the auditor's report or authenticate any other document of the company which the law requires to be signed by the auditor.

9. Right to be indemnified

For many purposes, an auditor is considered to be an officer of the company. As an officer he has a right to be indemnified out of the assets of the company against any liability incurred by him in defending himself against any civil or criminal proceedings by the company, if he is held not guilty by the law.

Duties of an Auditor

1. Duty to report to members (Sec 227(2))

The auditor is required to make a report to the members of the company:

- (a) On the accounts examined by him i.e., auditor has to state in his report, whether, in his opinion, proper books of accounts as required by the law have been maintained by the company. He has to also see that the books should be so kept as to give a true and fair view of the state of affairs of the company.
- (b) Whether or not he has obtained all the information and explanations which to the best of his knowledge was necessary for discharging his duties.
- (c) Whether the report on the accounts of any branch office audited by a person other than the company auditor are forwarded to him u/s Sec 228.
- (d) He has also to state whether the Balance Sheet and Profit and Loss account are drawn up according to the requirements of the Companies Act.

- (e) The auditor has to mention in his report if he is not satisfied with the information and explanations given to him with regard to any points.

2. Duty to assist Investigators (Sec 249 V (B))

Where an inspector is appointed under Sec 235 or 237 to investigate the affairs of the company, it is the duty of an auditor to assist them in every possible way. The auditor can be asked to produce the working papers for this purpose (Sec 240 (6) (b)).

3. Duty as to inquiry

It is the duty of the auditor to inquire on various points i.e., whether the loans and advances have been properly secured, whether any personal expenses have been charged to revenue account to mis-utilize the funds of the company. The auditor is also required to see whether any investments are sold by the concern at a price lower than the purchase price.

4. Duty to sign audit report (Sec 229)

It is the duty as well as the right of the auditor to sign the report prepared by him. In case the auditor is a firm, then only a partner of the firm practicing in India can sign the report.

5. Duty to certify the Statutory Report (Sec 165(4))

The auditor has to certify the correctness of the statutory report to the extent it is related to

- The shares allotted by the company.
- Amount of cash received in respect of such shares and
- An abstract of the receipts and payments of the company.

6. Duty as to Prospectus (Sec 56)

If an existing company issues prospectus, it should contain a statement of profit and losses and assets and liabilities of the company. The rate of dividend paid by the company in respect of each class of shares in the company for each of the 5 financial years preceding the issue of the prospectus.

7. Duty as to report under voluntary winding up (Sec 488(2))

Where a company has been wound up voluntarily then a required number of directors has to make a declaration as to its solvency, such declaration will not have effect unless it is accompanied by a report of the auditor relating to the profit and loss account and the Balance Sheet. It is the duty of the auditor to prepare such report in accordance with the provisions of the Companies Act.

Q9. Define Auditor's Lien.

Ans : (Dec.-19)

An auditor has got no lien in the books of accounts which he has audited. As a general rule the book of accounts should always be available in the registered office of the company for the inspection of the public and the shareholders of the company. All such books of accounts are the property of the company and as such, these cannot be removed from the head office of the company.

In the case of Herbert Alfred Burelign vs. Ingram, Clark Ltd. (1901), it was held that the auditor had no lien on the books of accounts in respect of audited work.

However, in case of Chan trey Martin and Co. vs Martin, London (1953), it was decided that the auditor has only the lien on the working papers prepared by him for producing the balance sheet. From these two cases, it is clear that an auditor cannot exercise his right of lien on the books of accounts of the companies. Thus, an auditor cannot have a lien on the books of accounts.

2.3 CIVIL AND CRIMINAL LIABILITIES OF AUDITORS

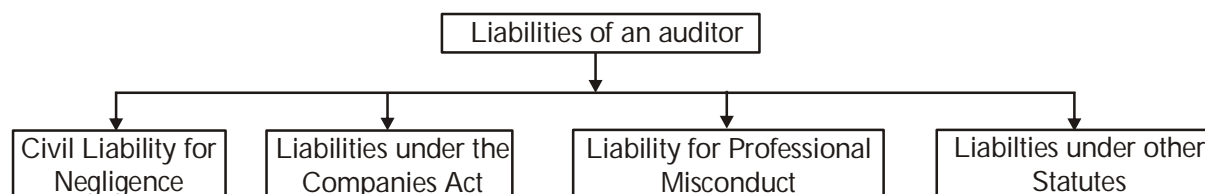
Q10. Describe the civil and criminal liabilities of an auditor.

Ans : (July-21)

(A) Civil Liability for Negligence

Under this, the auditor is liable for the following,

1. This liability takes place when it is being proved that the auditor was careless/negligent while performing his duties as an auditor and this has resulted in loss.
2. The auditor might be held personally responsible for any loss incurred if in case there are acts of omissions and commissions because of the auditor's carelessness.
3. In case of *Trisure India Ltd. Vs A.I Ferguson & Co (1987)* 61 company. Case, 548C it has been noted that the auditors job is to check and audit the company matters and financial books of the firm and he is not liable to perform the job of a detective.



4. Civil liability for negligence arises if it is proved that,
 - (i) The auditor was negligent (careless) on duty
 - (ii) The loss was a result of the auditors negligence
 - (iii) The loss was suffered by the client of the auditor.

(B) Liabilities Under the Companies Act

Under this act, the auditor is liable for the following:

(i) Civil Liability

The auditor might be held accountable for civil liability under the following sections,

- (a) **Section 477:** According to this section, the court has the power to summon and scrutinize any officer of the company (including the auditor) if they have been suspected to be indebted to the company or if in case they hold the ability to provide information about the promotion, formation, trade dealings, property, books, papers or company affairs.
- (b) **Section 478:** According to this section, in case if an order is being passed for winding up of a company and that the official liquidator suspects that a company official (including auditor) has committed any fraud, then the auditor is liable for public examination on the day fixed for this.
- (c) **Section 545:** This section enlists rules for prosecution of fraudulent officials, inclusive of the auditor and members of the company.
- (d) **Section 633:** This section is conserved with the power of the court to give relief to an accused auditor if it believes that the auditor is not liable and has honestly carried out his auditing duties.

(ii) Liability for Mis-statement in the prospectus (Sec.-62)

The auditor is liable to pay for any loss to the shareholders or debentures if in case he has given any false statement as an expert in the prospectus. However he is not liable in the following cases:

- (a) He gave the statement in good faith, and had no knowledge that the statement is false.
- (b) If he takes back his permission in writing prior to the registration of the prospectus or prior to the allotment of shares.

(iii) Liability for Misfeasance (Breach of trust) (Section 543)

An auditor is liable to pay for the damages of an aggrieved party for any breach of trust or (Misfeasance). The time limit for taking an action is five years.

(iv) Criminal Liability Section 2(30)

An auditor is considered as criminally liable under the following sections:

- (a) Section 63:** As per this section, an auditor is criminally liable of presenting false statement in the prospectus.

Punishment

He is liable for a punishment upto 2 years jail and ₹5000 fine or both unless he proves that the statement was wrong.

- (b) Section 68:** According to this section, the auditor is held liable for fraudulently forcing the people to invest money.

- (c) Section 545, 539 :** As per these sections, an auditor is liable for fraud during the process of winding up of a company.

Punishment

He is liable for a punishment of upto 7 years jail and fine as per section 539.

- (d) Section 628:** According to this section, an auditor is liable for intentionally ignoring the material facts, providing false information related to balance sheet, report, other certificate, prospectus or any document of accounts.

(C) Liability for Professional Misconduct

The auditor is held liable for breaking the professional code of conduct which is laid down by the Institute of Chartered Accountants of India formed under the Chartered Accountants Act, 1949.

(D) Liabilities Under other Statutes

The liabilities under other statutes are as follows,

(i) Liabilities Under Income Tax Act (Sec 278)

If in case an auditor certifies wrong accounts, which are submitted to the income tax department, then he is liable for imprisonment upto two years and further he might also be disqualified from practicing.

(ii) Liability Under Consumer Protection Act, 1986

An auditor would be charged under the Consumer Protection Act, if he gives wrong advice towards payment of fees.

2.4 AUDIT PLANNING**Q11. Define audit planning. What are the objectives of audit planning?**

Ans :

Meaning

Detailed planning acts as one of the prerequisites for effective and efficient completion of the audit work. Audit planning can be defined as "a systematic and continuous plan of action which the auditor usually follows during the course of audit". In simple words, audit planning refers to the process of preparing in advance, all the steps which the auditor would follow in a sequential order.

Objectives

The objectives of audit planning are,

1. According to the Auditing and Assurance Standards-1(AAS-1) "the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner". The main purpose of audit is usually,
 - (a) Assigning tasks to the audit staff
 - (b) Designing and developing deadlines for completing the audit work
 - (c) Scheduling dates for midterm and year end audit.
2. Audit planning basically aims that sufficient time is used for key areas of audit.
3. It aims at equidistribution of work among the auditor's staff.

4. It aims to create an atmosphere of co-operation and co-ordination among the auditor's staff, thus facilitating on-time completion of the audit work.
5. It aims at solving the main problems during the course of audit work.
6. The main objective is to ensure timely completion of the audit work.

Q12. State the significance of audit planning.

Ans :

Audit planning provides the following advantages to the auditor and the client company:

1. It ensures quick identification of the potential problem areas.
2. It provides a clear time map within which the audit work needs to be completed.
3. It ensures that proper attention is being paid to the key areas.
4. It helps to create an atmosphere of co-operation and coordination among the auditors staff and the client company officials.
5. It ensures optimum utilization of time and other resources.

2.4.1 Commencement of Audit

Q13. What are the steps required by an auditor before the commencement of audit in an organization?

(OR)

Discuss the steps to be followed before the commencement of an audit.

Ans : (Dec.-20)

A person, who is qualified under Section 226, will be appointed as auditor to company under Section 224, Before Commencing the Audit work. The following preliminary steps are to be executed.

1. Verification of Appointment:

First of all auditor has to conform whether his appointment is properly made or not. If appointment is not proper, he can claim remuneration, if he is appointed by share

holders, he has to see whether the procedure specified under Section 224, is properly followed or not. If he is appointed by directors he has to go through the resolution made by the court.

2. Verification of Memorandum

Memorandum is started of the company. It deals with external affairs of the company. Out of its clauses, the information written under objects clause, liability clause and capital clause is useful to auditor. Therefore he should refer to memorandum and such information should be taken to audit notebook.

3. Verification of Articles

Articles read about internal affair of the Company. It includes calls on share, transfer of shares, transmission of shares, reserves, payment of dividend etc. All these things are useful to Company auditor and hence abstracts from articles should be taken to audit notebook.

4. Verification of Articles

Articles read about internal affair of the Company. It includes calls on share, transfer of shares, transmission of shares, reserves, payment of dividend etc. All these things are useful to Company auditor and hence abstracts from articles should be taken to audit notebook.

5. Verification of Prospectus

Before commencing the audit work, auditor should refer to prospectus also to obtain information relating to minimum subscription, preliminary expenses, underwriters commission, terms of issue etc.

6. Verification of Contract Deeds

On account of legal entity company can enter into contracts. Auditor should refer to those contract deeds to know about names of parties to the Contract, Contract prices, other terms etc.

7. Verification of Certificate of incorporation and certificate of Commencement of business

If it is first audit of the company, auditor should refer to Certificate of Incorporation and Certificate of Commencement of Business issued by registrar of Companies to conform that the company has got formed properly in accordance with requirements of companies act.

8. Verification of Internal Check System

Internal check means arrangement of staff in such a way where work done by one clerk automatically gets checked by the other. Well planned internal check system minimizes scope for frauds and errors. In presence of well designed internal check system, auditor can follow shortcut methods like test checking etc. Good internal check system reduces the work load of auditor.

9. List of Books

Auditor should obtain list of books maintained by the company. Company maintains several statutory books or compulsory books, Statistical or Optional books; Cost records, financial records etc. All those books are to be listed.

10. List of Offices

Auditor should refer to organization chart of the company and key positions are to be found. Here auditor has to gather names, rights, duties, specimen signatures etc of staff members employed at such key positions.

11. Verification of Financial Statement

Auditor should get copies of previous 3 or 4 years financial statements along with audit reports. By going through them an idea with regard to profitability, financial position and previous auditor's opinion can be obtained.

12. Central Government Permission

On certain occasions company has to obtain permission to central government. For example; to issue share warrants, to grant to directors etc. Here auditor has to observe whether permission from Central Government is obtained or not.

13. Audit Program

Planning of audit work is called Audit Programme. It shows division of audit work among audit staff. After preparation of audit program audit work can be commenced. Audit program has several advantages like completion of audit work within desired period, proper entrustment of work, etc. At the same time audit programme has certain disadvantages also like making work mechanical etc.

2.5 ENGAGEMENT LETTER

Q14. Explain the concept of engagement letter.

(OR)

Write short note on audit engagement letter.

(OR)

Define engagement letter.

Ans :

It is a document sent by the auditor to the client under audit, usually before the commencement of the audit, which signifies confirmation of his acceptance of appointment as an auditor specifying its objectives, scope and terms and conditions.

In case of statutory audit which is governed by law, an engagement letter ensures that the client clearly there of. In case of audit which is not conducted in pursuance of the requirements of law, the engagement letter confirms the verbal arrangements reached between the auditor and the enterprise under audit.

In such a case the auditor should get a copy of the letter signed by a responsible official of the enterprise so that the engagement letter becomes an agreement in relation to the objective, scope and the obligations of the auditor.

The form and contents of audit engagement letter will differ from one client to another following are the matters generally referred in the letter.

- (a) The objective of the audit of financial information.
- (b) Responsibility of management for preparation of financial statements under Audit,
- (c) Nature or form of Audit reports or other communication of results of the engagement.
- (d) Scope of the Audit work, time period to complete the work, and pronouncements of the professional body to which the auditor is subject.

Besides the letter may also refer to the following aspects :

1. Availability of records, documents, information and explanation required in connection with audit.
2. Basis for computation of audit fees and billing arrangements
3. Arrangements regarding the conduct of Audit
4. In case of non-statutory audits, the purpose for which the Audit Report can be used.
5. Communication with the previous Auditor and arrangements with other auditors, experts for particular aspects of audit and the services of internal auditor and the staff of the client for the purpose of audit.
6. lastly, request for written confirmation from management with regard to the representations concerning the audit.

Engagement letter in case of a repeated audit:

It is required only under the following circumstances :

- (a) If there is a change in the management
- (b) If there are changes in the terms of audit engagement
- (c) To remove the misunderstanding, if any relating to the objective and scope of audit.
- (d) If there is a significant change in the size or nature of the business concern, which may affect the audit procedures to be adopted, schedule for completion of work and so on.

2.6 AUDIT PROGRAM

Q15. Define audit programme. What are its merits and demerits?

Ans.: (July-21, July-19, Dec.-19, Dec.-18)

Meaning

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

Definitions

- (i) **According to Megis,** An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.
- (ii) **According to Holmes,** Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

Advantages

- (i) It provides audit assistants with a set of clear instructions about their duties. The audit assistants will be careful in the performance of their duties. It promotes division of work over the audit staff in a well organized manner.
- (ii) It enables the auditor to keep constantly in touch with the work done and the general progress of the audit.
- (iii) It is possible to fix the responsibility on the audit assistants as regards items of checking carried on by them, if subsequently it transpires that their checking has been inadequate. This stops scamping.
- (iv) It serves as a valuable evidence (as regards the extent of checking and other functions performed in relation to an audit) if at any time thereafter, an action is brought against the auditor alleging negligence in the performance of his duties. He can produce

the audit programme in defence as a proof of his having carried on the work with reasonable skill and care.

- (v) It serves as a guide for the audit to be carried out by the auditor in the succeeding years.
- (vi) It provides a check against the possibility of certain important items requiring verification being omitted, and thereby ensures that the audit shall proceed in a systematic manner.
- (vii) It provides for systematic audit routines and thus eliminates inefficiency and saves time.
- (viii) The chance of work being over-looked is obviated. In case an audit assistant goes on leave or leaves the work abruptly, the portion of work done by him can easily be located and the unfinished work can be resumed by another member of the audit- staff without any difficulty.
- (ix) Last but not the least, the auditor is saved from the botheration of issuing instructions to his senior and junior staff time and again, and
- (x) It assures adherence to the principles of auditing and accounting.

Disadvantages

There are, however, certain disadvantages of such an Audit Programme.

- (i) The work may become too mechanical. An efficient audit assistant cannot show his intelligence and also loses his initiative because he has to follow directions as given in the pre-determined audit programme. Thus, inefficiency increases and the incentive to work is taken away.
- (ii) Sometimes, work may be hurried in order to complete it within the required schedule.
- (iii) A rigid and inflexible programme cannot be laid down for each type of business because each business may have different problems and procedures.
- (iv) The audit programme may be followed mechanically year after year though the business may change in its operation or conduct, and

- (v) Inefficient audit assistants may take shelter behind the programme i.e., defend deficiencies in their own work on the plea that no specific instruction is contained in the audit programme.

2.7 AUDIT NOTE BOOK

Q16. What is an audit note book? Discuss its contents.

(OR)

What is an audit note book? Explain the contents of an audit note book.

Ans :

(July-21, Dec.-18)

Introduction

During the course of audit, audit staff has to make several queries which might not have been satisfactorily answered. If the audit clerk comes across several difficulties or new points he should note them down in a book called audit note book, for due discussion with his superiors. The audit note book is also used for recording important points to be included in the Auditor's Report.

Definition

According K. Eric L. Kohler defines an audit notebook as "A record, used chiefly in recording audits, containing data on work done and comments outside of the regular subject matter of working papers. It generally contains such items as audit programme, notations showing how sections of the audit are carried out during successive examinations, information needed for the auditor's office and for staff administration, personnel assignments, time requirement and notations for use in succeeding examination. It may be a part of permanent file."

The audit note book may be in the form of a bound register or loose sheets filed together. In either case, it is part of the permanent record of the audit office which is used by the auditor while preparing his report. A separate audit note book is maintained by the audits for each concern.

An audit note book should be in two parts :

- (i) For keeping a record of general information as regards the audit as a whole, and
- (ii) For recording special points which the audit staff may have come across during the course of audit of the accounts of different years.

An audit note book should contain the following information:

Contents

An audit notebook usually contains the following information,

1. Document Records

It contains a brief description of various documents like Memorandum of Association, Articles of Association, Minute books, Contracts and so on.

2. Audit Program Copy

It may contain an attached copy of the audit program.

3. List of Errors Frauds

The auditor will note down any errors or fraudulent transactions during the course of audit and would record a brief description of them.

4. Company Information

The audit notebook might include names and designations of company's main officials, list of records maintained by the firm and so on

5. Audit dates

It includes the date of starting of and completion of the audit work and the work given to the chief assistant and other subordinates.

6. Internal Control

An audit notebook might also include a brief description about the systems of internal control which is followed by the client company.

7. Other Vital Data

An audit notebook would also include information related to loans taken and given guarantees, important amount balances and so on.

Q17. Explain the advantages and disadvantages of audit note book.

Ans :

Advantages

Some of the advantages of the audit note book are.

1. It ensures the uniformity and helps in knowing the amount of work performed.
2. Important matters relating to the audit work may be easily recalled.
3. Facilities and preparation of the audit report.
4. In case of the assistant in charge is changed, no difficulty is faced in continuing the incomplete work.
5. The responsibility of the errors undetected can be fixed on clerk concerned.
6. The audit note book shows the extent of the interest and pain taken by the audit staff. It helps in their appraisal.
7. It ensures that the audit programme has been sincerely followed. Deviations can be noticed.
8. It is reliable evidence in the court of law, If an auditor has to defend himself.

Disadvantages

The following are the demerits of maintaining an audit notebook,

1. Acts as Proof of Negligence

If an auditor does not carryout his audit duty diligently, then the audit notebook would act as a proof of non-performance of work or negligence on part of auditor.

2. Outdated Information

In case of using an old audit book it would provide old and outdated information, which would effect the auditor work performance.

2.8 AUDIT WORKBOOK

Q18. Define audit working papers. State its objectives.

Ans :

Meaning

The term audit working papers designate the files of analysis, summaries, comments and correspondence built by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about the accounts which are under audit.

Definitions

- (i) **According to Arnold W. Johnson,** " Audit working papers are the written private materials, which an auditor prepares for each audit. They describe the accounting information which he receives from his client, the methods of examination used, the conclusions (and reasons thereof) and the financial statements."
- (ii) **According to Jack C. Robertson,** "Working papers are auditor's own evidence of compliance with generally accepted auditing standards and of the decisions respecting all procedures necessary in the circumstances unique to the audit engagement."

They consist of draft copies of trial balances, adjusting entries, accounts analysis, schedules of debtors and creditors summaries of reconciliation statements, certificates of official comments, copies of correspondence between auditors and debtors, creditors and bank, detailed schedule of items like depreciation, inventories previous audit reports, important quarries with explanation audit programme and other important materials.

Objectives

The working paper serves following purposes:

1. They represent the volume of work performed by the auditor and his staff, which helps in preparing the report.

2. They show the extent of adherence to accounting principles and auditing standards.
3. They are useful as evidence against the charge of negligence.
4. They act as guide for subsequent examinations.
5. They enable the auditor to know the weakness of the internal check system in operation as also the accounting system.
6. They assist the auditor in coordinating and organizing the work of audit clerks.
7. They assist in planning and performance of audit work.

Q19. What are the different types of working papers?

Ans :

Types of Audit Workbook/ Working Papers

Audit working papers are divided into three types. They are:

1. Permanent file papers
2. Audit administrative papers and
3. Audit evidence papers.

1. Permanent File Papers

In this type of papers, the continuing interest of the audits of same client over many years is recorded. It can be used every year. It acts as a ready source of information for the staff that is sent for the audit for the first time. The related matters should be listed out appropriately. These papers include,

- (i) Memorandum and articles of association and other statutory documents such as partnership deed.
- (ii) The brief description regarding the kind of business being operated and places of business,
- (iii) The previous year's balance sheet copies.
- (iv) Continuing contracts copies.

- (v) The copies of other documents and minutes of meetings which have a continuing significance.
- (vi) The statements that demonstrate a note of any accounting matters of importance.
- (vii) The details of companies history and its products.
- (viii) Lists of account, records and responsible officials and structure of organization.
- (ix) The instructions regarding client's internal audit, stock taking or internal accounting.

- (d) Audit time budget.
- (e) Questionnaire of EDP control.
- (f) Memoranda of incomplete procedures and review notes.
- (g) Internal control systems and flow charts.
- (h) Questionnaire of management control.
- (i) Questionnaire of internal control.
- (j) Audit programme.

2.9 AUDIT MARKINGS

Q20. Write about audit markings.

Ans :

Auditor performs his audit procedures, he uses a variety of distinctive, special ticks or symbols to indicate that a particular work has been done. Those are called as tick marks, check marks or 'audit markings.' They may be in the form of alphabetic letters, numbers, geometric designs, etc., He may adopt different types of tick marks for different type of work such as postings, additions, carry forwards, contra entries, vouching and so on.

Following are the important points to be noted with regard to the use of audit markings.

2. Audit Evidence Papers

These papers comprise the records of all the procedures followed the tests carried out, decision taken during the audit. These type of papers show the quality of audit. Hence, these papers should be clear, concise, complete, informative and well-indexed.

3. Audit Administrative Papers

These audit administrative papers are also known as "current file". It comprise the result of the previous planning stages of the audit. Generally, these administrative papers are attached with current year's audit evidence papers. It includes all the work which is performed during the planning of audit evaluation of internal control, preparation of audit programme and assignment of staff. Each year, the print of current file includes the following items,

- (a) Appointment letter.
- (b) Memoranda of meetings with management.
- (c) Memoranda of meetings with the clients audit committee.

1. These tick marks should be small and distinctive.
2. Different colours or inks should be used for different periods
3. There should be different types of markings for different types of work.
4. Audit staff should be clearly instructed not to disclose the meaning of different ticks to the staff of the client.
5. The staff of the client should be asked not to make use of the tick marks which are used by the audit staff.

Audit marking help the auditor in the following ways :

1. Audit markings help the auditor in establishing the extent of work performed by the audit staff.
2. These markings help him in distinguishing entries in the books of account which are already examined from those which have not been examined.
3. Audit markings provide evidence of the work performed by him. He can defend himself in case any charges of negligence are levelled against him.
4. A transaction or a document which has already been examined by the auditor cannot be produced before him in support of any other transaction.

Auditors normally use pens or pencils of different colours for audit markings. The auditors also mark documents examined by them. Sometimes auditors use pencils of different colours to indicate different audit procedures.

Rahul Publications

Short Question and Answers

1. Define audit programme.

Ans :

Meaning

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

Definitions

- (i) **According to Megis**, An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.
- (ii) **According to holmes**, Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

2. What is an audit note book?

Ans :

Introduction

During the course of audit, audit staff has to make several queries which might not have been satisfactorily answered. If the audit clerk comes across several difficulties or new points he should note them down in a book called audit note book, for due discussion with his superiors. The audit note book is also used for recording important points to be included in the Auditor's Report.

Definition

According K. Eric L. Kohler defines an audit notebook as "A record, used chiefly in recording audits, containing data on work done and comments outside of the regular subject matter of working papers. It generally contains such items as

audit programme, notations showing how sections of the audit are carried out during successive examinations, information needed 'for the auditor's office and for staff administration, personnel assignments, time requirement and notations for use in succeeding examination. It may be a part of permanent file."

3. Qualifications of an auditor.

Ans :

- 1. Sec 226(1) of the Company's Act lays down that a person shall not be qualified for appointment as an auditor of a Company unless he is a Chartered Accountant within the meaning of the Chartered Accountant Act 1949.
- 2. In case of a firm, if all its partners are practicing Chartered Accountants in India are qualified for appointment by its firm's name to be auditors of a company. In such a case any of its partners can act as an auditor in the name of the firm.
- 3. Certified auditors (Sec 226 (2)) Apart from the practicing chartered accountants, a person holding a certificate under the Restricted Auditor's Certificate Rules 1956 is also qualified to be appointed as auditor of a Company. (Such certified auditors are subject to rules framed in this behalf by Central Government).

4. Disqualification of a company auditor.

Ans :

- 1. A body corporate.
- 2. An officer or employee of the company.
- 3. A person who is a partner, or who is in the employment under an officer or employee of the company.
- 4. A person who is indebted to the company for an amount exceeding Rs. 1000 or who has given any guarantee or provided any security in relation with the indebtedness of

any third person to the company for an amount exceeding Rs. 1000.

A person also shall not be qualified for appointment as auditor of a company, if he is by virtue of the above listed provisions disqualified for appointment as auditor of any other corporate body which is that company's subsidiary, holding company or a subsidiary of that company's holding company, or would be so disqualified if the corporate body were a company. [Section 226(4)]

The provisions of Section 226 as stated above, are intended to ensure that the auditors are independent of the companies they are, appointed to audit.

If an auditor, after his appointment, becomes subject to any of the disqualifications specified above, he shall be deemed to have vacated his office as such.

In this connection, Section 8 of Chartered Accountants Act, 1949, is also relevant since the chartered accountant is also subject to the disabilities stated in this Section.

5. Remuneration of auditor.

Ans :

- The remuneration of the auditor of a company may either be fixed by the company at its general meeting or can be fixed in any manner determined in a general meeting.
- In case the auditor is appointed by the Board or the Central Government his remuneration may be fixed by the appointing authority.
- The remuneration is inclusive of all expenses allowed to him and he is not entitled to any other payment, whether as expense or otherwise.
- If an auditor is asked to do any other work over and above his normal work of audit he is entitled to get extra remuneration in addition to normal fee for the audit.
- The approval of such remuneration is not obtained in the general meeting of the company.

- Such remuneration is a matter of arrangement between the auditor and the Board of Directors. However, the remuneration paid as fees, expenses or otherwise for such services to the auditor should be disclosed in the profit and loss account. (Schedule VI Part II Clause B). In its statement, on payment to auditors for other services, the Council of the Institute of Chartered Accountants of India has recommended that the remuneration for other services (other than audit work) performed by the auditor should be classified under the following heads in order to give correct information to shareholders and to others who read the accounts of the company :

- (i) For taxation matters
- (ii) For company law matters
- (iii) For management services
- (iv) For internal auditing and
- (v) For other services.

- It is also to be noted that any sums paid by the company in respect of the auditor's expenses in carrying out his duties shall be deemed to be included in the expression 'remuneration'.

6. Define Auditor's Lien.

Ans :

An auditor has got no lien in the books of accounts which he has audited. As a general rule the book of accounts should always be available in the registered office of the company for the inspection of the public and the shareholders of the company. All such books of accounts are the property of the company and as such, these cannot be removed from the head office of the company.

In the case of *Herbert Alfred Burelign vs. Ingram, Clark Ltd.* (1901), it was held that the auditor had no lien on the books of accounts in respect of audited work.

However, in case of *Chan trey Martin and Co. vs Martin, London* (1953), it was decided that the auditor has only the lien on the working papers prepared by him for producing the balance sheet.

From these two cases, it is clear that an auditor cannot exercise his right of lien on the books of accounts of the companies. Thus, an auditor cannot have a lien on the books of accounts.

7. Define audit planning.

Ans :

Meaning

Detailed planning acts as one of the prerequisites for effective and efficient completion of the audit work. Audit planning can be defined as "a systematic and continuous plan of action which the auditor usually follows during the course of audit". In simple words, audit planning refers to the process of preparing in advance, all the steps which the auditor would follow in a sequential order.

8. Objectives of audit planning.

Ans :

1. According to the Auditing and Assurance Standards-1(AAS-1) "the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner". The main purpose of audit is usually,
 - (a) Assigning tasks to the audit staff
 - (b) Designing and developing deadlines for completing the audit work
 - (c) Scheduling dates for midterm and year end audit.
2. Audit planning basically aims that sufficient time is used for key areas of audit.
3. It aims at equidistribution of work among the auditor's staff.
4. It aims to create an atmosphere of co-operation and co-ordination among the auditor's staff, thus facilitating on-time completion of the audit work.
5. It aims at solving the main problems during the course of audit work.
6. The main objective is to ensure timely completion of the audit work.

9. Engagement letter.

Ans :

It is a document sent by the auditor to the client under audit, usually before the commencement of the audit, which signifies confirmation of his acceptance of appointment as an auditor specifying its objectives, scope and terms and conditions.

In case of statutory audit which is governed by law, an engagement letter ensures that the client clearly there of. In case of audit which is not conducted in pursuance of the requirements of law, the engagement letter confirms the verbal arrangements reached between the auditor and the enterprise under audit.

In such a case the auditor should get a copy of the letter signed by a responsible official of the enterprise so that the engagement letter becomes an agreement in relation to the objective, scope and the obligations of the auditor.

The form and contents of audit engagement letter will differ from one client to another following are the matters generally referred in the letter.

- (a) The objective of the audit of financial information.
- (b) Responsibility of management for preparation of financial statements under Audit,
- (c) Nature or form of Audit reports or other communication of results of the engagement.
- (d) Scope of the Audit work, time period to complete the work, and pronouncements of the professional body to which the auditor is subject.

10. Define audit working papers.

Ans :

Meaning

The term audit working papers designate the files of analysis, summaries, comments and correspondence built by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about the accounts which are under audit.

Definitions

- (i) **According to Arnold W. Johnson,** "Audit working papers are the written private materials, which an auditor prepares for each audit. They describe the accounting information which he receives from his client, the methods of examination used, the conclusions (and reasons thereof) and the financial statements."
- (ii) **According to Jack C. Robertson,** "Working papers are auditor's own evidence of compliance with generally accepted auditing standards and of the decisions respecting all procedures necessary in the circumstances unique to the audit engagement."

11. Audit markings.*Ans :*

Auditor performs his audit procedures, he uses a variety of distinctive, special ticks or symbols to indicate that a particular work has been done. Those are called as tick marks, check marks or 'audit markings.' They may be in the form of alphabetic letters, numbers, geometric designs, etc., He may adopt different types of tick marks for different type of work such as postings, additions, carry forwards, contra entries, vouching and so on.

Following are the important points to be noted with regard to the use of audit markings.

1. These tick marks should be small and distinctive.
2. Different colours or inks should be used for different periods
3. There should be different types of markings for different types of work.
4. Audit staff should be clearly instructed not to disclose the meaning of different ticks to the staff of the client.
5. The staff of the client should be asked not to make use of the tick marks which are used by the audit staff.

12. Duties of an Auditor.*Ans :*

1. Duty to report to members (Sec 227(2))
2. Duty to assist Investigators (Sec 249 V (B))
3. Duty as to inquiry
4. Duty to sign audit report (Sec 229)
5. Duty to certify the Statutory Report (Sec 165(4))
6. Duty as to Prospectus (Sec 56)
7. Duty as to report under voluntary winding up (Sec 488(2))

13. Rights of an auditor.*Ans :*

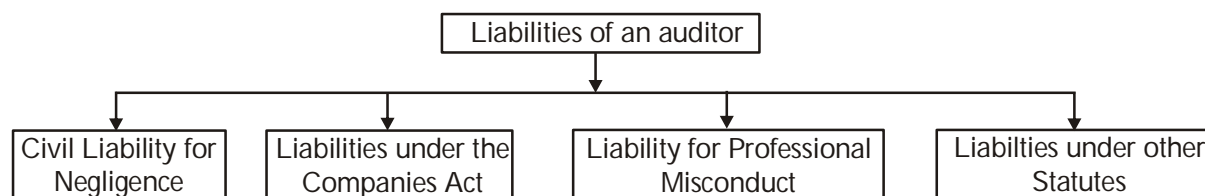
1. Right of access to books, accounts and vouchers (Sec 227 (1))
2. Right to obtain information and explanation (Sec 227 (1))
3. Right to receive notice and to attend general meeting (Sec 231))
4. Right to report to members (Sec 227(2))
5. Right to have legal and technical advice
6. Right to visit Branch office (Sec 228)
7. Right to receive remuneration (Sec 224 (8))
8. Right to Sign Audit Report (Sec 229)
9. Right to be indemnified

14. Civil liabilities of an auditor.*Ans :***(A) Civil Liability for Negligence**

Under this, the auditor is liable for the following,

1. This liability takes place when it is being proved that the auditor was careless/negligent while performing his duties as an auditor and this has resulted in loss.
2. The auditor might be held personally responsible for any loss incurred if in case there are acts of omissions and commissions because of the auditor's carelessness.

3. In case of *Trisure India Ltd. Vs A.I Ferguson & Co* (1987) 61 company. Case, 548C it has been noted that the auditors job is to check and audit the company matters and financial books of the firm and he is not liable to perform the job of a detective.



4. Civil liability for negligence arises if it is proved that,
- The auditor was negligent (careless) on duty
 - The loss was a result of the auditors negligence
 - The loss was suffered by the client of the auditor.

(B) Liabilities Under the Companies Act

Under this act, the auditor is liable for the following:

(i) Civil Liability

The auditor might be held accountable for civil liability under the following sections,

- Section 477:** According to this section, the court has the power to summon and scrutinize any officer of the company (including the auditor) if they have been suspected to be indebted to the company or if in case they hold the ability to provide information about the promotion, formation, trade dealings, property, books, papers or company affairs.
- Section 478:** According to this section, in case if an order is being passed for winding up of a company and that the official liquidator suspects that a company official (including auditor) has committed any fraud, then the auditor is liable for public examination on the day fixed for this.
- Section 545:** This section enlists rules for prosecution of fraudulent officials, inclusive of the auditor and members of the company.
- Section 633:** This section is conserved with the power of the court to give relief to an accused auditor if it believes that the auditor is not liable and has honestly carried out his auditing duties.

(ii) Liability for Mis-statement in the prospectus (Sec.-62)

The auditor is liable to pay for any loss to the shareholders or debentures if in case he has given any false statement as an expert in the prospectus. However he is not liable in the following cases:

- He gave the statement in good faith, and had no knowledge that the statement is false.
- If he takes back his permission in writing prior to the registration of the prospectus or prior to the allotment of shares.

(iii) Liability for Misfeasance (Breach of trust) (Section 543)

An auditor is liable to pay for the damages of an aggrieved party for any breach of trust or (Misfeasance). The time limit for taking an action is five years.

(iv) Criminal Liability Section 2(30)

An auditor is considered as criminally liable under the following sections:

- (a) **Section 63:** As per this section, an auditor is criminally liable of presenting false statement in the prospectus.

Punishment

He is liable for a punishment upto 2 years jail and ₹5000 fine or both unless he proves that the statement was wrong.

- (b) **Section 68:** According to this section, the auditor is held liable for fraudulently forcing the people to invest money.

- (c) **Section 545, 539 :** As per these sections, an auditor is liable for fraud during the process of winding up of a company.

Punishment

He is liable for a punishment of upto 7 years jail and fine as per section 539.

- (d) **Section 628:** According to this section, an auditor is liable for intentionally ignoring the material facts, providing false information related to balance, sheet, report, other certificate, prospectus or any document of accounts.

(C) Liability for Professional Misconduct

The auditor is held liable for breaking the professional code of conduct which is laid down by the Institute of Chartered Accountants of India formed under the Chartered Accountants Act, 1949.

(D) Liabilities Under other Statutes

The liabilities under other statutes are as follows,

(i) Liabilities Under Income Tax Act (Sec 278)

If in case an auditor certifies wrong accounts, which are submitted to the income tax department, then he is liable for imprisonment upto two years and further he might also be disqualified from practicing.

(ii) Liability Under Consumer Protection Act, 1986

An auditor would be charged under the Consumer Protection Act, if he gives wrong advice towards payment of fees.

Choose the Correct Answers

1. Examples of casual vacancy are vacancy arising due to - [d]
(a) Resignation of the auditor (b) Death of the auditor
(c) Disqualification of the auditor (d) All of the above
2. Auditor has to obtain _____ audit evidence; [d]
(a) Adequate (b) Correct
(c) Relevant (d) Sufficient and appropriate
3. _____ of the Companies Act, 1956 contains provisions regarding the appointment of the company: [c]
(a) Section 223 (b) Section 221
(c) Section 224 (d) Section 226
4. The external auditor has to check the accounts of the organization, and their compliances to various- [a]
(a) Rules and regulations (b) Needs and purposes
(c) Requirements (d) Auditing standards
5. The first auditor so appointed shall hold office till the conclusion of- [c]
(a) First accounting year
(b) Next accounting year
(c) First Annual General Meeting (AGM)
(d) First statutory meeting
6. Where the vacancy is caused by resignation of auditor, such vacancy shall only be filled by the - [c]
(a) C&AG (b) Central Government
(c) Company in general meeting (d) Board of directors
7. In a casual vacancy in the office of auditors arising by his resignation it should only be filled by the company in a _____. [c]
(a) Board's meeting (b) Extraordinary general meeting
(c) General meeting (d) Annual general meeting
8. The auditors have the right to attend. [d]
(a) Board meeting (b) Annual general meeting
(c) Extraordinary general meeting (d) Any general meeting
9. The auditor shall have the right to receive _____ for auditing the accounts of the company. [a]
(a) Remuneration (b) Commission
(c) Reward (d) Award
10. Auditor has to obtain _____ audit evidence; [d]
(a) Adequate (b) Correct
(c) Relevant (d) Sufficient and appropriate

Fill in the Blanks

1. The auditor of a government company shall be appointed by _____.
2. The liabilities of an auditor can be _____.
3. The first auditors appointed hold office till the Completion of first _____.
4. Auditors of a joint stock company are appointed by _____.
5. A company auditor can be removed by _____.
6. SEC 224(2) Deals with _____.
7. Under _____ set of standardized instructions which are to be followed while conducting audit
8. _____ is a dairy maintained by audit staff to note errors
9. _____ is a document sent by the auditor to the client usually before the commencement of the audit.
10. _____ are the written private materials which an auditor prepares for each audit.

ANSWERS

1. Central government
2. Civil and Criminal
3. AGM
4. AGM
5. General meeting
6. Reappointment of auditor
7. Fixed Audit program
8. Audit Note book
9. Engagement letter
10. Audit working papers

One Mark Answers

1. Auditor.

Ans :

An auditor is a person or a company of chartered accountants who have expertised knowledge in the field of audit and accounts. If a person wants to become an auditor in India, then he/she must be the member of the Institute of Chartered Accountants of India (ICAI). ICAI is an authoritative body in the profession of accounts and audit.

2. Auditor's Lien.

Ans :

An auditor has got no lien in the books of accounts which he has audited. As a general rule the book of accounts should always be available in the registered office of the company for the inspection of the public and the shareholders of the company. All such books of accounts are the property of the company and as such, these cannot be removed from the head office of the company.

3. Define audit planning.

Ans :

Detailed planning acts as one of the prerequisites for effective and efficient completion of the audit work. Audit planning can be defined as "a systematic and continuous plan of action which the auditor usually follows during the course of audit". In simple words, audit planning refers to the process of preparing in advance, all the steps which the auditor would follow in a sequential order.

4. Audit programme.

Ans :

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

5. Audit working papers.

Ans :

The term audit working papers designate the files of analysis, summaries, comments and correspondence built by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about the accounts which are under audit.

UNIT III

INTERNAL CONTROL, INTERNAL CHECK AND INTERNAL AUDIT:

Meaning and Objectives of Internal Control – Internal Check and Internal Audit – Internal Check Vs. Internal Audit – Internal Control vs. Internal Audit.

3.1 INTERNAL CONTROL

3.1.1 Meaning

Q1. What do you mean by the term internal control.

(OR)

Describe the meaning of internal control.

Ans : (July-19, Dec.18)

Meaning

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

Definitions

- (i) **According to The American Institute of Certified Public Accountants**, "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."
- (ii) **According to The system of internal control can be defined as**, "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

3.1.2 Objectives of Internal Control

Q2. Explain the objectives of internal control.

(OR)

Discuss the objectives of internal control.

Ans : (July-21, July-19, Dec.-18)

Objectives

1. Providing reliable data

Business decisions require accurate information to run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.

2. To promote operational Efficiency

The controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use

of resources so as to promote the operational efficiency.

3. To encourage adherence to the prescribed policies

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

4. Safeguarding assets and records

the physical assets of the company can be stolen, misused or accidentally destroyed if not properly protected by adequate controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company.

Q3. List out the advantages and disadvantages internal control.

Ans : (Dec.18)

Advantages

1. Detection of Errors and Frauds

Internal control systems are structured in such a way that work done by one employee in a process is checked by another without knowledge of the former. In such an environment, any fraud committed is brought to light unless there is collusion among fraudsters.

2. Time Saving

Auditor can test check or sample check the transactions to ensure reliability, and accuracy of entries in the books. Hence, he can complete his audit work and prepare financial statements within the prescribed time.

3. Minimum Scope for Errors and Frauds

Each employee does only a limited work assigned to him, moreover, consciousness of his work being independently checked by another keeps him to be always alert at work. In such a context, chances for commission of error or fraud are lesser.

4. Operational Efficiency

It facilitates fixation of accountability, error – free work performance, accuracy reliability and authenticity of entries and eradicate inefficiency, fraud, theft, etc. Moreover, this system enables the management to assess the performance of employees. All these collectively contribute to enhance the operational efficiency of organization as a whole.

Disadvantages

1. Deficiencies in organizational structure make internal control ineffective.
2. Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.
3. The internal control procedures normally fail to keep a check on unusual transactions.
4. The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.
5. Members at the toplevel management may override or interfere with control.

Q4. What are the different types of internal control.

Ans :

1. Physical control

Physical control deals with all the control tools used by the management for protecting and safeguarding the physical assets of the organization. Physical assets includes land, building, machinery, equipment, cash and so on. Firms usually make use of security personnels, locks, restricted entry and so on as the tools to protect the physical assets. For example, usually, in banks, usually the cashier would be provided with an iron safe, alarm bell and security guard for protecting and safeguarding cash which is a physical asset.

2. Administrative Control

Administrative control deals with the control tools which are used by the management for controlling and ensuring the smooth functioning of administrative operations.

The various tools of administrative controls include,

- (i) Vesting authority and assigning clear duties and responsibilities to the important workers.
- (ii) Clear job description.
- (iii) Developing standards for operating methods.
- (iv) Developing organizational charts.
- (v) Allowing the entry of only authorized employees etc.

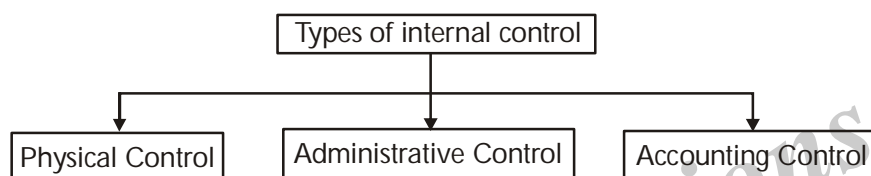


Fig.: Types of internal control

3. Accounting Control

Accounting control refers to all the control tools which are associated with the accounting system that is being used in the organization. The following are the important aspects of the accounting control system,

- (i) The main aim of accounting control is to maintain and carry out all the transactions as per the orders of the management.
- (ii) Under accounting control, the firm may follow internal check system wherein the work performed by one person is being checked by other person.
- (iii) The firm may delegate authority and responsibility to different levels and to particular people according to the existing situations of an organization. This ensures correct execution of work and accountability among the workers.
- (iv) The firm must follow the standard accounting policies and procedures which are given by the Institute of Chartered Accountants of India.
- (v) The organization must use good Internal audit for examining accounting controls and for making necessary changes.

Q5. What is test checking? explain the precautions which are to be taken while applying test checking in auditing.

Ans :

Test checking is a method of auditing where in a sample of transactions are selected and checked rather than checking each and every transaction recorded in the books of accounts.

Professor Meig states that, "test checking means to select and examine a representative sample from a large number of similar terms".

The concept of test checking is based on the 'theory of probability' in which some part selected from the aggregate of items tends to possess same characteristics as that of aggregate of items. The aggregate of items are commonly known as 'universe' or 'population'.

Audit sampling may be by way of:

- a) Test checking or Judgemental Sampling
- b) Statistical Sampling Or Judgemental Sampling

In case of large business concerns where the number of transactions to be checked are very large and the time at the disposal of the auditor is very limited, then a few transactions may be checked at random, such a check is called as test check. The auditor should apply test checking only when there is a good and effective system of internal check prevailing in the concern.

The usual practice is that a representative numbers of entries of each class is selected and checked, if they are found correct, the remaining entries are also taken to be correct and test checking is based upon the theory of probabilities which state that a sample selected from a series of items will tend to show the same characteristics present in the full series of the items. Therefore, the selection of items and the extent of test checking would mainly depend upon the auditor's judgment and the assessment of a particular situation.

Test checking can prove beneficial to the auditor as it will reduce his routine work and he can devote his time to more important aspects of the work. But it should be kept in mind that if the internal control system is reliable and test checks are applied and discrepancies are found, a thorough checking of the books and other relevant records become necessary. Test checking does not relieve an auditor from his liability if in future, mistakes are

detected. In applying test checks in auditing, the following precautions must be taken:

- (i) Entries selected for test checking should be representative of the whole, and the entries of every description must be tested.
- (ii) Selection of items to be checked should be at random.
- (iii) A number of entries for the first and the last month of the period covered by the accounts should be checked.
- (iv) Cash book should be thoroughly checked. Test check should not be applied to cash book.
- (v) The test check must cover the work of every official connected with the maintenance of accounts.
- (vi) Periods and entries selected for test check should be different at each audit. For example, if accounts pertaining to the months of May and June were selected for test checking in 1988, accounts relating to August and September may be selected in 1989, for the purpose.
- (vii) It must contain an element of surprise verification and the auditor should always change the methods of test checking, and
- (viii) The method of test checking should be kept secret from the client's staff.

Advantages

- (i) The volume of work is reduced. It saves time and the auditor can utilize this time to conduct his audit work in other places.
- (ii) The scope and area of test checking can be greatly extended.
- (iii) There is a moral check on the client's staff as they do not know the period or portion of work which will be taken up for test checking.

Limitations

There are a few limitations of test checking. Since test checking is based on the selection of the representative items, it is always possible that some of the errors or frauds remain undetected.

To overcome this, auditors use the techniques of statistical sampling for the purpose of test checking. Secondly, the client's staff may become careless because they know that their work will not be checked in detail by the auditor.

In spite of its limitation, it is a good substitute for detailed checking for those business houses where it is impracticable to check each transaction.

Q6. What are the principles of internal control.

Ans :

1. Plan of Organization

For good internal control system there should be an appropriate plan and structure of the organization. Organizational structure provides for the proper assignment of authority and responsibility.

2. Sound Practices

An internal control system requires sound practices to be followed in the performance of duties and functions of each department of the organization.

3. Managerial Supervision

The management of the organization should regularly supervise and review the financial position of the organization. The supervision and review will help the management to know whether things are going on as they should or not.

4. Double Entry System

Double entry system must be used for recording the business transactions. The duties must be allocated to different persons in regarding the different parts of transactions.

5. Competent Staff

Competent staff must be employed for the effective handling of functions. Incompetent employees reduce the efficiency of internal control.

6. Sufficient Staff

Keeping in view the nature and size of organization the management should appoint sufficient staff.

7. Division of Work

The work of the organization should be divided among the staff members according to their training and abilities. No one should be allowed to perform the work from original to end.

8. Rotation of Duties

Rotation of duties and job is the important principle of internal control. No staff member should be allowed to perform the same duty for a long time.

9. Use Modern Appliances

Modern mechanical appliances such as cash registers, accounting machines should be used.

10. Clear Cut Duties

Duties for the performance of job must be clearly stated. Only one job must be given to one person because one person can perform only one job in better way.

11. Clear Cut Instructions

Clear cut instructions should be given by top level management to lower management and

to workers. Instructions should be given in black and white instead of verbal instructions.

12. Clear Rules and Regulation

The rules, regulation and policy of the management should be clear to the employees. Every employee should perform his function according to rules and regulations.

13. Proofs of Work Done

There should be proofs of the work done by each employee of the organization. The staff should therefore, initial invoices, bills, receipts etc.

14. Detail Records

Detail records should be maintained of goods received and sent out, cash received and paid and assets purchased.

15. No Complete Confidence

There should not be too much confidence on any because a reliable person may also commit a fraud for his benefit. In business mostly frauds are occurred by trusted persons.

16. Proper Incentive

Management should introduce different incentive plans to the hard working and honest employees. Incentive plans increase efficiency and reduce chances of errors and frauds.

17. Confirmation to Outsiders

Direct confirmation to outsiders is an important principle of internal control. Debtor balances may be checked by direct communication to debtors to check the accuracy of accounting records.

18. Correspondence

All daily correspondence received should be open daily by a responsible officer. The mail must be opened in the presence of reasonable officer.

19. Remittance and deposits

All remittances and receipts should be deposited in the bank as soon as possible.

20. Physical inspection of cash and bank

Cash balance and bank balance must be physically checked by the responsible official

3.2 INTERNAL CHECK

Q7. Define internal check. What are the objectives of internal check?

Ans :

(July-21, Dec.18, July-19)

Meaning

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

Definitions

- (i) **According to F.R. M.e paula**, "internal check means practically a continuous internal audit Carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff."
- (ii) **According to D.R. Davar**, " Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim.
- (iii) **According To Joseph Lancaster**, "The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion."

All the definitions of internal check give a common idea about system organized within the concern itself, wherein the work of one employee is automatically checked up by the other and the possibility of error or fraud is reduced to the minimum.

Objectives

1. To exercise moral pressure over the staff.
2. To ensure that the accounting system produces reliable and adequate information.
3. To provide protection to the resources of the business against fraud, carelessness and in efficiency.
4. To distribute work in such a manner that no business is left unrecorded.
5. To allocate duties and responsibilities of each clerk in such a way that he may held responsible for particular fraud or error.
6. To increase the efficiency of clerks because the allocation of duties is based on the principle of division of labour.
7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Q8. Explain the characteristics of internal check.

Ans :

1. Responsibility

Responsibility of each individual must be properly defined and fixed. The work of the business should be allocated amongst various clerks in such a manner that their duties and responsibilities are clearly and judiciously divided.

2. Completion

The work should be divided in such be divided in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end. However, there should be no duplication of work

3. Rotation of Employees

A good system of internal check should not allow person having custody of assets to have access to the books of account. A system of transfer or rotation of employees from one seat of work to another must be allowed by the business.

4. Automatic Check

A good system of internal check must provide for an automatic checking of the work of one clerk by the other.

5. Reliance

No clerk of the business should be relied upon too much.

6. Safeguards

Safeguards should be prescribed to keep unused cheque books, files and securities etc.

7. Supervision

A strict supervision should be exercised to ensure that the prescribed internal check and procedures are fully operative.

8. Formal sanction

No deviation should be allowed from the established procedures till it is formally sanctioned by the top official.

9. Periodical review

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

Q9. Explain the advantages, disadvantages of internal check.

Ans :

Advantages

1. For the Business

(a) Proper division of work

Internal check entails a proper and rational distribution of work among the members of staff of the enterprise keeping in view their individual qualifications, experience and area of specialisation.

(b) Detection of errors and 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 other, this helps in the early detection and discovery of errors and frauds and possibilities of the commission of errors and frauds can be minimised.

(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.

(d) Moral check

Knowledge of subsequent checking of each employee's work by others, acts as a great check to commission of errors and frauds.

2. For the Auditor

(a) Quick preparation of final accounts

The Profit & Loss Account and the Balance Sheet are prepared without any loss to time.

(b) Convenience to auditor

Where an organization is operating system of internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.

3. For the Owner

(a) 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 genuineness and accuracy of the accounts.

(b) Increase in profits

Overall efficiency and economy in operations result in more profits –thus ensuring larger dividends for the owners or shareholders.

Disadvantages

Dependence on each other proves fatal in the quick disposal of the work. If one person is absent, the day-to-day work will be seriously disrupted. Following are some of the disadvantages of a system of internal check.

1. Costly for small business

A system of internal check is quite expensive especially for small Business houses.

2. Quality is sacrificed for promptness

In an internal check system quality of work declines because the clerks of the business attach greater importance to become quick and do not care if in the process their work gets substandardised.

3. Carelessness among high officials

The possibility of some of the responsible and high officials being complacent, increases as they believe, through not always rightly, that under a sound system of internal check nothing can go wrong.

4. Disorder in the working of a business

In the absence of a properly organised system of internal check there will be chaos and disorder in the working of business.

5. Risky for an auditor

If the auditor does not apply tests and procedures of his own and if he relies on the output of the system his work cannot be free from irregularities if the system itself proves to be defective.

Q10. Describe a Suitable Internal Check System for Purchases and Sales.*Ans :* (Dec.20)**Internal Check with Regard to Sales**

The system of internal check regarding sales should take care of following :

1. On receipt of the order, it should be numbered and preserved in Orders Received Book with full particulars.
2. The Despatch Department should be given a copy of the order with necessary particulars.
3. The Despatch Department should take steps to pack the goods as per order.
4. The statement of goods as prepared by the Despatch Department should be checked with the customer's order and then invoice will be prepared in triplicate by means of carbon papers.
5. A responsible official should check the invoice particularly the rates charged and calculations made.
6. With the help of the copy of invoices entries should be made in Sales Day Book.
7. On dispatch of the goods records should be made in the Goods Outward Book.
8. Two copies of the invoice may be sent to customer who will return one of them after signing it. It will serve the purpose of delivery note. Third copy will be retained for further reference.
9. Entries should be made in Goods inward Book for all the goods returned by the customers. Credit notes should be prepared and should be duly checked and initialed by the responsible official.
10. With the help of credit notes, records should be made in the Sales Return Book.

Internal Check With Regard To Purchases**1. Requisition**

The procedure for issuing purchase requisitions should be specified. The head of the department, who is in need of goods,

should fill a requisition slip duly signed and then should send to the purchase department. The details about the quality, quantity and the time by which the goods must be supplied be clearly mentioned in the requisition slip.

2. Enquiry

Purchases department makes an enquiry about terms and conditions of the purchases from different suppliers for these purposes tenders are generally invited. But, who shall open and accept the tenders, should be clearly specified. As a rule lowest tender should be accepted and decision be taken.

3. Purchase Order

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

4. Receipt of goods

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

5. Making the payments

The purchase department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with the purchase order and incoming inspection report and should verify the calculations. The accounts department should enter the invoice in purchase book. Only responsible official should draw cheque for the payment of invoice. At the time of signing, a signing authority must verify that correct payment is made.

Q11. Describe a system of internal check in respect of wage payments suitable for a large manufacturing concern.

Ans : (Dec.19)

The following system is recommended to have effective internal check system for wage payment,

(i) Maintenance of Wage Records

In this, the records are maintained with the help of time work recording (payment on basis of time), piece work recording (payment on basis of work performed) pass-out recording (payment on basis of hours worked) and overtime recording (payment for extra work).

(ii) Preparation of Wage Sheets

The task of preparing wage sheets must be performed by a separate department. In order to reduce the irregularities employees of wage department are assigned with this task. The information with respect to the attendance of the employees can be obtained from the job cards, attendance registers, pass-out slips, overtime slips etc. Separate wage sheets are prepared for both the piece workers and time workers. The required details which are recorded in the wage sheet are as follows,

- (a) Name of employee.
- (b) Identification number and name of department.
- (c) Total working hours in production process.
- (d) Details regarding work performed.
- (e) Applicable wage rates.
- (f) Total amount of wages paid.
- (g) Bonus entitlement.
- (h) Overtime wages.
- (i) Deductions.
- (j) Net amount of wages paid.

(iii) Payment of Wages

The payment of wages can be done in the following manner,

- (a) The payment of wages task is not assigned to the employees who are dealing with the preparation of wage sheet task in order to avoid disturbances among them.
- (b) The wage department submits wage sheets to the chief cashier who is responsible for making required arrangements with the bank for the withdrawal of required cash for payment.
- (c) The employee who is receiving the wages should be present personally and a thumb impression is taken from him as a proof of wage received by the employee.
- (d) The responsible person should be present at the time of payment for recognizing the employee.
- (e) With respect to the unclaimed wages, there should be proper arrangements.
- (f) Giving advances to the employees should be avoided if it is compulsory, then they are deducted from the wages of the prescribed employee.

Q12. Discuss the principles of internal check relating to cash payments and cash receipts.

(OR)

Suggest a good system of internal check over cash.

Ans : (Imp.)

Cash Receipts

1. There should be a separate clerk known as cashier to deal with the receipts of cash. Immediately upon receipts of cash a rough record of the amount should be made. The cashier should not be authorized to keep cash with him. He should not be allowed to make expenditure out of it and to make entries in the ledger and other books of prime entry.
2. All receipts should be banked daily. From time to time the bank reconciliation statements should be prepared to reconcile bank and cash balances.

3. Bank pay-in-slips should not be prepared by the same person who is in charge of making actual deposits in the bank.
4. All receipts should be acknowledged by means of printed receipts. Counter-foils of all the receipts issued should be properly maintained. Unused receipt must be kept with some responsible officer.
5. Spoiled receipts should be cancelled and not torn off. If some alterations are made in the receipts already written, it should be properly initialed.
6. Copies of receipts previously issued must be marked duplicate.
7. Some responsible persons of the firm should verify the balance of cash by carrying out a surprise physical check from time to time.

Cash Payments

1. The person in charge of making payments should have no connection with the receipts of cash.
2. All payments should, as far as possible be by cheque excluding petty cash payments. The cheques drawn for payment should be order cheques and as far as practicable they should be crossed.
3. Arrangements should be made to ensure that the vouchers supporting payments cannot be presented for the payments twice, such vouchers should be stamped as paid before the cheques are signed.
4. An official should check up the statements received from creditors and verify with the invoices and ledger accounts only after proper verifications cheques should be drawn in favour of the creditors.
5. For sanctioning the payments of special nature, only directors and senior officers should be empowered.
6. Bank reconciliation statements should be prepared to reconcile bank and cash balances from time to time by some authorities other than the cashier.
7. Bank cheques must be held under lock and key with a responsible officer.
8. Receipts duly signed and stamped should be obtained for each payment.

9. Receipts so obtained should be properly arranged and maintained through proper filing system.
10. To ensure the availability of cash discounts, monthly or periodic payments should be made on the fixed dates.

Q13. Describe the principles of internal check relating to fixed assets

Ans :

1. A proper authority should be designated for the sanction of capital expenditure. The authority may be given to managing director, a factory manager or a committee may be set up for this purpose.
2. A proper authority should be designated even for sale of fixed assets, transfer or even for discarding of an asset.
3. Proper accounting records in respect of fixed assets should be maintained and it should be ensured that the proper accounting distinction is observed between capital and revenue expenditure.
4. There should be a periodic inspection of assets.
5. A fixed asset register must be maintained giving details of all the fixed assets. In this register description of the assets, their cost and location should be mentioned. Management should also ensure that all the fixed assets are verified physically from time to time.
6. Perfect arrangements should be made to ensure that fixed assets are properly maintained and applied in the service of the company.
7. Where the fixed assets are transferred between branches or members of the sale group, proper arrangements in respect of their pricing, depreciation and accounting should be made.
8. Depreciation rates are to be authorized and evidenced and which persons are to be responsible for carrying out and checking the necessary calculations.
9. Lastly it should be seen that these fixed assets should be adequately insured.

3.3 INTERNAL AUDIT

Q14. Define internal audit. State the objectives of internal audit

Ans : (Dec.-20)

Meaning

Internal audit is a review of operations and records undertaken within a business by specially assigned staff. It is a post-transaction review to evaluate the correctness of records and the effectiveness of operations on a continuous basis in an organization by its own staff. The term 'internal audit' has been defined as "the independent appraisal of activity within an organization for the review of accounting, financial and other business practices as a protective and constructive arm of management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of controls. It deals primarily with accounting and financial matters, but it may also properly deal with matters of an operating nature." From the definition, it is clear that internal audit not only includes the verification of accounting matters but also financial and other matters.

The common understanding of the term internal auditing has been that its purpose is to ensure that the accounting and allied records are properly maintained; that the assets of the enterprise have been properly safeguarded and the policies and procedures laid down by the management are complied with. However, the modern view suggests that internal auditing need not be confined to financial transactions and that its scope may be extended to the task of reviewing whether the resource utilization of the enterprise is efficient and economical. This would therefore mean the review of all operations of the organization as well as to ascertain the effectiveness of the management.

Objectives

The objects of the internal audit are summarised as under:

- (i) To verify the correctness, accuracy and authenticity of the financial accounting and statistical records presented to the management and to the external agencies.

- (ii) To confirm that liabilities have been incurred by the organization in respect of its valid and legitimate activities.
- (iii) To comment on the effectiveness of the internal control system and procedures and the internal check system in force and to suggest ways and means to improve these systems.
- (iv) To examine the protection afforded to the company assets and the uses to which they are put.
- (v) To identify the authorities responsible for purchasing assets and other items as well as the disposal of assets.
- (vi) To ensure that the standard accounting practices which have to be followed by the organization are strictly adhered to.
- (vii) To undertake special review of the managerial function of the organization.
- (viii) To assist the management in achieving the most efficient administration of the operation by establishing procedures for adherence to company operating policies, and
- (ix) Compliance by various segments with the policies, plans and procedures of the organization as well as with the relevant rules, laws and regulations.

Q15. What are the functions of internal audit?

Ans :

The following are the functions of the internal auditors,

(a) Appraisal Function

The function of the internal auditor is to appraise the employees work, instead of doing a particular task of data processing.

(b) Service to the Organization

The below mentioned are required by the management,

1. Protection of organization's assets.
2. Well-created internal control system.
3. Fulfillment of its policies.

4. By practice, the working of internal control system is possible.

5. The information needed by management for effective control must be complete and accurate. This information could be other that which is provided by the accounting system.

The function of internal auditor is to make sure that these requirements are attained. Internal auditor can be viewed as the eye of the board in the enterprise.

(c) Other Duties

The other duties involves the following,

1. The internal auditor should be concerned with the reaction of the internal control system towards mistakes and it requires necessary changes to avoid mistakes.
2. He must be interested in the execution of social responsibility policies implemented by the senior executives.
3. In internal control affairs, he should act as a training officer.
4. He must perform auditing of the information furnished to management specifically relating to management accounting reports and interim accounts.
5. He should be concerned with the internal control system's response or reaction to external stimuli. The internal control system must change consistently as the world cannot remain constant.
6. He can take a part of external auditor's duties relating to figures in the annual accounts.
7. He must be conscious with agreement with external regulations like those on the financial services, related parties, environment etc.

Q16. Describe the elements of internal audit.

Ans :

The elements which are essential for internal audit are,

1. Staffing

The internal audit department must have sufficient staff in terms of grades, numbers and experience.

2. Independence

An independent employee undertakes the task of internal auditing. Internal auditors are the firm's employees, so it is not so simple to obtain independence.

3. Due Care

An internal auditor must perform like an external auditor in terms of judgement, care and skill. He should be technically advanced and must possess personal standards as an external auditor relating to honesty, integrity, probity and knowledge.

4. Relationships

Constructive working relationships and mutual understanding with management, review agencies, external auditors and audit committee must be promoted by the internal auditor as the goal is mutual understanding.

5. Systems Control

The internal auditor should check the system's operations in similar manner like an external auditor i.e., through recording, investigation, identification and compliance testing of the controls.

6. Specific Audit Planning

To include the mentioned tasks that are allotted by the management, the internal auditors must design an audit programme based on the objectives of the organization and objectives of internal audit of the organization.

7. Evidence

Like the external auditors, the internal auditor also has equivalent standards for evidence. Audit evidence are analyzed by the auditor in terms of importance, reliability and sufficiency.

Q17. Mention the advantages and disadvantages of internal audit.

Ans :

Advantages

Internal audit is essential in the large scale organizations. The following are the advantages of internal audit given by, R.S Waldron,

1. It helps in offering service to the management.
2. It ensures implementation of an effective internal control system.
3. Builds a good foundation for the creation of trading accounts and statements.
4. Monitors and checks the operations of the existing methods and policies and makes sure that they are suitable and productive and not waste.
5. Shows the departures out of the existing methods.
6. Lays greater emphasis on the system's deficiencies, control, practices and so on.
7. Identifies the loopholes.
8. Provides remedies and improvements.

Disadvantages

Some of the disadvantages of internal audit are,

1. Expensive

Small Organization cannot afford internal audit system as the cost of operating an internal audit department is very huge.

2. Biased Opinion

The employees of the internal audit department mostly work under the guidance of the management and they are paid employees of the organization . Unbiased view regarding the financial statements cannot be expected from them.

3. Inefficient Staff Members

The internal auditor may not be able to perform his responsibilities appropriately as there is no standard qualification given for their appointment so an inefficient person may get selected in the department.

4. Possibility of Distortion

If internal audit department assists the management in misrepresenting the financial figures then the users of this information will be completely misguided.

5. Possibility of Becoming Ineffective

The management will not get any benefit, if the employees of internal audit department are inefficient or if the internal audit is not carried out properly.

Q18. What are the difference between internal audit and external audit?

(OR)

What are the difference between internal audit and statutory audit?

Ans :

(Dec.-19)

S.No.	Basis of Distinction	Statutory Audit	Internal Audit
1.	Appointment	Statutory Auditor is appointed by the shareholders in certain cases by the directors and such appointment is compulsory	Internal auditor is appointed by the management and such appointment is optional. Need not possess formal qualifications.
2.	Qualifications	He must possess formal qualifications as laid down by the statute (for ex: companies Act of 1956 Sec 226)	Need not possess formal qualifications.
3.	Status	The statutory audit is independent of the enterprise which engages him.	The internal auditor is an employee of the concern.
4.	Objective	Detection of errors and fraud and also to report whether the balance sheet and profit and loss account reveal a true and fair picture of the state of affairs of the concern.	Detection of errors and fraud is the objective of internal audit.
5.	Scope of work	The scope the statutory audit is determined by the statute.	The scope of the internal audit is determined by the management.
6.	Conduct of audit	Work of audit is conducted after preparation of the final statement of accounts.	Work of audit is continuous in nature.
7.	Remuneration	It is fixed as per the statute/shareholders.	It is fixed by the management
8.	Report	Submission of report is compulsory in Statutory Audit.	Submission of report is not compulsory in Internal Audit.
9.	Removal	He can be removed by the shareholders.	He can be removed by the management
10.	Application of Chartered Accountant Act	Statutory Auditor can be prosecuted for misconduct as per the C.A Act 1949.	No prosecution as there are no formal qualifications.
11.	Application of Test checks	Test checks can be applied by the statutory auditor.	Internal auditor has check all the transactions.
12.	Attendance at meetings	Statutory Auditor has a right to attend the meetings of shareholders.	Internal auditor has no such right to attend the meetings of shareholders.
13.	Satisfaction	statutory audit is conducted to the satisfaction of the shareholders or third parties.	Internal audit is conducted for the satisfaction of the management.
14.	Suggestion	Statutory audit may give his suggestions if specified as per the scope of work.	Internal auditor can give suggestion.

3.4 INTERNAL CHECK VS. INTERNAL AUDIT

Q19. Bring out the differences between internal check and internal audit.

(OR)

Explain the differences between internal check and internal audit.

Ans :

(July-19, Dec.-18)

S.No.	Basis of Distinction	Internal check	Internal Audit
1.	Meaning	It is an arrangement of duties allocated in such a manner that the work of one person is automatically checked by another.	It is an independent appraisal of the operations and records of the company.
2.	Aim/Objective	It aims at minimising the errors and fraud.	It aims at discovering errors and fraud.
3.	Scope of work	The scope of internal checks is very limited.	The scope of internal audit is comparatively wide.
4.	Nature of work	The work is continuously checked in the very process of its being performed.	It is a post mortem on work already done and the internal auditor has to report, from time to time, to the management about the various inefficiencies and suggest improvements.
5.	Timing of work	Internal check is in operation during the course of transactions.	Internal audit starts when the accounting process ends.
6.	Involvement	A large number of employees are needed for the implementation of internal check system.	A small number of persons are needed for its implementation.

Q20. Explain the similarities between internal check and internal audit.

Ans :

(Dec.-18)

S.No.	Internal Check	S.No.	Internal Audit
1.	It is conducted for investigating internal affairs of the organization.	1.	It is also conducted for the same purpose.
2.	It helps the organization in detecting and eliminating frauds or errors.	2.	It also helps the organization in the same manner.
3.	It allows to cross check the assigned work in organization.	3.	It allows to cross check as well as take action against frauds.
4.	It is one of the types of investigation.	4.	It is also one of the types of investigation.

3.5 INTERNAL CONTROL VS INTERNAL AUDIT

Q21. Explain the differences between internal control and internal audit.

(OR)

Bring out the differences between internal control and internal audit.

Ans :

(Dec.-18)

S.No.	Point of Difference	Internal Control	Internal Audit
1.	Objective	The objectives of internal control is to ensure the execution of transactions as per the management general.	The main objective of internal audit is to detect the errors and frauds and their prevention.
2.	Advantages	The advantages of internal control includes time saving, flexibility, identification of defects, lesser risk of omission and provision for training facility.	The advantages of internal audit includes prevention of errors and frauds, periodic physical verification, early detection of errors and frauds, early completion of annual audit.
3.	Disadvantages	The disadvantages of internal control includes the ignorance of unusual activity, collusion, chances of human error, costly and rigid.	The disadvantages of internal audit includes extra cost, biased opinion, chances of distortion, chances of becoming ineffective etc.
4.	Basic Principles	The basic principles of good internal control includes maintenance of records, supervision division of responsibility, trustworthy employees etc.	The basic principles of internal audit includes clear objectives, time bond programme, internal audit report, scope of audit and follow-up action etc.
5.	Elements	The element of internal control includes monitoring, risk assessment, communication and information control environment.	The elements of internal audit includes staffing, independence, due care, relationships, reporting etc.

Q22. Explain the differences between internal control and internal check.

Ans :

(July-21)

S.No.	Internal Control	S.No.	Internal Check
1.	It consists of various control procedures adopted by an organisation in financial and non financial areas.	1.	It is an arrangement of the work of different clerks that the work of one person is automatically check by another.
2.	It covers accounting and non-accounting spheres.	2.	It is applied to the accounting system of a concern.
3.	It includes internal check and internal audit systems.	3.	It is a part of the internal control system.
4.	The objective is to bring about efficiency and orderliness in operation	4.	The objective of internal check is to minimise the chances of errors and frauds.

Short Question and Answers

1. Define internal check.

Ans :

Meaning

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

Definitions

- (i) **According to F.R. M.e paula**, "internal check means practically a continuous internal audit Carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff."
- (ii) **According to D.R. Davar**, " Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim."
- (iii) **According To Joseph Lancaster**, "The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion."

2. Internal Control.

Ans :

Meaning

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

Definitions

- (i) **According to The American Institute of Certified Public Accountants**, "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."
- (ii) **According to The system of internal control can be defined as**, "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

3. Internal Audit.

Ans :

Meaning

Internal audit is a review of operations and records undertaken within a business by specially assigned staff. It is a post-transaction review to evaluate the correctness of records and the effectiveness of operations on a continuous basis in an organization by its own staff. The term 'internal audit' has been defined as "the independent appraisal of activity within an organization for the review of accounting, financial and other business practices as a protective and constructive arm of management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of controls. It deals primarily with

accounting and financial matters, but it may also properly deal with matters of an operating nature." From the definition, it is clear that internal audit not only includes the verification of accounting matters but also financial and other matters.

The common understanding of the term internal auditing has been that its purpose is to ensure that the accounting and allied records are properly maintained; that the assets of the enterprise have been properly safeguarded and the policies and procedures laid down by the management are complied with. However, the modern view suggests that internal auditing need not be confined to financial transactions and that its scope may be extended to the task of reviewing whether the resource utilization of the enterprise is efficient and economical. This would therefore mean the review of all operations of the organization as well as to ascertain the effectiveness of the management.

4. Objectives of internal control.

Ans :

Objectives

1. Providing reliable data

Business decisions require accurate information to run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.

2. To promote operational Efficiency

The controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use of resources so as to promote the operational efficiency.

3. To encourage adherence to the prescribed policies

The system of internal control is meant to provide reasonable assurance that procedures

and rules of various institutes are followed by company personnel.

4. Safeguarding assets and records

the physical assets of the company can be stolen, misused or accidentally destroyed if not properly protected by adequate controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company.

5. What are the different types of internal control.

Ans :

1. Physical control

Physical control deals with all the control tools used by the management for protecting and safeguarding the physical assets of the organization. Physical assets includes land, building, machinery, equipment, cash and so on. Firms usually make use of security personnels, locks, restricted entry and so on as the tools to protect the physical assets. For example, usually, in banks, usually the cashier would be provided with an iron safe, alarm bell and security guard for protecting and safeguarding cash which is a physical asset.

2. Administrative Control

Administrative control deals with the control tools which are used by the management for controlling and ensuring the smooth functioning of administrative operations.

The various tools of administrative controls include,

- (i) Vesting authority and assigning clear duties and responsibilities to the important workers.
- (ii) Clear job description.
- (iii) Developing standards for operating methods.
- (iv) Developing organizational charts.
- (v) Allowing the entry of only authorized employees etc.

3. Accounting Control

Accounting control refers to all the control tools which are associated with the accounting system that is being used in the organization. The following are the important aspects of the accounting control system,

- (i) The main aim of accounting control is to maintain and carry out all the transactions as per the orders of the management.
- (ii) Under accounting control, the firm may follow internal check system wherein the work performed by one person is being checked by other person.
- (iii) The firm may delegate authority and responsibility to different levels and to particular people according to the existing situations of an organization. This ensures correct execution of work and accountability among the workers.
- (iv) The firm must follow the standard accounting policies and procedures which are given by the Institute of Chartered Accountants of India.
- (v) The organization must use good Internal audit for examining accounting controls and for making necessary changes.

6. Explain the characteristics of internal check.

Ans :

1. Responsibility

Responsibility of each individual must be properly defined and fixed. The work of the business should be allocated amongst various clerks in such a manner that their duties and responsibilities are clearly and judiciously divided.

2. Completion

The work should be divided in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end. However, there should be no duplication of work

3. Rotation of Employees

A good system of internal check should not allow person having custody of assets to have access to the books of account. A system of transfer or rotation of employees from one seat of work to another must be allowed by the business.

4. Automatic Check

A good system of internal check must provide for an automatic checking of the work of one clerk by the other.

5. Reliance

No clerk of the business should be relied upon too much.

6. Safeguards

Safeguards should be prescribed to keep unused cheque books, files and securities etc.

7. Supervision

A strict supervision should be exercised to ensure that the prescribed internal check and procedures are fully operative.

7. Objectives of internal audit.

Ans :

Objectives

The objects of the internal audit are summarised as under:

- (i) To verify the correctness, accuracy and authenticity of the financial accounting and statistical records presented to the management and to the external agencies.
- (ii) To confirm that liabilities have been incurred by the organization in respect of its valid and legitimate activities.
- (iii) To comment on the effectiveness of the internal control system and procedures and the internal check system in force and to suggest ways and means to improve these systems.
- (iv) To examine the protection afforded to the company assets and the uses to which they are put.

- (v) To identify the authorities responsible for purchasing assets and other items as well as the disposal of assets.
- (vi) To ensure that the standard accounting practices which have to be followed by the organization are strictly adhered to.
- (vii) To undertake special review of the managerial function of the organization.
- (viii) To assist the management in achieving the most efficient administration of the operation by establishing procedures for adherence to company operating policies, and

8. Disadvantages of internal audit.

Ans :

1. Expensive

Small Organization cannot afford internal audit system as the cost of operating an internal audit department is very huge.

2. Biased Opinion

The employees of the internal audit department mostly work under the guidance of the management and they are paid employees of the organization . Unbiased view regarding the financial statements cannot be expected from them.

3. Inefficient Staff Members

The internal auditor may not be able to perform his responsibilities appropriately as there is no standard qualification given for their appointment so an inefficient person may get selected in the department.

4. Possibility of Distortion

If internal audit department assists the management in misrepresenting the financial figures then the users of this information will be completely misguided.

5. Possibility of Becoming Ineffective

The management will not get any benefit, if the employees of internal audit department are inefficient or if the internal audit is not carried out properly.

9. Advantages of internal audit.

Ans :

- 1. It helps in offering service to the management.
- 2. It ensures implementation of an effective internal control system.
- 3. Builds a good foundation for the creation of trading accounts and statements.
- 4. Monitors and checks the operations of the existing methods and policies and makes sure that they are suitable and productive and not waste.
- 5. Shows the departures out of the existing methods.
- 6. Lays greater emphasis on the system's deficiencies, control, practices and so on.
- 7. Identifies the loopholes.
- 8. Provides remedies and improvements.

10. Explain the similarities between internal check and internal audit.*Ans :*

S.No.	Internal Check	S.No.	Internal Audit
1.	It is conducted for investigating internal affairs of the organization.	1.	It is also conducted for the same purpose.
2.	It helps the organization in detecting and eliminating frauds or errors.	2.	It also helps the organization in same manner.
3.	It allows to cross check the assigned work in organization.	3.	It allow to cross check as well as take action against frauds.
4.	It is one of the type of investigation	4.	It is also one of the type investigation.

11. Explain the differences between internal control and internal check.*Ans :*

S.No.	Internal Control	S.No.	Internal Check
1.	It consists of various control procedures adopted by an organisation in financial and non financial areas.	1.	It is an arrangement of the work of different clerks that the work of one person is automatically check by another.
2.	It covers accounting and non-accounting spheres.	2.	It is applied to the accounting system of a concern.
3.	It includes internal check and internal audit systems.	3.	It is a part of the internal control system.
4.	The objective is to bring about efficiency and orderliness in operation	4.	The objective of internal check is to minimise the chances of errors and frauds.

12. What is test checking?*Ans :*

Test checking is a method of auditing where in a sample of transactions are selected and checked rather than checking each and every transaction recorded in the books of accounts.

Professor Meig states that, "test checking means to select and examine a representative sample from a large number of similar terms".

The concept of test checking is based on the 'theory of probability' in which some part selected from the aggregate of items tends to possess same characteristics as that of aggregate of items. The aggregate of items are commonly known as 'universe' or 'population'.

Audit sampling may be by way of:

- (a) Test checking or Judgemental Sampling
- (b) Statistical Sampling Or Judgemental Sampling

In case of large business concerns where the number of transactions to be checked are very large and the time at the disposal of the auditor is very limited, then a few transactions may be checked at random, such a check is called as test check. The auditor should apply test checking only when there is a good and effective system of internal check prevailing in the concern.

The usual practice is that a representative numbers of entries of each class is selected and checked, if they are found correct, the remaining entries are also taken to be correct and test checking is based upon the theory of probabilities which state that a sample selected from a series of items will tend to show the same characteristics present in the full series of the items. Therefore, the selection of items and the extent of test checking would mainly depend upon the auditor's judgment and the assessment of a particular situation.

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Choose the Correct Answers

1. The purpose of internal audit is to evaluate the [a]
(a) Accounting system (b) Internal audit system
(c) Management accounting system (d) Statutory audit system
2. The internal audit staff can provide new ideas about- [d]
(a) Accounting matters (b) Auditing matters
(c) Legal matters (d) Various business matters
3. The purpose of internal audit is to determine the proper use of- [d]
(a) Accounting staff (b) Audit staff
(c) Leegal staff (d) Resources
4. The purpose of internal audit is to exmine the- [c]
(a) Auditing policies (b) Recruitment policies
(c) Accounting policies (d) Production and sale policies
5. The limitation of internal audit is- [d]
(a) Shortage of time (b) Shortage of finance
(c) Shortage of time and finance (d) Shortage of staff
6. Balance sheet audit is also known as : [d]
(a) Continues Audit (b) Annual audit
(c) Internal audit (d) Financial audit
7. At present, partnership firms in India are _____ to get their financial statements audited. [b]
(a) Legally required (b) Not legally required
(c) Compulsorily (d) None of the above
8. Which type of audit is conducted by the Internalaudit staff : [c]
(a) Cost Audit (b) Secretarial Audit
(c) Internal Audit (d) Tax Audit
9. _____ lays out the strategies to be followed to conduct an audit. [b]
(a) An action plan (b) An audit plan
(c) An audit programme (d) All of the above
10. Working papers are the connecting link between the- [d]
(a) Auditor and his staff
(b) Audit assistant and management
(c) Auditor and audited accounts
(d) Client's records and the audited accounts

Fill in the Blanks

1. _____ covers the control of the whole management system
2. _____ is a valuable part of internal control
3. The purpose of internal audit is to detect the _____ and _____ which have already been committed
4. _____ is an independent appraisal function established within an organisation to examine the activities
5. This scope of internal audit is comparatively _____.
6. In case of sales returns separate _____ credit notes are to be prepared and adjusted
7. _____ should be prepared for the goods returned to suppliers and credit notes are to be obtained from suppliers.
8. In cash payments _____ statements are to be prepared at end of every month.
9. The goods are to be sold on credit only against _____ received from buyers.
10. _____ is a review of various operations and records of the company by staff specially appointed for this purpose.

ANSWERS

1. Internal control
2. Internal check
3. Errors and Frauds
4. Internal Audit
5. Wide
6. Credit notes
7. Debit notes
8. Bank reconciliation
9. Purchase orders
10. Internal Audit

One Mark Answers

1. Internal control.

Ans :

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

2. Internal check.

Ans :

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

3. Internal audit.

Ans :

Internal audit is a review of operations and records undertaken within a business by specially assigned staff. It is a post-transaction review to evaluate the correctness of records and the effectiveness of operations on a continuous basis in an organization by its own staff.

4. Define Test Checking.

Ans :

Test checking means to select and examine a representative sample from a large number of similar terms.

5. What are the different types of Internal Audit?

Ans :

The internal audit includes the following types,

1. Compliance auditing
2. Efficiency auditing and
3. Effectiveness auditing.

UNIT IV

VOUCHING:

Meaning – Objectives – Types of Vouchers – Vouching of Trading Transactions
– Vouching Cash Transaction – Auditing in an EDP Environment.

4.1 VOUCHING

4.1.1 Meaning

Q1. What is vouching?

(OR)

Define vouching.

(OR)

Examination of vouching.

(OR)

What do you understand by vouching?

Ans :

(July-21, Dec.-18, July-19, Dec.-19, Dec.-18)

Meaning

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

Definitions

- (i) **According to J.R. Batliboi** "Vouching means testing the truth of items appearing in the books of original entry."
- (ii) **According to Dicksee** "Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof."
- (iii) **According to Joseph Lancaster**, "It is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This, however, is, quite wrong, for vouching comprises such an examination of the ledger entries as will satisfy the auditor, not only that the entry is supported by documentary evidence but that it has been properly made upon the books of accounts."

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

The following are the examples of vouchers for certain transactions.

S.No.	Nature of Transaction	Vouchers Available
1.	Cash Receipts	Counterfoils of receipts issued, carbon copies of receipts, contracts, correspondence and letters from the debtors confirming the balances of their accounts.
2.	Cash Paid	Original receipts from payee, invoices, bills, demand notes, salary books, wage sheets, contracts, confirmation by creditors etc.
3.	Purchases	Invoices, copies of orders and correspondence etc.
4.	Sales	Orders record and goods outward books etc.
5.	Opening Journal entries	Purchase and sales returns, bills payable and receivables and last year's balance sheet's entries etc.

4.1.2 Objectives

Q2. Explain the objectives of vouching.

Ans :

(July-21, Dec.-19, Dec.-18)

1. All the transactions which are 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, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account.

Q3. Explain the importance of vouching.

Ans :

(Dec.-19, July-19)

- It is fundamental to all audit procedures and the success of an audit will depend upon the thoroughness with which vouching is completed.

- It is an important tool in the hands of an auditor and the success of an auditor in vouching depends upon his intelligence, commonsense, observation and tact with which he handles his work. An auditor should not merely check the arithmetical accuracy of the books or compare the entries with the available documentary evidence, but he should go to the source of a transaction.
- Thus, the process of vouching invariably involves the examination of documentary evidence necessary to authenticate and support the recorded transactions which are purported to have taken place during the period under review.
- Vouching also includes routine checking of carry forwards, extensions, posting into the ledgers, casts, sub-casts and other calculations in the books of original entry. In a small concern, an auditor may be able to conduct a detailed vouching of the transaction.
- However, vouching may be a lengthy process in big organizations unless there is an efficient internal control system in existence, which will ensure arithmetical accuracy as well as proper authorization and recording of various transactions. For example, in the case of a bank or a big trading concern where thousands of transactions of varied nature are processed every day, it would be impracticable for the auditors to conduct detailed vouching.
- If the internal control system in operation is efficient, the auditor may rely on few test checks and can conduct what is known as the balance sheet audit.

Q4. What is meant by routine checking? Distinguish between vouching and routine checking.

Ans :

(Dec.-18)

Meaning

Every business organization is maintaining certain records and books which are common to all organizations irrespective of their nature, size and constitution. The act of analysis of such common records and books is usually referred to as "Routine checking". Thus, routine checking is a form of simple checking which is initiated by accurately establishing the casts and sub-casts by properly carrying forward the balances without making manipulation in the books of accounts.

Differences

S.No.	Nature	Vouching	Routine Checking
1.	Meaning	Vouching is an auditing technique to check the accuracy and authenticity of recorded transactions.	Routine checking is a form of simple checking of the arithmetic accuracy of the books of accounts.
2.	Scope	It has a wider scope than compared to routine checking.	It has narrower scope, than compared to vouching.
3.	Objective	Its main objective is to check and verify the documentary evidence provided in support of the transactions recorded in the books.	Its main objective is to examine and analyze the totals and balances of the subsidiary books.
4.	Relationship	The process of vouching includes routine checking too.	Routine checking is a part of vouching. Thus both are interrelated with each other.
5.	Inputs	Auditor uses regular books of accounts as the inputs of vouching.	Routine checking uses all the subsidiary books and ledger accounts as inputs.
6.	Type of evidence	It provides the evidence related with authenticity and accuracy of primary books.	It provides evidence in books by making tick marks against the checked entries or error entries.
7.	Errors	It helps in identifying errors of principle, omission and commission and frauds.	It helps in identifying only small mathematical errors.
8.	Job performance	Being a responsible job, it is performed by the auditors senior staff.	It may be performed by a junior clerk,

Q5. State the features and advantages of routine checking.

Ans :

Features

It is characterized by the following features,

1. Traditional System

Routine checking represents the most simplest and traditional form of checking.

2. Expensive

The process of routine checking is expensive in nature and is associated with both time and cost.

3. Detailed Checking

The detailed checking refers to the thorough analysis of each and every transaction which needs to be recorded in the books of prime entry or subsidiary books.

4. Extensive Checking Method

Through routine checking, extensive checking and vouching of all accounting entries become possible.

5. Analysis of each and every Item

Unlike test checking, routine checking plays a vital role in analyzing all types of transactions.

6. Identifies Accounts Errors and Frauds

Even though the different accounting errors and fraud are identified by routine checking, it is unable to trace out the material importance of errors and frauds.

Advantages

Routine checking has the following advantages,

1. Simple and easy to Perform

Routine checking represents the simplest form of auditing which is carried out by the person who is having sufficient accounting knowledge.

2. Constitutes the Significant Base

Auditors carryout in-depth analysis of all the transactions based on the results of routine checking. In this manner, routine checking acts as the base on which further research has to be carried out.

3. Verifies the Accuracy Levels of Transactions

In addition to the identification of errors and frauds, if it is carried out with due care then it enables the auditor to verify the arithmetical accuracy of the accounting transactions.

4.2 TYPES OF VOUCHERS

Q6. Write about types of vouchers.

(OR)

Explain the various types of vouchers.

Ans. :

(July-19, Dec.-18)

Vouchers are categorized into two types. They are,

- I. Supporting vouchers
- II. Accounting vouchers.

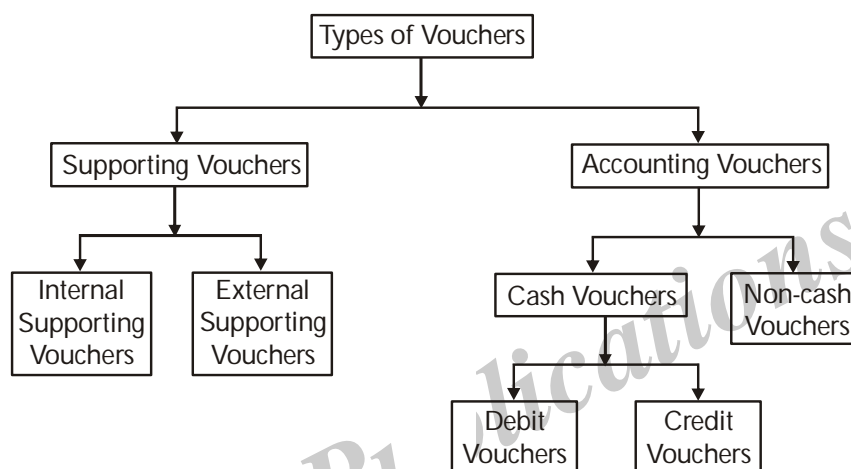


Fig.: Types of Vouchers

I. Supporting Vouchers

These vouchers are nothing but the written evidences support of the transactions that have taken place. Supporting vouchers are divided into two, i.e., Internal supporting vouchers and external supporting vouchers.

(a) Internal Supporting Vouchers

The organization prepares internal supporting vouchers and the third parties validate it.

(b) External Supporting Vouchers

Usually, third parties prepare the external supporting vouchers.

II. Accounting Vouchers

The vouchers made by the accountant on the basis of supporting vouchers, are called accounting vouchers. They must be signed by the authorised signatory of the enterprise for recording in the books of accounts. The accounting vouchers are made for both cash and non-cash transactions. These vouchers are of two types,

1. Cash vouchers
2. Non-cash vouchers.

1. Cash Vouchers

The documentary proof of cash payments and cash receipts, is known as cash voucher. The two types of cash vouchers are, debit voucher and credit voucher.

(a) **Debit (Payment) Vouchers:** The written evidences of the cash payments are called debit vouchers. There vouchers are prepared mainly for recording the transactions that involve cash payments. Examples of debit vouchers includes,

- Cash payment of salaries.
- Cash purchases of goods, fixed assets and investments.
- Payment to creditors, employees and bank etc.
- Repayments of loans and advances.
- Deposit of cash into the bank.

(b) **Credit Vouchers:** The documentary proof of cash receipt is called as credit voucher. For recording the transactions of cash receipts, these vouchers are prepared.

2. Non-Cash Vouchers

Non-cash vouchers are also called as transfer vouchers. They are the written evidences for transactions that do not involve cash. It is prepared for the credit transactions.

Q7. What are the principles of vouching?

Ans :

1. Arranged Voucher

In the books of accounts the vouchers are based an entry. A voucher is helpful to support any transaction, which may be cash memo fill, voucher, ticket or others.

2. Checking of Date

The voucher date can also be checked; it must be related to the current year. The date of the last or future year must not be adopted.

3. Checking of Authority

The vouchers are considers correct only when the proper authority signs on them. For the approval of the dealing the owner or the management must put the signatures for the

approval of dealing if the vouchers are without the signatures of the proper authority. They are not considers the true.

4. Cutting or Change

There should be no changes in the vouchers. Any person for making the fraud can change the time, date, amount and name of concern. So, these changes cannot be acceptable till the approval authority has made the signature.

5. Compare the Words and Figures

The auditor should satisfy himself amount written on the vouchers, it figures and words are same or not.

6. Transaction Must Relate to Business

For the correctness of the vouchers it is necessary that it relate with the business. Concern, the vouchers must be in the name of the business and also the manager. If it does not the vouchers are not acceptable and doubtful.

7. Case of Personal Vouchers

The auditor should not accept the voucher in personal name. There is a chance than an officer of the company has purchased any item in his personal capacity.

8. Checking of Account Head

Auditor must be satisfied about the head of account in which cash is deposited and drawn. He should examine the documentary evidence in these regards.

9. Revenue Stamps

For the stamps, the stamps act 1899 is applicable while fixing the revenue stamps. The stamps are required according to the valuation of the amount or cash memo. There is no need of vouchers if amount is less than twenty rupees.

10. Case of Cancelled Voucher

The auditor should not accept the cancelled vouchers because it has already served the purpose of payment. There will be a danger of double payments, if it is accepted.

11. Important Notes

For finding the correct decision, the auditor can also take help from the working papers of the previous year and others paper or note related to business and available with the management.

12. Minutes Book

When the meeting of shareholders is held. All the resolutions and decisions of the directors and shareholders are recorded in the minute's book. This minutes book must be examine by the auditor. He has to check that these decisions have been implemented in the books of accounts or not.

4.3 VOUCHING OF TRADING TRANSACTIONS**Q8. Explain the process of vouching trading transactions**

Ans : (July-21)

1. Vouching of credit purchases

The main aim vouching of purchases book is to see that all purchase invoices are entered in purchases book and the goods entered in the purchases book are entered are actually received by the business.

While vouching credit purchases the auditor should examine and see the following points.

- (i) There should be proper record for all purchase orders. A duplicate copy of the order is kept in office for record.
 - (ii) A copy of purchase order shall be send to the Accounts Department.
 - (iii) All goods received should be recorded on goods received note; a copy of it should be sent to Accounts Department.
- The auditor should see that only credit purchases of the goods are recorded in purchase book.
 - The purchases book can be verified from purchase invoices, copies of orders placed, goods received note, goods inward book, copies of challans from suppliers.

- The quantity mentioned in the invoice must be same as is shown in the purchase order.
- The price charged by the supplier must be as per quotation/pricelist of the supplier.
- The supplier bill must be in the name of business and for the period under audit.
- While vouching the purchase vouchers, each voucher should be stamped or initialed after examination, so that it could not be produced again.
- Any purchase, made not for the purpose of business of the client, must not be debited to purchase account.
- Duplicate invoices must not be entered in the purchase book if original invoices have already been recorded.
- The auditor should be more careful while vouching the purchase made in the first and last month of the accounting period, because sometimes the purchase of last year may be included in the purchases of first month of current year or purchases of the last month of current year may be recorded in the next.

2. Vouching of Purchase Returns

While vouching the purchase returns the following points should be taken into consideration by the auditor.

- He should see that a Debit note has been sent to the supplier or Credit note has been received from the supplier.
- The quantity returned as per the return note must correspond with storekeeper's record, return outward register and gatekeeper's outward register.
- The amount showed in the credit note should be verified.
- He should be careful about the recordings of purchases return in the current year. Sometimes the profits of current year may be manipulated by recording current year's purchases return in the subsequent year.
- The purchases return of the first month and last month of the Accounting year should be vouched carefully, to detect any manipulation of amounts.

3. Vouching of Credit Sales

- The sales register should be examined with copies of sales invoices. The sale of capital items should not be recorded in the sales book, otherwise the profits will be inflated.
- Test check should be applied on the calculations made in sale invoices.
- The totaling and the castings of sales book should be verified.
- Sales Tax, duties collected thorough sales invoices must be recorded under separate accounts.
- It should be verified that all sales invoices are prepared on the basis of challans and then sales invoices are entered in sales book and from there, posted to their respected accounts.
- Sales made in the current year must be recorded under that year and shall not be treated as sales of subsequent year.
- All cancelled sales invoices must be kept together for verification by auditor, Who should see that cancelled invoices are properly treated in the books.
- The statement of accounts should be verified by getting confirmations from the customers.

4. Vouching of Sales Return

The Auditor should pay special attention to the following while vouching the sales return

- Date on which the goods are actually returned.
- Credit note or Debit note of sales return.
- Gatekeeper's receipt book.
- Return inward register.
- Stores records.
- Corresponding entry for the return of goods in customer's account.
- Goods returned should form the part of closing stock at cost price or market price whichever is less.

5. Vouching of Goods sent on consignment basis

- The goods sent on consignment basis by principal to his agent should not be considered as sale.
- Only when the goods are sold by the consignee, the entry for sale should be made in the books.
- The goods sent on consignment still lying with the consignee should be taken into closing stock. A separate book should be maintained to show the record of goods sent on consignment basis.
- At the end of the year an account sale is received by the consignee, indicating the goods sold by him and balance of closing stock of goods sent on consignment basis.
- The auditor should verify the goods sent on the consignment basis from proforma invoices, goods outward register, correspondence with consignee and account sales.

Q9. Explain the precautions to be taken by an auditor while vouching trading transactions.

Ans :

(Dec.-19, Dec.-18)

1. Over Statement or Under-Statement of Profit

The auditor must check the amount of profits so that it should not be overstated or understated, these may be due to,

- (i) Omission of sales returns.
- (ii) Over valuation of closing stock.
- (iii) Omission of bad debt recovered.
- (iv) Understatement of expenses.
- (v) Inflating the sales amount.
- (vi) Understatement of purchases.
- (vii) Undercharging of depreciation or insufficient provision for doubtful debts or discount or debtors.

In all the above situations the final statements will not represent correct and accurate position of

the business. In the same way, the auditor must check that the profits are not understated. According to the Companies Act 1956, excess provisions are considered as reserves. Similarly, excess amount of provision of depreciations, bad debts or liabilities should be transferred to reserves.

2. Differences between Capital and Revenue Items

At the time of recording the transactions, if capital and revenue items are not differentiated properly then profits will be either over or understated and correct and appropriate position will not be represented by the balance sheet.

3. Valuation of Current Assets

If the valuation of current assets is over stated than their realisable value then the profits of current year will be inflated.

4. Fictitious Assets

Expenses relating to fictitious assets must be written off as soon as possible such as worthless patents, development expenses or trade marks in order to calculate real net assets value of business.

5. Stock-in-Trade

There is no maintenance of running account for stock in financial records. Ascertain the closing stock value by physical quantities which are counted and applied the values. Closing stock should be entered in the books by debiting closing stock account and crediting trading account in order to ascertain appropriate and fair profits. There is a great impact of valuation method of stock, its correctness and verification. The auditor must check closing stock because there should be no misappropriation, loss, leakage or theft of goods. He should identify reasons behind any discrepancy which may be because of,

- (a) Goods purchased but in transit.
- (b) Purchased goods but bill is not provided by the supplier.
- (c) Goods returned by the customer are not included in stock.
- (d) Sale of goods but delivery is not done.

- (e) Loss of goods at the time of processing, loading and unloading.
- (f) Misappropriation of sale proceeds of the goods.
- (g) Failure in adjusting goods which are sent or received on the basis of approval or consignment.
- (h) Failure in adjusting goods which are distributed as the samples or goods lost by fire.
- (i) Goods which must be returned back to supplier are included in stock.

As closing stock of a year will be opening stock of next year. Because of this reasons the stock should be valued regularly from year to year, if not the profits of one year will be transferred to the next year.

4.4 VOUCHING CASH TRANSACTION

Q10. What is vouching of cash transaction? What are the points which need to be verified by the auditor while vouching the cash receipts and payments

Ans : (July-19, Dec.-18)

The auditing of cash transactions is regarded as one of the most important aspects in the examination and verification of the financial statements because cash is referred as the liquid and easily manipulated asset of the business. Thus, the auditor needs to be very careful while vouching the cash transaction in the books of accounts. Vouching is defined as 'testing the reliability or truthfulness of the terms shown in the journal'. In the same sense, vouching of cash transaction refers to testing the reliability or truthfulness of cash transactions in the books of accounts. An organization may become successful if in case they follow good technique for vouching of cash transaction. The organization must conduct internal check and internal control system in order to verify the books of accounts. The auditor should verify the internal check system of the organization while vouching the cash receipts and payments.

Points to be Consider while Vouching the Cash Receipts and Payments

The auditor needs to check and verify the following points at the time of vouching:

1. Rough Cash Book

The auditor needs to verify that the organization maintains rough cash books for recording the cash transactions.

2. Printed Receipts and Counter Foil

A printed receipt and counter foil must be issued at the time of receiving cash. This reduces the chances of cash fraud.

3. Receipt Books

The receipt books serially numbered and the receipt books which are not being used must be kept safely in the locker.

4. Deposit Cash into Bank

The cash which is received must be deposited in the bank on the same day.

5. Petty Cashier

Imprest system must be followed by the petty cashier in order to maintain and record petty or small transactions. This ensures good internal control system in the organization.

6. BRS

The auditor should assure that the firm prepares bank reconciliation statement on a regular basis and updates it often.

7. Cash Register

It is advisable and highly recommended to maintain automatic cash register.

8. Cheque Payments

It is better to use cheques for receipts as well as for payments in order to minimize the possibility of fraud.

9. Special Payments

Any payments of special nature needs to be made under the control of a responsible company official and not the cashier.

Q11. Write about vouching of cast transactions in detail.

Ans :

(Dec.-18)

Vouch of cash receipts

1. Cash sales

In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same. Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.

2. Cash received from the debtors

The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.

3. Loans

While vouching the loans received, the terms and the 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.

4. Bills receivable

Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonor of such bill has been made.

A verification of the bills discounted should

be made. Whether, entry for discount has been made. Such bills should appear as contingent liability in the balance sheet; if the date of maturity is after the date of balance sheet.

5. Sale of Investment

If the sales have been affected through a bank, the auditor should examine the bank advice to know the various details. Sometimes the investment is sold through the broker. Broker's sold note or commission should be examined to verify the sale proceeds and commission charged by the broker.

If the investments are sold at cum-dividend price, auditor should see that proper apportionment has been made between capital receipts and revenue receipts.

Sometimes the investments are made against specified funds. Profit or loss on sale of such investments must be transferred to such funds account.

6. Sale of Fixed Assets

Sale of fixed assets may be vouched with minute book of board of directors, correspondence, agents' sale account and sale contract. It should be seen that proper account has been credited. Any profit arising on the sale of asset shall be credited to revenue account which is not available for distribution of dividends. If any expense on the sale of assets is paid, the sale proceeds of the asset should be reduced by such amount and the balance should be credited to asset account. It must be seen that sale of fixed assets has been sanctioned by the authorized person or committee.

Vouching of cash payments

1. Cash Purchases

Good purchased are actually received by store keeper. Cash memos can be compared with goods inward book to verify the goods received. Only the net amount (after trade discount) should be entered in the books.

2. Payment to creditors

Should be examined with the receipts issued

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

3. Bills payable

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

4. Wages

Wages paid and calculated for various months should be compared. If the wages of particular month differ from the preceding month, the auditor should look into the reasons for difference. Random checking of wages calculations should be made. The auditor should see the proper record is maintained for unpaid wages, deductions for any advance taken by the worker should also be verified, and deductions made from the wages should also be entered in the proper account. Special attention should be given to the payments made to casual workers.

5. Payment of Salaries

In vouching the payment of salaries following points are important

- (a) Auditor should check salary register with the entries made in the cash book
- (b) He should examine carefully alterations in the amount of deductions on account of fines, funds, loans, insurance etc.

6. Purchase of Investment

The auditor should compare the investment purchased with Broker's Bought Note. If the possible, physical verification of investments should be made. Investments must be in the

name of the company. Where the investments are purchased at cum-interested price, interest included in the purchase price should be debited in the interest account and the balance in investment account. Later on when the interest is received on the investment, it should be credited in the interest account.

7. Rent paid

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

8. Loans

Auditor should be that the loan voucher should be supported by the receipt given by the party. Further details regarding terms and condition of the loan can be verified from the loan agreement. It should be seen that installment of loan along with interest are received in time. Mortgage Deeds and other documents should also be examined.

9. Interest on Loan

Auditor should verify that rate of interest on loan does not differ from the terms and conditions of loan agreement. Debenture interest can be verified from debenture interest book. All the payments of interest must be supported by vouchers and receipts.

Q12. What are the points an auditor should look into while examining vouchers?

Ans : (Dec.-19)

The auditor must consider the following points while vouching payments,

1. Payments Authenticity

The auditor must examine the authenticity of payment and also Verify whether the payment is actually being made or not.

2. Legality of Payments

The auditor needs to ensure the legality of the payment made, that is, the payment should not have any legal restriction or should

not be against any ordinance or act. If any payment voucher is found to be against this, then it would be considered as "Void abinitio" (void from the start).

3. Payment Accuracy

The auditor must check the accuracy/correctness of the amount of payment which is being paid. He must verify the amount in words with the amount in figures. Further, he must also cross check the amount with cash book balance.

4. Appropriate Payment Voucher

The auditor must assure that each and every payment is supported by a voucher. If any payment is made without a voucher, the auditor should investigate further and find out the reasons for it.

5. Appropriate Payment Record

The auditor must ensure that all the payments made are recorded separately and accurately.

6. Payment Due Date

The auditor should also pay attention to the due dates of payments, that is, whether the payment is being made before or after the due date. In case of early payment, he must find out the reasons for it.

4.5 AUDITING IN AN EDP ENVIRONMENT

Q13. Discuss briefly about auditing in an EDP environment.

Ans : (Dec.-20, July-19)

Introduction

EDP system has introduced new products of modern banking services in where they can satisfy new wants of bank's customer who are moving and they do not know any distance to catch banking products. Therefore to handle these progress and advancements, the role of internal controls as no longer but more and more has become significant and they must cover and support security of all sections in bank's activities, specially new banking products like Internet banking, in other words the auditing of banks in the new millennium has been

involved with the new challenges, so new skills, new knowledge, new techniques, etc. have been required.

EDP System Definition

The Electronic Data Processing (EDP) or Automated Data Processing (ADP) in initial days and Computer Information Systems (CIS) or Management Information Systems (MIS) or Information Technology (IT) in nowadays refer to a system or environment in which a computer of any type or size is utilized to process data by an organization or entity.

Definitions

- (i) **According to Weber (1988)** "EDP auditing is a function that has been developed to assess whether computer system safeguard assets, maintain data integrity, and achieve the goals of an organization effectively and efficiently".
- (ii) **According to Kaveri (1996)** defines that the EDP audit is a process of collecting and evaluating evidences to ensure whether the computer system provides for the safeguard of the assets through adoption of security and control measures, data integrity and optimum use of assets.
 - (a) Establishing auditing standards and guidance for financial statement audits of such high quality that they are acceptable to investors, auditors and governments, banking regulators, securities regulators and other key stakeholders across the world.
 - (b) Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters.
 - (c) Establishing standards and guidance for other related services.
 - (d) Establishing quality control standards covering the scope of services addressed by the Board.
 - (e) Publishing other papers on auditing and assurance matters, thereby advancing the public understanding of the roles and responsibility of professional auditors and assurance service providers.

Q14. Explain the various problems of EDP environment.

Ans :

(Dec.-19)

1. No Supporting Vouchers

In conventional accounting, there are some basic documents which are to be authorised by the officers to generate a transaction. In contrast, in a high level computerised environment and several transactions are directly supplied into the computer without the authorization record in the standard form of vouchers. In the same way, the computer may perform the calculations, interest, discount and other arithmetic operations as per the criteria of arithmetic which are already fixed in the programme. Thus, many difficulties may arise in checking the data from outside and how it is recorded.

2. Liable to Manipulations

The computers perform the instructed operations faithfully and obediently. It has no idea of whom must it be loyal, until a programme is developed to recognize the trustworthy persons. Therefore, the computer input, processing and output are prone to manipulations very easily. The management should ensure restrictions of access to computers. The restrictions may also lead to the problems such as material manipulation calculated in the computer, authorization levels, throwing out the exceptional transactions.

3. Computer Virus

The main issue related with the computer is the "computer virus", due to which the computer gets stuck or become dead. It is the troublesome practice done on particular areas of computer and affects the functioning of the important area of computer. The computer virus can attack the systems in many ways. Sometimes, they do not create more inconveniences and sometimes they create high level of inconvenience and make the system dead. At times, the computer virus stays till a specific date and disappears after a period of time. Often, they create problems

to some particular softwares and do not harm other programmes. Therefore the system should be protected against the virus using vaccine softwares like use of knowledgeable technical employees, controlled use of disc, programme in the system.

4. Coding Problem

Unlike manual accounting, which uses self-explanatory accounting heads the computerized accounting involves more use of coding. The development and operating of coded accounting software of business transactions needs due care and experience.

5. Garbage in Garbage Out

Here, the input is supplied into computer and gets processed and gives a final result. If the computer system is reading any instruction wrongly, then it is written by its own. In case of continuous manipulations, unclear highly complex logical sequence, the system will not give intended results if the corrections are done at an improper place of processing.

Q15. Discuss in detail the audit approach in an EDP environment and the impact of computerization on audit approach.

Ans :

There has been no change in the scope and objectives of auditing with the computerisation of accounting. It is important for the auditor to convey his view regarding the fairness and truth of financial statements which are audited by him. There exist no primary records, visible audit trail and output in EDP environment. The computerization of accounts has lead to the changes in firms and procedures. Similarly, storing has modified firms, procedures and accounting data storage and its processing. In EDP environment, the auditor should evaluate the sufficiency of internal control relating to input, processing and of storing accounting information.

Impact

The auditor should make decision regarding whether to conduct audit using the computer or with the use of computer. These approaches are

called as "Auditing around the Computer" and "Auditing through the Computer".

(i) Audit Around the Computer Traditional Approach

When the auditing is conducted in traditional way, it is referred to as audit around the computer. Here, the auditor treats the computer as black box. The print out generated from the computer is collected and is used when either the system is simple or the system uses generalized software which is extensively used by many others. The auditor can take into consideration generalized softwares, such as account receivable, payroll account payable packages which are often error free and can be used without checking the processing aspect. This approach is found to be very simple. In the computer system, even if the auditor does not have a clear idea regarding the functioning of computer, he can easily carryout the audit.

The demerit of this approach is that there are limited applications of the generalized software packages. The system is deteriorated and the auditor will not be able to evaluate it easily, if there are any changes in the environment.

(ii) Auditing through the Computers

This approach takes the assistance of computers in auditing. The auditing system and programmes are used by the ' auditors. The audit techniques that make use of systems are called as "Computer Assisted Auditing Techniques" (CAAT).

To conduct the audit using computers, it needs technical competence of the auditor. It is essential for the auditor to verily the control prevailing inside the system and also the result generated by the computers. Within the system, the auditor formulates the set of input and applies it to the programs. The outcomes of the systems are verified with the pre-determined solution. The auditor checks the errors generated by the computer. Auditing can be conducted using computers when it is not possible to check the validity of direct evaluation of large volumes of inputs and outputs in EDP environment.

Short Question and Answers

1. Define vouching.

Ans :

Meaning

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

Definitions

- (i) **According to J.R. Batliboi** "Vouching means testing the truth of items appearing in the books of original entry."
- (ii) **According to Dicksee** "Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof."
- (iii) **According to Joseph Lancaster**, "It is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This, however, is, quite wrong, for vouching comprises such an examination of the ledger entries as will satisfy the auditor, not only that the entry is supported by documentary evidence but that it has been properly made upon the books of accounts".

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

2. EDP

Ans :

Introduction

EDP system has introduced new products of modern banking services in where they can satisfy new wants of bank's customer who are moving and they do not know any distance to catch banking products. Therefore to handle these progress and advancements, the role of internal controls as no longer but more and more has become significant and they must cover and support security of all sections in bank's activities, specially new banking products like Internet banking, in other words the auditing of banks in the new millennium has been involved with the new challenges, so new skills, new knowledge, new techniques, etc. have been required.

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- (a) Establishing auditing standards and guidance for financial statement audits of such high quality that they are acceptable to investors, auditors and governments, banking regulators, securities regulators and other key stakeholders across the world.

3. Explain the objectives of vouching.

Ans :

1. All the transactions which are 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, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account.

4. Explain the importance of vouching.

Ans :

- It is fundamental to all audit procedures and the success of an audit will depend upon the thoroughness with which vouching is completed.
- It is an important tool in the hands of an auditor and the success of an auditor in vouching depends upon his intelligence, commonsense, observation and tact with which he handles his work. An auditor should not merely check the arithmetical accuracy of the books or compare the entries with the

available documentary evidence, but he should go to the source of a transaction.

- Thus, the process of vouching invariably involves the examination of documentary evidence necessary to authenticate and support the recorded transactions which are purported to have taken place during the period under review.
- Vouching also includes routine checking of carry forwards, extensions, posting into the ledgers, casts, sub-casts and other calculations in the books of original entry. In a small concern, an auditor may be able to conduct a detailed vouching of the transaction.
- However, vouching may be a lengthy process in big organizations unless there is an efficient internal control system in existence, which will ensure arithmetical accuracy as well as proper authorization and recording of various transactions. For example, in the case of a bank or a big trading concern where thousands of transactions of varied nature are processed every day, it would be impracticable for the auditors to conduct detailed vouching.
- If the internal control system in operation is efficient, the auditor may rely on few test checks and can conduct what is known as the balance sheet audit.

5. Vouching trading transactions.

Ans :

(i) Vouching of credit purchases

The main aim vouching of purchases book is to see that all purchase invoices are entered in purchases book and the goods entered in the purchases book are entered are actually received by the business.

While vouching credit purchases the auditor should examine and see the following points.

- There should be proper record for all purchase orders. A duplicate copy of the order is kept in office for record.

(ii) Vouching of Purchase Returns

While vouching the purchase returns the following points should be taken into consideration by the auditor.

- He should see that a Debit note has been sent to the supplier or Credit note has been received from the supplier.
- The quantity returned as per the return note must correspond with storekeeper's record, return outward register and gatekeeper's outward register.
- The amount showed in the credit note should be verified.

(iii) Vouching of Credit Sales

- The sales register should be examined with copies of sales invoices. The sale of capital items should not be recorded in the sales book, otherwise the profits will be inflated.
- Test check should be applied on the calculations made in sale invoices.
- The totaling and the castings of sales book should be verified.
- Sales Tax, duties collected thorough sales invoices must be recorded under separate accounts.
- It should be verified that all sales invoices are prepared on the basis of challans and then sales invoices are entered in sales book and from there, posted to their respected accounts.

6. Routine checking.

Ans :

Every business organization is maintaining certain records and books which are common to all organizations irrespective of their nature, size and constitution. The act of analysis of such common records and books is usually referred to as "Routine checking". Thus, routine checking is a form of simple checking which is initiated by accurately establishing the casts and sub-casts by properly carrying forward the balances without making manipulation in the books of accounts.

7. Distinguish between vouching and routine checking.

Ans :

S.No.	Nature	Vouching	Routine Checking
1.	Meaning	Vouching is an auditing technique to check the accuracy and authenticity of recorded transactions.	Routine checking is a form of simple checking of the arithmetic accuracy of the books of accounts.
2.	Scope	It has a wider scope than compared to routine checking.	It has narrower scope, than compared to vouching.
3.	Objective	Its main objective is to check and verify the documentary evidence provided in support of the transactions recorded in the books.	Its main objective is to examine and analyze the totals and balances of the subsidiary books.
4.	Relationship	The process of vouching includes routine checking too.	Routine checking is a part of vouching. Thus both are interrelated with each other.
5.	Inputs	Auditor uses regular books of accounts as the inputs of vouching.	Routine checking uses all the subsidiary books and ledger accounts as inputs.
6.	Type of evidence	It provides the evidence related with authenticity and accuracy of primary books.	It provides evidence in books by making tick marks against the checked entries or error entries.
7.	Errors	It helps in identifying errors of principle, omission and commission and frauds.	It helps in identifying only small mathematical errors.
8.	Job performance	Being a responsible job, it is performed by the auditors senior staff.	It may be performed by a junior clerk,

8. Advantages of routine checking.*Ans :*

Routine checking has the following advantages,

1. Simple and easy to Perform

Routine checking represents the simplest form of auditing which is carried out by the person who is having sufficient accounting knowledge.

2. Constitutes the Significant Base

Auditors carryout in-depth analysis of all the transactions based on the results of routine checking. In this manner, routine checking acts as the base on which further research has to be carried out.

3. Verifies the Accuracy Levels of Transactions

In addition to the identification of errors and frauds, if it is carried out with due care then it enables the auditor to verify the arithmetical accuracy of the accounting transactions.

9. Supporting Vouchers

These vouchers are nothing but the written evidences support of the transactions that have taken place. Supporting vouchers are divided into two, i.e., Internal supporting vouchers and external supporting vouchers.

(i) Internal Supporting Vouchers

The organization prepares internal supporting vouchers and the third parties validate it.

(ii) External Supporting Vouchers

Usually, third parties prepare the external supporting vouchers.

10. Accounting Vouchers

The vouchers made by the accountant on the basis of supporting vouchers, are called accounting vouchers. They must be signed by the authorised signatory of the enterprise for recording in the books of accounts. The accounting vouchers are made for both cash and non-cash transactions. These vouchers are of two types,

1. Cash vouchers
2. Non-cash vouchers.

1. Cash Vouchers

The documentary proof of cash payments and cash receipts, is known as cash voucher. The two types of cash vouchers are, debit voucher and credit voucher.

(a) Debit (Payment) Vouchers: The written evidences of the cash payments are called debit vouchers. These vouchers are prepared mainly for recording the transactions that involve cash payments. Examples of debit vouchers includes,

- Cash payment of salaries.
- Cash purchases of goods, fixed assets and investments.
- Payment to creditors, employees and bank etc.
- Repayments of loans and advances.
- Deposit of cash into the bank.

(b) Credit Vouchers: The documentary proof of cash receipt is called as credit voucher. For recording the transactions of cash receipts, these vouchers are prepared.

2. Non-Cash Vouchers

Non-cash vouchers are also called as transfer vouchers. They are the written evidences for transactions that do not involve cash. It is prepared for the credit transactions.

11. What are the principles of vouching?*Ans :***1. Arranged Voucher**

In the books of accounts the vouchers are based an entry. A voucher is helpful to support any transaction, which may be cash memo fill, voucher, ticket or others.

2. Checking of Date

The voucher date can also be checked; it must be related to the current year. The date of the last or future year must not be adopted.

3. Checking of Authority

The vouchers are considered correct only when the proper authority signs on them. For the approval of the dealing the owner or the management must put the signatures for the approval of dealing if the vouchers are without the signatures of the proper authority. They are not considered true.

4. Cutting or Change

There should be no changes in the vouchers. Any person for making the fraud can change the time, date, amount and name of concern. So, these changes cannot be acceptable till the approval authority has made the signature.

5. Compare the Words and Figures

The auditor should satisfy himself amount written on the vouchers, its figures and words are same or not.

6. Transaction Must Relate to Business

For the correctness of the vouchers it is necessary that it relate with the business. Concern, the vouchers must be in the name of the business and also the manager. If it does not the vouchers are not acceptable and doubtful.

7. Case of Personal Vouchers

The auditor should not accept the voucher in personal name. There is a chance that an officer of the company has purchased any item in his personal capacity.

8. Checking of Account Head

Auditor must be satisfied about the head of account in which cash is deposited and drawn. He should examine the documentary evidence in these regards.

12. What is vouching of cash transaction?

Ans :

The auditing of cash transactions is regarded as one of the most important aspects in the examination and verification of the financial statements because cash is referred as the liquid and easily manipulated asset of the business. Thus, the auditor needs to be very careful while vouching the cash transaction in the books of accounts. Vouching is defined as 'testing the reliability or truthfulness of the terms shown in the journal'. In the same sense, vouching of cash transaction refers to testing the reliability or truthfulness of cash transactions in the books of accounts. An organization may become successful if in case they follow good technique for vouching of cash transaction. The organization must conduct internal check and internal control system in order to verify the books of accounts. The auditor should verify the internal check system of the organization while vouching the cash receipts and payments.

13. What are the points an auditor should look into while examining vouchers

Ans :

The auditor must consider the following points while vouching payments,

1. Payments Authenticity

The auditor must examine the authenticity of payment and also verify whether the payment is actually being made or not.

2. Legality of Payments

The auditor needs to ensure the legality of the payment made, that is, the payment should not have any legal restriction or should not be against any ordinance or act. If any payment voucher is found to be against this, then it would be considered as "Void ab initio" (void from the start).

3. Payment Accuracy

The auditor must check the accuracy/correctness of the amount of payment which is being paid. He must verify the amount in words with the amount in figures. Further, he must also cross check the amount with cash book balance.

4. Appropriate Payment Voucher

The auditor must assure that each and every payment is supported by a voucher. If any payment is made without a voucher, the auditor should investigate further and find out the reasons for it.

5. Appropriate Payment Record

The auditor must ensure that all the payments made are recorded separately and accurately.

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Choose the Correct Answers

1. The auditor is most likely to examine related party transactions very carefully while vouching [c]
(a) Credit sales (b) Sales returns
(c) Credit purchases (d) Cash purchases
2. Which of the following is most crucial to a purchase department? [c]
(a) Reducing the cost of acquisition (b) Selecting supplies
(c) Authorizing the acquisition of goods (d) Assuring the quality of goods
3. In case of sales return, the auditor should examine which documents? [d]
(a) Credit notes, advice notes and inward return notes
(b) Debit notes, advice notes and inward return notes
(c) Purchase invoices, advice notes and inward return notes
(d) Credit notes, inspection report and inward return notes
4. In order to vouch, which of the expenses, the auditor will examine Bill of Entry. [a]
(a) Custom (b) Excise duties
(c) Sales tax (d) Income tax
5. In case of unclaimed wages, the auditor should examine whether [a]
(a) The amount has been deposited in a separate bank account
(b) Deposited with the cashier
(c) Held in a safe deposit box
(d) All of these
6. A Voucher is a _____. [a]
(a) Document is support of an entry made in books of accounts.
(b) Invoice received from suppliers.
(c) Receipt issued to a customer for cash.
(d) Despatch receipt
7. Voucher relates to _____. [d]
(a) Cash receipt (b) Cash payment.
(c) Credit transactions. (d) All the above

8. Verification is _____. [c]
- (a) The art of recording the business transaction
 - (b) An examination of the books of accounts
 - (c) The act of establishing the accuracy of entries in the books of accounts
 - (d) None of the above
9. The main object of the audit of the cash book may be _____. [b]
- (a) To verify the assets and liabilities.
 - (b) To know that all receipts and payments have been properly recorded.
 - (c) To check the internal control system in business.
 - (d) To check the bank balance.
10. Stock in trade is valued _____. [b]
- (a) At cost price
 - (b) At market price
 - (c) At cost price or market price whichever is less
 - (d) At cost price less depreciation

Fill in the Blanks

1. In vouching cash sales _____ should be fully checked with carbon copies of cash memos
2. _____ voucher includes purchase and sales returns, bills payable and receivables and last year's balance sheet's entires etc.
3. In case of return of loan by others, the auditor should check the _____ with the entry made in the books.
4. Bills receivable book may be verified because the various details regarding _____ are available in it.
5. _____ system regarding cash sales must be effective
6. When cash is received from customers, a _____ is issued
7. _____ honoured on the date of maturity and are returned by the payee after reveiving the payment.
8. A _____ is a written paper or document in support of an entry in the books of accounts.
9. _____ voucher includes invoice, copies of orders and correspondence etc.
10. _____ voucher includes orders record and goods outward books etc.

ANSWERS

1. Cash register
2. Opening Journal entries
3. Counter foil
4. Bill matured
5. Internal control
6. cash memo
7. Bills payable
8. Voucher
9. Puchase
10. Sales

One Mark Answers

1. Vouching?

Ans :

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books.

2. Supporting Vouchers.

Ans :

These vouchers are nothing but the written evidences support of the transactions that have taken place. Supporting vouchers are divided into two, i.e., Internal supporting vouchers and external supporting vouchers.

3. What do you understand from Auditing in an EDP Environment?

Ans :

As computers are being used in almost all activities of a business, it has now become essential to introduce new auditing approach in an Electronic Data Processing (EDP) environment.

4. What are the different types of Vouchers?

Ans :

Vouchers are categorized into two types i.e., supporting vouchers and accounting vouchers. Supporting vouchers are further classified into internal and external whereas accounting vouchers are farther classified into cash vouchers and non-cash vouchers.

5. What do you mean by Cash Voucher?

Ans :

The documentary proof of cash payments and cash receipts is known as cash voucher.

UNIT V

VERIFICATION AND VALUATION OF ASSETS:

Meaning and Definition – Distinction – Verification and Valuation of various Assets and Liabilities – Audit Committee – Role of Audit Committee – Audit Reports.

5.1 VERIFICATION AND VALUATION

5.1.1 Meaning and Definition

Q1. What do you mean by verification and valuation?

Ans : (Dec.-18, July-19)

Verification

After a thorough examination of the books of accounts pertaining to their correctness and authenticity of the transactions recorded in them, the auditor should start verification of the assets and liabilities appearing in the balance sheet. In order to do this, he should first satisfy himself about the actual existence of assets and liabilities because the record of the assets and liabilities as appearing in the balance sheet may not be correct. In case the balance sheet shows an asset which in fact does not exist or which is stated at a value different from what is considered reasonable, both the balance sheet and the connected profit and loss account would be incorrect. It is often seen that assets are purchased and properly recorded in the books of accounts, but subsequently they might have been disposed off, destroyed, pledged or misappropriated and no entry had been made to record this fact in the books of account before the closing of these books. It means that the actual position of assets is different from what has been shown in the balance sheet.

Meaning

To verify means to establish whether the actual facts or details are in agreement with those that are asserted. One of the important duties of an auditor during the course of audit is to verify the assets and liabilities appearing in the Balance Sheet. The auditor has not only to examine the arithmetical accuracy of the transactions, but he has to also see that the

various items appearing in the Balance Sheet are in the possession of the concern.

The Objectives of verification are achieved by proper combination of compliance and substantive audit procedures. Therefore, an auditor has to keep in mind the following points while verifying the assets

- (i) To ensure that assets are in existence at the date of the balance sheet and they belong to the client.
- (ii) To satisfy that assets have been acquired for the business and are clearly stated in the balance sheet.
- (iii) To satisfy himself that the assets are properly valued for the purpose of the balance sheet.
- (iv) To verify that assets are free from any charge, lien or encumbrances, and
- (v) To satisfy himself that the assets are in the possession of the client or in the custody of the persons authorized by him.

Valuation

The fact has been established that the verification of assets also includes their proper valuation. The correct valuation of assets and liabilities is very important because the accuracy of the balance sheet of any concern also depends on it. At the same time, the correct profit or loss cannot be calculated unless assets are properly valued.

Valuation is not merely the determination of the values of the assets as appearing in that balance sheet but is also a critical examination of these values on the basis of normally accepted accounting standards.

Thus, the valuation of the assets should be done by a responsible officer of the concern and

the duty of the auditor is to see whether they have been properly valued or not. But a more pertinent question is that how can he find out at what value should these assets appear in the balance sheet. For this purpose, he should obtain the certificates of professional and approved valuers and other competent persons. He can always rely upon these certificates and should also mention this fact in his audit report. He cannot work as a valuer because he does not possess the technical knowledge to find out the value of the assets. At the same time the valuation and its basis will differ according to the type of the assets and the purpose for which they are held.

However, he can always apply certain tests to find out the value of the assets. As stated by Lancaster, "An auditor is not a valuer and cannot be expected to act as such. All that he can do is to verify the original cost price and to ascertain as far as possible that the current values are fair and reasonable and are in accordance with the accepted commercial principles." In case he is not satisfied with the mode of valuation or if he feels that the values have not been determined on the basis of generally accepted conventions, he must include this fact in his audit report.

Q2. Explain the methods of valuation.**1. Cost price**

The price which is paid for acquisition of an asset is known as its cost price; of course the expenses incurred in the purchase of an asset and its installation are included in its cost price.

2. Market value

A value which an asset can fetch in the market when sold is known or termed as market value.

3. Replacement value

It is a price at which a particular asset can be replaced. The expenses such as commission, freight etc. are also included in such a value.

4. Book value

A value at which an asset appears in the books of accounts is known as its book value. It is usually the cost less depreciation written off so far.

5. Going concern value or Conventional value or Token value or Historical value

It is equivalent to the cost less a reasonable amount of depreciation written off. No notice is taken of any fluctuation in the price of the assets. Reason for this is that these assets are acquired for use in the business and not for resale.

6. Realisable value

A value which will be realised in the market and received from the sale of an asset is known as its realisable value.

7. Scrap value

A value which may be obtained from the asset if it is sold as scrap.

5.1.2 Distinction

Q3. What are the differences between verification and valuation of assets?

(OR)

Distinguish between verification and valuation.

Ans :

(July.-19)

S.No.	Verification	S.No.	Valuation
1.	Verification implies the process by which the auditor satisfies himself the accuracy of assets and liabilities appearing in balance sheet by actual inspection or otherwise.	1.	Valuation implies critical examination and testing of determined values of assets by auditor based on generally accepted conventions and accounting principles.
2.	Verification done by the auditor or his senior assistant.	2.	Valuation is done by the proprietors or officials of concerns.
3.	Auditor does himself the work of verification of assets.	3.	Auditor may seek the assistance and opinion of technicians if necessary.
4.	Verification is based on physical inspection as well as documentary evidence.	4.	Valuations very few direct evidences are available.
5.	The auditor is entirely responsible for the verification of assets.	5.	The auditor does not give any guarantee. An auditor is not value.
6.	Verification has a broader implication and in fact it includes valuation itself.	6.	Valuation is just a part of verification only.

Q4. What are the differences between vouching, verification and valuation.

Ans :

S.No.	Nature	Vouching	Verification	Valuation
1.	Objective	Vouching is concerned with examining documentary evidence evidence to ascertain the authenticity of entries in the books of accounts	Verification proves the existence, ownership and title of the owner of the assets.	Valuation certifies the correct value of the assets and liabilities at the date of Balance Sheet.
2.	Personnel	Vouching is done by the senior and audit staff and audit clerks.	Verification is done by the auditor himself or his associates.	Valuation is done by the owners or officers or expert valuers.
3.	Time Period	Vouching is done after the end of the of the transactions in the books of accounts	Verification is done at the entry of the financial year.	Valuation is done at the end at financial year.
4.	Basis/Evidence	Vouching is done as the basis of documentary evidence (Vouchers)	Verification is done on the basis of evidence such as title deeds, receipts or payments made etc.,	Valuation is done on the basis of certificates given by the owners or responsible officials of the concern.
5.	Responsibility	Auditor is held to be responsible if he is negligent while vouching the books of accounts.	Auditor is held to be responsible if he is negligent in verification of assets and liabilities.	Auditor is not responsible for improper valuation, as valuation is done by the owner or authorized valuers, which he has accepted as correct.

Q5. What are the differences between vouching and verification.*Ans :*

S.No.	Nature	Vouching	Verification
1.	Meaning	The act of examining the vouchers is known as vouching. A voucher is any documentary evidence in support of a transaction entered in the books of account.	Verification can be explained as establishing the truth or securing some kind of confirmation with respect to the assets and liabilities appearing in the Balance Sheet of a concern.
2.	Nature & Purpose	Vouching involves establishing the arithmetical accuracy and the authenticity of the transactions of a concern. Vouching proves that an asset ought to exist.	Verification goes beyond vouching. It seeks to establish that assets as stated in the Balance Sheet of a concern exist in fact and that the liabilities are properly disclosed. Verification proves that an asset does exist.
3.	Time	It is done during the whole year.	It is done at the end of the year.
4.	Utility	Certifies correctness of records.	Certifies correctness of assets and liabilities.
5.	Personnel	It is done by the junior staff of the auditor under the supervision of a senior person.	It is done by the auditor himself assisted by senior.

Q6. What are the objectives of verification of assets?*Ans :*

The main objectives of verification of assets are as follows:

1. Inspecting Arithmetical Accuracy

Verification of assets is carried out basically in order to ascertain the arithmetical accuracy of the assets and liabilities as shown in the books of accounts.

2. Determining the Existence of Assets

The major objective of verification is to ensure and determine the actual existence of assets at the date of the balance sheet.

3. Confirmation of Ownership

Verification aims at confirming the ownership of asset, that is, whether the ownership of the asset belongs to company or not and whether it has an absolute right to use such an asset or not.

4. Asset Valuation

Verification enables the company to check the asset valuation process through which they can find out whether the assets are being properly valued or not or are they undervalued or overvalued.

5. Knowledge of Fraud

Verification aims to provides knowledge about fraudulent transaction related to the assets and liabilities of the organisation.

6. Actual Position of Assets and Liabilities

Verification aims to provide detailed information about the current position of assets and liabilities. It also ensures that the assets are free from any charge or mortgage.

7. Financial Position

The main aim of verification is to find out the correct financial position of the business. The auditor needs to submit a report of verification stating the true and fair position of business.

Q7. Discuss the importance of verification and valuation of assets.

Ans :

Importance of Verification of Assets

'Verification of Assets' is an important responsibility of an auditor. The duty of auditor is not complete when he has checked all the entries in the books of accounts. The authentication of an entry under the date on which it is made, does not confirm the existence of the related asset at the date of the balance sheet. Similarly, it is not necessary that the value of such asset is same as on the date of original entry. The auditor is responsible to justify the existence of such asset and its value, as at the date of the balance sheet. Therefore, this requires the auditor to properly verify the assets.

The balance sheet and Profit and Loss account would be considered incorrect if the balance sheet has an asset that does not exist. The Companies Act has extended the duties of auditor under section 227 (4A). The Act states that the auditor should present some additional matters in his report such as verification of stock and fixed assets. The verification of these assets should be done with utmost care.

Importance of Valuation of Assets

An important responsibility of an auditor is to verify the original cost of asset and confirm that such valuation is reasonable and fair. There exist well-defined modes of valuation for determining the original cost.

Valuation of assets is carried out on a 'going concern' or a 'break up value' basis. In going concern method, one should find out and compute the cost of acquiring the related assets and the rate of depreciation which is to be provided. When a company decides to wind up, the break up value is taken into consideration.

In break-up value basis, assets are valued at their realizable value. Thus the determination of an asset's value is done differently in different ways.

Q8. Explain the techniques of verification.

Ans :

1. Inspection

It means physical inspection of the assets i.e. company cash in the cash box, physical inventory, inspection of shares certificates, documents etc. Inspection provides reliable audit evidence about the existence of the tangible assets inspected but not necessarily as to the ownership or value of such assets. It involves examining records, documents or tangible assets and provides audit evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal controls over their processing. Inspection also provides three major categories of documentary audit evidence, listed in ascending degree of reliability, viz:

- (a) Evidence created and held by the entity;
- (b) Evidence created by third parties and held by the entity; and
- (c) Evidence created and provided to auditors by third parties

2. Observation

The auditor may observe or witness the inspection of assets done by others. The auditor, by observation, looks at a procedure being performed by others, for example the auditors observe the counting of stock by the entity's staff or the performance of internal control procedures as part of the conduct of an audit.

3. Confirmation

It means obtaining written evidence from outside parties regarding existence of assets. Confirmation involves obtaining response to an enquiry to corroborate information previously made available to the auditors in the course of the audit. Examples of direct confirmation are as follows:

- (a) Confirmation of debts by communication with debtors;
- (b) Confirmation of legal cases by communication with the entity's solicitors; and
- (c) Confirmation of bank balances by communication with the entity's bankers.

5.2 VERIFICATION AND VALUATION OF VARIOUS ASSETS AND LIABILITIES

Q9. Explain the verification process of fixed assets to be adopted by the auditor.

(OR)

Explain the verification and valuation of various assets appearing in the balance sheet.

Ans : (July-21, Dec.-19, Dec.-18)

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

- (i) **Intangible assets**, viz., Goodwill, Patents, Trademarks, Copyright etc.
- (ii) **Fixed assets**, viz, Land and Building, Plant and Machinery, Furniture and fixtures, Motor vehicles etc.
- (iii) **Floating assets**, viz, Cash-in-hand and at Bank, Bills receivable, Stock-in-trade, Sundry debtors, Investment etc.
- (iv) **Fictitious assets**, viz., Preliminary expenses, Discount on Issue of shares or debentures etc.

1. Intangible Assets

(i) Goodwill

Goodwill is the value of reputation of the firm. It enables the firm to earn more than the normal rate of profit.

In the words of Prof. Dicksee, "When a man pays for goodwill, he pays for something which places him in the position of being able to earn more money than he would be able to do by his own unaided efforts.

- **Verification:** Where goodwill has been purchased along with a running business, the same should be verified from the agreement with the vendor showing the price paid for it. But when the amount is not specially fixed, goodwill is the amount for the purchase of the business over the net assets taken over.

It should be verified that the goodwill has been recorded in the books of accounts only when some consideration in money or its equal has been paid for. As required by AS-10 issued by the ICAI on fixed assets, goodwill be recorded in the books only when some consideration in money or money's worth has been paid for.

- **Valuation:** Goodwill should be valued at cost less amounts written off. It is no part of an auditor's duty to comment upon the price paid for goodwill even though he considers it to be excessive. The auditor must satisfy himself that the future benefits associated with goodwill do exist to justify the continuation of goodwill account. An auditor cannot insist on writing off the goodwill account, but if it appears to him that the future benefit is non-existent, he should insist on the account being written off.

(ii) Patents

A patent is an official document, which secures to an investor exclusive right for years to make, use or sell his invention.

- **Verification:** The auditor should examine the patents with the help of the certificate which have granted such patent rights. The auditor should also ensure that the patents are registered in the name of the client. Patent rights are acquired in the following two ways :
 - a) By Purchase
 - b) By Development and Research.
- **Valuation:** Patents must be valued at cost less depreciation. There may be the causes of depreciation, viz.

- a) Lapse of time,
- b) Obsolescence, and
- c) The patented article going out of fashion.

The patents should be written off in a period of sixteen years after which the right automatically lapses unless the term is extended. Where patents have been obtained in the name of some employee of the firm, auditor must see that it is properly assigned in favour of firm.

(iii) Copyright

A copyright is the exclusive legal right to produce or reproduce some kind of literary work. It is the legal protection provided to an author by which the publication of his work by other is prohibited. The period of copyright is for the life of the author and fifty years after his death.

- **Verification:** The procedure of verification of this item is more or less the same as that of patent rights. In verifying copyrights, auditor should inspect the agreement between the auditor and the publisher. If there are many copyrights with a business e.g. Kalyani Publishers, the auditor should call for a schedule thereof from the client and verify them from this schedule.
- **Valuation.** Generally the value of the copy right is not stable because copyrights lose their value by passage of time. If the sale of the publication is very low or nil, the copyright should be written off. In the balance-sheet copyright must be shown at cost less amounts written off from time-to-time.

(iv) Trade Marks

"A trade mark is a distinctive mark attached to goods offered for sale in the market so as to distinguish the same from similar goods and to identify them with a particular trader."

- **Verification:** Trade marks can be verified by examining the assignment deed duly endorsed by the office of the

Register of Trade Marks. Trade marks can be acquired like copyrights.

- **Valuation:** The valuation method is the most suitable method of valuation of trade marks. It should be seen that trade marks are properly valued and shown in the balance sheet.

2. Fixed Assets

(i) Land and building

Almost all the business or industrial undertakings own Land and Building as common premises. For verification and valuation purposes, auditor should distinguish between the freehold property and the leasehold property.

Freehold Land and Building

- **Verification:** The auditor should examine the title deeds to ensure that they are in the name of the client. The title deeds should cover all the land and buildings shown in the books of account. Any addition or sale, during the year should be carefully examined.
- **Mortgaged property:** If the property is mortgaged, auditor should obtain a certificate from the mortgagees or their solicitor to the effect that the title deeds are in their possession. Auditor should also make enquiry to find out that there is no second or subsequent mortgage.
- **Valuation of Freehold Land:** Freehold land, being a non-depreciable asset is generally shown at cost which includes the purchase-price, broker's commission, registration fees, legal charges etc. If payments have been made to the municipality, corporation or improvement trust for laying of water mains, sewers, roads etc., i.e. development charges these should also be included in the cost.
- **Valuation of Buildings:** Buildings should always be valued at cost less depreciation at a reasonable rate. Depreciation should be provided even

where the buildings have not been used during the year. Depreciation should always be provided in spite of the argument given by some people that the market or realisable value of buildings is far higher than the cost and therefore, a provision for depreciation may be dispensed with. Actually, the market or realisable value of buildings keep on fluctuating.

(ii) Plant and Machinery

- **Verification:** Auditor should commence the process of verification by obtaining a schedule of plant and machinery certified by some responsible officer of the concern. Verification of plant and machinery will become easy with the help of this schedule. Generally, in big manufacturing concerns, a Plant Register is maintained to keep a detailed record of plant and machinery such as

- a) Name and description of machine ;
- b) Number/code number allotted to the machinery for easy identification;
- c) Name of the supplier ;
- d) Location of plant;
- e) Date of installation ;
- f) Purchase price, cost of installation and other items of expenditure to be capitalised ;
- g) Expected life of the machinery ;
- h) Rate of depreciation and method thereof;
- i) Amount of depreciation;

- **Verification with regard to imported machinery:** In verifying the imported machinery, the auditor should look into the following :

- a) The agreement with the foreign supplier to note the terms and conditions on which the machinery has been supplied.

- b) The import licence covering the imported plant, should be verified.
- c) Copy of the invoice, documents relating to customs duty should be examined.

➤ **Valuation of Plant and Machinery.**

For valuing the plant and machinery, the auditor should prepare a list of each machine from the Plant Register and should get the list certified by the Works Manager.

The Auditor should see that Plant and Machinery Account is shown in the Balance Sheet at cost less depreciation after making proper adjustments regarding new purchases of machinery and sale of old machinery during the year under audit.

3. Floating Assets/Current Assets

(i) Cash-in-hand

- **Verification:** The auditor should verify the cash-in-hand by actually counting it on the date of the Balance Sheet. A fundamental aspect of the verification of cash-in-hand is the time *i.e.* when it should be verified. The verification should be made at the close of the business or on the date of the balance sheet. The auditor should insist upon the presence of a cashier to witness the counting.

(ii) Cash at Bank

In verifying the bank balance, the auditor should take the following steps.

- (a) **Comparison of the Balances as shown in the Cash Book and the Pass Book:** The auditor should compare the balances as shown in the Pass Book with the balance as shown in the Cash Book.

- (b) **Preparation of Bank Reconciliation Statement:** In order to ascertain the correct position with regard to the cheques issued by the organisation but not yet presented for payment or the

cheques deposited by the organisation but not yet cleared, the auditor should prepare a bank reconciliation statement. Many types of frauds can be detected with the help of Bank reconciliation statement.

(c) **Obtaining a letter of confirmation from the Bank:** It is possible that fictitious Pass Book may be presented to the auditor. In such a suspicious situation, he should obtain a letter of confirmation or a certificate directly from the Bank. In absence of this he can check accounts himself in the bank ledger.

(d) **Separate certificates for different Accounts should be obtained.** Auditor should obtain separate certificates for Fixed Deposit Account? Current Account, Saving Bank Account, etc. from the bank.

(e) In case there are accounts with more than one bank, the auditor should verify them individually.

(iii) Bills Receivable

Bills Receivable denote a broad category of formal documents of indebtedness including promissory notes and acceptance receivable.

Objectives of verification

Objectives of verification of Bills Receivable are:

- to establish the accuracy of amounts ;
- validity of the bills as claim ;
- their collectibility ; and
- a fair disclosure in the financial statements.

4. Fictitious Assets

(i) Preliminary Expenses

It is the amount spent on the creation and location of the company. Since this expenditure is of a capital nature, it is 'shown in the balance-sheet. This asset should be written off as early as possible. The auditor should verify that the balance of preliminary

expenses • ' hich has not been written off, is shown in the balance sheet under heading, Miscellaneous Expenditure."

ii) **Discount on Issue of Shares/Debentures**
Discount on issue of shares or debentures should be shown separately under the heading 'Discount on Issue of Shares or Debentures". Being a fictitious asset, it should be Written off as early as possible. The auditor should verify that the balance of Discount on Issue of Shares or Debentures' which has not been written off, is shown in the balance sheet.

Q10. Discuss the verification and valuation of liabilities.

Ans :

(Dec.-20)

Verification of liabilities is as important as the verification of assets. If liabilities 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 concern. Verification of liabilities 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 overstated or even deliberately omitted. He should obtain a certificate from some responsible official as to their correctness.

1. Capital

It is not a liability in the strict sense of the word. Nevertheless, 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 a 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.

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 the debentures and

that the limits, if any, has not been crossed.

- (ii) 'Debenture Trust Deed' should be inspected and with its help, the debenture account in the ledger should be examined.
- (iii) If necessary, the auditor can obtain a certificate from the debenture holders.
- (iv) Since debentures are supposed to be redeemed, the auditor should see the arrangements for their redemption.

3. Trade Creditors

- (i) The first task of the auditor is to ask for a schedule of the creditors. The schedule should be checked with the balance of ledger accounts and statements of account received from creditors.
- (ii) The purchase ledger should be checked with the books of original entry, invoices, credit notes etc.
- (iii) If the client maintains provision in respect of discount on creditors, he should check the same with reference to the creditors' account.
- (iv) He should see that all purchases during the year have been taken account of. Special care should be exercised with regard to the purchases made at the close of the year.

4. Bills Payable

These are acknowledgements of debts payable. Auditor should take following steps to verify this liability.

- (i) The auditor should obtain a list of outstanding obligations on account of bills payable. This should be checked with the Bills Payable Book and Bills Payable Account and any variation

between the two should be properly reconciled.

- (ii) With the permission of his client, the auditor should obtain confirmatory statements from the drawers directly.
- (iii) The bills paid after the Balance Sheet date should be verified with the entries passed in the Cash Book.

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 balances of the unpaid loans directly from the creditors of the company. In case the loans or overdrafts have been taken from a bank, an agreement with the bank and a certificate to that effect should be obtained and examined.

6. Outstanding 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.

7. Contingent Liabilities

Contingent liability is a liability which may or may not arise. According to Monogoinery, "the term contingent liability should be used in the accounting sense to designate a possible liability of presently determinable or undeterminable amount which arises from past circumstances or action which may or may not become a legal obligation in the future.

Examples of Contingent Liabilities :

- i) Liabilities on Bills Receivable discounted and not matured.
- ii) Liability under a guarantee.
- iii) Liabilities arising out of litigation in respect of trademarks, copyrights etc.

5.3 AUDIT COMMITTEE

Q11. Define Audit Committee. Explain its merits and demerits.

Ans : (July-21, Dec.-19, Dec.-18)

Meaning

An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management.

Most audit committees are made up of three to five or sometimes as many as seven directors who are not a part of company management.

The audit committee plays a critical role in providing oversight and serving as a check and balance on a company's financial reporting system. The committee provides independent review and oversight of a company's financial reporting processes, internal controls and independent auditors. It provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns.

By effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and that the outside auditors, through their own review, objectively assess the company's financial reporting practices.

Merits

1. It provides an internal reporting mechanism compared to reporting to the directors who may wish to hide or amend unfavorable internal audit.
2. Shareholder and public confidence in published financial information is enhanced because it has been reviewed by an independent committee.
3. Provides better communication between the directors, the external auditors and management.

Demerits

1. Fear that the purpose is to catch the management out.
2. Non-executive directors being overburdened with details.
3. Additional cost in terms of time involved.

5.3.1 Role of Audit Committee

Q12. Explain the role of audit committee.

Ans : (Dec.-20)

It is generally the role and responsibility of the audit committee to review with management and/or the independent auditor the following :

- Review the adequacy of this policy on an annual basis and obtain board approval of any revisions of this policy.
- Review the annual engagement letter, which includes the fee arrangement. In addition, pre-approve any non-audit services provided by the independent auditors, including tax services, before the services are rendered.
- Review the organization's significant accounting policies, practices and financial reporting controls and the adequacy of such controls.
- Review the organization's significant accounting and reporting principles, practices and procedures applied in preparing financial statements. In addition, discuss with the independent auditors their judgments about the quality of the organization's accounting principles used in financial reporting.
- Review the scope and general extent of the independent auditor's general audit, including the factors considered in determining the audit scope, including the major risk factors. The independent auditors should confirm to the committee that no limitations have been placed on the scope or nature of the audit procedures.

- Inquire as to the independence of the independent auditors and obtain from them, at least annually, a formal written statement delineating all relationships between the independent auditors and the organization, including other consulting work, if any, performed by the independent auditors for the organization.
- Review the results of the audit with the auditors and management, including:
 - The independent auditor's audit of the financial statements and their report.
 - Matters required to be discussed by Statement on Auditing Standards (SAS) No. 61, Communications with Audit Committees, as amended (AICPA, Professional Standards, vol 1, Au sec 380) related to the conduct of the audit.
 - Investigate and respond to serious disputes or difficulties arising from the audit, if any.
 - Once management has received and commented on the findings of a draft management recommendation letter, if any, from the auditors, it is the function of the audit committee to receive the final management letter and follow up with management on recommendations on how to better adhere to "best practices" from the auditors.
- Monitor the Association's compliance with legal and regulatory requirements.
- Review annually the Association's Standard of Conduct and Code of Ethics policy, if any, and insure that management has established a system to enforce this policy.

Q13. What are the functions and powers of audit committee?

Ans :

Functions

Under Section 292 (A) of Companies Act 1956, the audit committee which is in agreement with the terms of reference should be mentioned in

written form by the board. The following matters must be periodically discussed by the audit committee with the auditors,

1. Scope of audit including the monitoring of auditors.
2. Compliance of internal control system.
3. Internal control system.
4. The half-yearly and annual financial statements must be evaluated before submitting it to the board.

In order to investigate the issues relating to the items which are mentioned in this section, the audit committee should possess authority. In order to conduct such investigation, the audit committee should have accessibility to the information available in the company's records and to the suggestions of external professional if required.

Powers

The following points depicts the powers of audit committee,

1. The audit committee has power to obtain data from any staff member.
2. It has power to enquire about any activity which comes under its control limits.
3. If required the audit committee should keep record of the presence of outsiders who possess related knowledge.
4. It has power to acquire legal or other professional advice from outside the organization.

5.4 AUDIT REPORTS

Q14. What is an audit report? Explain the contents of a company audit report.

(OR)

What are the points to be included in audit report?

(OR)

What is audit report? Write a note on its contents.

Ans :

(Dec.-18, July-19)

Meaning

An auditor's Report is the format of result of all the effort that goes into the audit. Communicating the Auditor's findings to interested users is part of all audits. Thus, the Final phase of an Audit involves preparing that communication, which is known as auditor's report.

Definitions

(i) **According to Lancaster**, "Audit report is statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of full facts of subject matter of the report."

(ii) **According to J.C. Ray**, defines audit report as, "The report shall either contain an expression of opinion regarding the financial statements, taken as a whole or an assertion to the effect, then an opinion cannot be expressed. When an overall opinion cannot be expressed the reasons therefore should be stated".

It presents the results of the examination done by the auditor. An audit involves collection of evidence about the financial statements. The evidence collected needs to be carefully shifted and analyzed to enable the auditor to draw appropriate conclusions. The conclusions drawn are communicated to the interested parties through the auditor's report.

Contents

Under section 227 (2) every auditor is required to make report to the shareholders on the accountants examined by him and every balance sheet and profit and loss A/c and every document declared by law to be part of or annexed to the balance sheet and profit or loss A/C which are placed before the shareholders of the company at the general meeting during tenure of his office. The report has to state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accountants give the information required by the Companies Act in manner so required and give a true and fair view.

(i) In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

(ii) In the case of profit and loss account, of the profit or loss account for its financial year.

Sub-section(iii) of the section 227 required that the auditor's report shall also state.

(a) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;

(b) Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of these books, and proper returns adequate for the purposes of his audits have been received from the branches not visited by him .

(c) Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

(d) Whether the company's balance sheet and profit and loss A/C dealt with by the report are in agreement with the books of accounts and returns.

If any of the matters as referred to in section 227 (2) and (3) is answered in the negative or with the qualification the auditor has to state in his report the reasons for such answer.

The Auditor's report shall also include a statement on such additional matters as specified by the Central Government under section 227 (4-A) of the Companies Act, This section empowers the Central Government to order the inclusion of certain matters in the auditor's report.

The Institute of Chartered Accountants of India requires the auditor's to ensure that the accounting standards are implemented in the presentation of financial statements covered by their audit reports. The deviation should be reported in the report.

Q15. What are the elements of a good audit report?*Ans. :* (Dec.-19)**(a) Title**

The auditor's report should have an appropriate title. It may be appropriate to use the term "Auditor's Report" in the title to distinguish the auditor's report from reports that might be issued by others, such as by the officers of the entity, the board of directors, or from the reports of others.

(b) Addressee

The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the auditor's report is addressed to the authority appointing the auditor.

(c) Opening or Introductory Paragraph

The auditor's report should identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements. The report should include a statement that the financial statements are the responsibility of the entity's management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on an audit.

(d) Scope Paragraph

The auditor should describe the scope of the audit by stating that the audit was conducted in accordance with auditing standards generally accepted in India. The reader needs this as an assurance that the audit has been carried out in accordance with established standards. The auditing and assurance standards issued by the Institute of chartered Accountants of India establish the auditing standards generally accepted in India.

(e) Opinion Paragraph

The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial

statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and where appropriate, whether the financial statements comply with the statutory requirements.

(f) Date of Report

The date of an auditor's report on the financial statement is the date on which the auditor signs the report expressing an opinion on the financial statements. The date of report informs the reader that the auditor has considered the effect on the financial statements and on the report of the events and transactions of which the auditor became aware and that occurred up to that date.

(g) Place of Signature

The report should name specific location which is ordinarily the city where the audit report is signed.

(h) Auditor's Signature

The report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report should be signed in the personal name of the auditor and in the name of the audit firm. The proprietor signing the audit report should also mention the membership number assigned by the Institute of chartered Accountants of India.

Q16. Explain the essential characteristics of a good audit report.**(OR)****Explain the qualities of a good audit report.***Ans. :* (Dec.-18)**1. Simplicity**

Simplicity is one of the most vital characteristics of a good audit report. The audit report must be simple and clear and must be easily understandable in nature. Therefore, confusing terms and facts must not be used.

2. Clarity

Clarity refers to clearness in the audit report. This implies that the audit report must not show/highlight any material information which is needed for assessment and performance appraisal of the organisation.

3. Brevity

Brevity refers to the conciseness in the audit report. For the purpose of maintaining length of the audit report, repetition of facts and figures must be prevented.

4. Firmness

The audit report must very clearly explain the scope of work which is to be carried out and must also show whether the books of accounts present a 'true and fair' view of the financial position of the organisation.

5. Objectivity

The audit report must be prepared by taking into account the objective evidence. The opinions which are made using the information and evidence and which are not quantified in terms of money must not be included in the audit report.

6. Consistency

Consistency in preparing the accounting information acts as a strong base of a good audit report. A good audit report must ensure that the stock valuation methods and depreciation method are following consistency.

Q17. What are the items to be included in audit reports?

Ans :

1. Fixed Assets:

The auditor's report shall include statements on the following matters:

- (a) Whether the company is maintaining the proper records showing particulars, including quantitative details and situations of fixed assets.

- (b) Whether these assets have been physically verified by the management at reasonable intervals, whether any material discrepancies were noticed on such verification, and if so whether the same have been properly dealt within the books of accounts.

- (c) If a substantial part of fixed assets has been disposed off during the year, Whether it has affected the going concern.

2. Inventories

The auditor has to make the following three specific statements on verification and valuation of inventories:

- (a) Whether the physical verification of inventory has been conducted at reasonable intervals by the management.

- (b) Are the procedures of physical verification of inventories followed by management reasonable and adequate in relation to the size of the company and the nature of its business? If not the inadequacies in such procedures should be reported.

- (c) Whether the company is maintaining proper records of inventory and whether any material discrepancies have been noticed on physical verification and if so, whether the same have been properly dealt in within the books of account.

3. Loans taken from/granted to parties covered under section 189

The auditor has to make four specific statements as under.

Has the company either granted or taken any loan, secured or unsecured to/from companies, firms or other parties covered in the register maintained under section 189 of the Act. If so give the number of parties and amount involved in the transactions.

- (a) Whether rate of interest and other terms and conditions of loans given or taken

by the company, secured or unsecured are prima facie prejudicial to the interest of the company

- (b) Whether the payment of principal amount and interest are also irregular
- (c) If overdue amount is more than 1 lakh, whether reasonable steps have been taken by the company for recovery/payment of principal and interest.

4. Internal control on purchase of assets and sale of goods

The auditor has to commit on the following:

Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business for the purchase of inventory and fixed assets and for the sale of goods?

Whether there is continuing failure to correct major weaknesses in internal control.

5. Maintenance of Cost Record

Whether the maintenance of cost records has been prescribed by the central government u/s 128 of the Act, Whether such accounts and records have been made and maintained.

6. Indication of sickness

Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year for not less than 50% of its net worth and whether it has incurred cash losses in such financial year immediately preceding in such financial year also.

7. Documents and records for Secured loans:

Whether adequate documents and records are maintained in case where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities? If not, the deficiency to be pointed out.

8. Guarantees for loans taken by other

Whether the company has given any guarantee for loans taken by others from bank

or financial institutions, the Terms and conditions whereof are prejudicial to the interest of the company.

9. Disclosure of end use of money raised from public issue

Whether the management has disclosed on the end use of money raised by public issue and the same has been verified.

10. Fraud

Whether the fraud on or by the company has been noticed or reported during the year if yes the nature and the amount involved to be indicated.

Q18. Explain the preparation of audit report.

Ans :

There are different types of audit reports, each has its own specific requirements. However, the common steps involved in preparing an audit report are as follows,

Step 1: Preliminary Meeting with Client

Firstly, the auditor should meet the client and discuss the various steps that are required to be taken to complete the audit reporting process.

Step 2: Obtaining an Accurate and Complete Organization Chart

For reporting purpose, it is essential to obtain an accurate and complete organization chart. This to understand clearly the working process of a business.

Step 3: Preparing a Chart

A chart should be prepared that demonstrates the details of the company such as industry conditions and operating features of purchases, revenue, inventory and payroll transactions.

Step 4: Establishing the Key Areas

After making initial research of the company and the client meeting, the auditor is required to consider the key areas in the audit. Documentation is not required here.

Step 5: Setting Start and Completion Dates With the Client

The auditor should carefully choose the start and completion dates with the client.

Step 6: Submitting the Engagement Letter

The engagement letter is required to be submitted with all the terms and conditions of the project.

Step 7: Business Financial Analysis

When a preliminary financial analysis is conducted, many flaws are discovered and several issues are detected. Therefore, a financial analysis of a business should be carried out thoroughly.

Step 8: Reviewing Systems and Internal Control

The company uses internal control mechanism to report on its own financial activities. Good systems reduce auditor's work and saves the audit fees of the client. In contrast to this, poor systems may result in many discrepancies and more chances of financial fraud.

Step 9: Reviewing of Control Environment

It is essential to check whether the management comply with the internal control systems that facilitates in the operation of business.

Step 10: Reviewing the Procedures for Prevention of Fraud

The auditor should adopt the essential procedures to prevent the manipulation of numbers to protect the company and its shareholders from any kind of damage.

Step 11: Assessment of Risk

By considering the above reviews, the "risk assessment" is carried out to know the major areas of audit which require more attention. In case of negligence in captain areas of system, additional steps should be taken.

Step 12: Review of Board of Directors

For a particular year, the review of Board of Directors is carried out and the emphasis is

laid on all the financial items and decisions taken in a year.

Step 13: Review of Financial Events

It is important to review the vital financial events subsequent to the financial year. The information of this review must be forwarded to the reader of financial statements, although they occurred after the time period being audited.

Step 14: Identifying the Specific Areas of Attention

After conducting the preliminary financial analysis, the specific areas that need special attention should be taken into consideration. The various irregularities must be identified and it should be checked that whether the accounting department should take an additional step for the audit or not.

Q19. Explain the kinds of audit reports.

(OR)

What are the different types of audit reports.

(OR)

State the various types of audit reports.

Ans :

(July-21, Dec.-20)

1. Fair Report

Fair report is also called as clean report. When the auditor gets completely satisfied about the fact that the financial statements i.e., profit and loss account and balance sheet presents a true and fair view of the company and that the company is following the accounting principles and statutory requirements, then in such a case, he would give an unqualified or clean report or fair report.

Therefore, when an auditor prepares a statement stating that in his opinion and to the best of his knowledge and as per the explanations given to him, the financial statement i.e., the balance sheet and profit and loss account presents a true and fair view of the business operations, then it is an unqualified or fair or clean report.

An auditor giving an unqualified opinion must not make any reference to particular aspects

of the financial statements in the report's body, because the same might be misinterpreted as a qualification. Moreover, in few cases, the report reader would understand in a better way, the financial statements if his attention is laid on vital issues like unusual events, accounting policies and so on.

2. Qualified Audit Report

Qualified Audit report refers to the report which is given by the auditor when he/she opines that the balance sheet does not present a true and fair view of the company's state of affairs or the profit and loss account does not present a true and fair view of the profit or loss for the year. The situations which make the auditors to give qualified report must be 'material' i.e., if in case any material requirement of Act or accounting standards break the law, then in such a case the auditor must give a qualified report.

In case, when an auditor gives a qualified report, he/she should decide the following,

- (i) As to which particular issue their reservations are applied.
- (ii) Whether the auditor firmly disagrees or whether he/she does not have proper proof to make a decision with respect to material items on accounts.
- (iii) Whether in any of the cases, the queries are so material that they influence the presentation of a true and fair view.

3. Piecemeal Report

The auditor may not give the opinion on the whole financial statements. His opinion may be related to few items that are contained in the statements on which he can satisfactorily give an opinion after audit. This opinion of auditor given on the financial statements is called as piecemeal opinion and the auditor's report having such opinion is called as piecemeal report.

4. Disclaimer of Opinion

The situation where an auditor is unable to express his opinion due to some reason in his report, then this report is treated as a disclaimer of opinion. Justified facts are to be incorporated in a disclaimer opinion. In some situations, client is unable to provide

the complete accounts information due to incomplete pending accounts negligence. When the auditor audits such work, it seems to be inconclusive, such report by the auditors is called a report with disclaimer. This report is presented when the auditor do not have sufficient information required to form an opinion.

5. Adverse Report

An adverse report is a negative report which is issued by an auditor in case when he is not satisfied with the overall financial performance of the concern which is presented to him. Usually, the financial statements of any concern must satisfy the Generally Accepted Accounting Principles (GAAP) and standards of India. Financial statements of any concern if in case does not satisfy the generally accepted accounting principles and standards, then the auditor has a right to issue adverse report for such financial statements.

Practically, adverse reports are issued very rarely when compared to the qualified report.

Short Question and Answers

1. Fair Reports

Ans :

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Ans :

It is generally the role and responsibility of the audit committee to review with management and/or the independent auditor the following :

- Review the adequacy of this policy on an annual basis and obtain board approval of any revisions of this policy.
- Review the annual engagement letter, which includes the fee arrangement. In addition, pre-approve any non-audit services provided by the independent auditors, including tax services, before the services are rendered.
- Review the organization's significant accounting policies, practices and financial reporting controls and the adequacy of such controls.
- Review the organization's significant accounting and reporting principles, practices and procedures applied in preparing financial statements. In addition, discuss with the independent auditors their judgments about the quality of the organization's accounting principles used in financial reporting.

- Review the scope and general extent of the independent auditor's general audit, including the factors considered in determining the audit scope, including the major risk factors. The independent auditors should confirm to the committee that no limitations have been placed on the scope or nature of the audit procedures.

4. Auditing Reports

Ans :

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An auditor's Report is the format of result of all the effort that goes into the audit. Communicating the Auditor's findings to interested users is part of all audits. Thus, the Final phase of an Audit involves preparing that communication, which is known as auditor's report.

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5. Qualified Audit Report.

Ans :

Qualified Audit report refers to the report which is given by the auditor when he/she opines that the balance sheet does not present a true and fair view of the company's state of affairs or the profit and loss account does not present a true and fair view of the profit or loss for the year. The situations which make the auditors to give qualified report must be 'material' i.e., if in case any material requirement of Act or accounting standards break the law, then in such a case the auditor must give a qualified report.

In case, when an auditor gives a qualified report, he/she should decide the following,

- (i) As to which particular issue their reservations are applied.
- (ii) Whether the auditor firmly disagrees or whether he/she does not have proper proof to make a decision with respect to material items on accounts.
- (iii) Whether in any of the cases, the queries are so material that they influence the presentation of a true and fair view.

6. Verification

Ans :

After a thorough examination of the books of accounts pertaining to their correctness and authenticity of the transactions recorded in them, the auditor should start verification of the assets and liabilities appearing in the balance sheet. In order to do this, he should first satisfy himself about the actual existence of assets and liabilities because the record of the assets and liabilities as appearing in the balance sheet may not be correct. In case the balance sheet shows an asset which in fact does not exist or which is stated at a value different from what is considered reasonable, both the balance sheet and the connected profit and loss account would be incorrect. It is often seen that assets are purchased and properly recorded in the books of accounts, but subsequently they might have been disposed off, destroyed, pledged or misappropriated and no entry had been made to record this fact in the books of account before the closing of these books. It

means that the actual position of assets is different from what has been shown in the balance sheet.

Meaning

To verify means to establish whether the actual facts or details are in agreement with those that are asserted. One of the important duties of an auditor during the course of audit is to verify the assets and liabilities appearing in the Balance Sheet. The auditor has not only to examine the arithmetical accuracy of the transactions, but he has to also see that the various items appearing in the Balance Sheet are in the possession of the concern.

The Objectives of verification are achieved by proper combination of compliance and substantive audit procedures. Therefore, an auditor has to keep in mind the following points while verifying the assets

- (i) To ensure that assets are in existence at the date of the balance sheet and they belong to the client.
- (ii) To satisfy that assets have been acquired for the business and are clearly stated in the balance sheet.
- (iii) To satisfy himself that the assets are properly valued for the purpose of the balance sheet.
- (iv) To verify that assets are free from any charge, lien or encumbrances, and
- (v) To satisfy himself that the assets are in the possession of the client or in the custody of the persons authorized by him.

7. Valuation

Ans :

The fact has been established that the verification of assets also includes their proper valuation. The correct valuation of assets and liabilities is very important because the accuracy of the balance sheet of any concern also depends on it. At the same time, the correct profit or loss cannot be calculated unless assets are properly valued.

Valuation is not merely the determination of the values of the assets as appearing in that balance sheet but is also a critical examination of these values on the basis of normally accepted accounting standards.

Thus, the valuation of the assets should be done by a responsible officer of the concern and the duty of the auditor is to see whether they have been properly valued or not. But a more pertinent question is that how can he find out at what value should these assets appear in the balance sheet. For this purpose, he should obtain the certificates of professional and approved valuers and other competent persons. He can always rely upon these certificates and should also mention this fact in his audit report. He cannot work as a valuer because he does not possess the technical knowledge to find out the value of the assets. At the same time the valuation and its basis will differ according to the type of the assets and the purpose for which they are held.

8. Explain the methods of valuation.

Ans :

1. Cost price

The price which is paid for acquisition of an asset is known as its cost price; of course the expenses incurred in the purchase of an asset and its installation are included in its cost price.

2. Market value

A value which an asset can fetch in the market when sold is known or termed as market value.

3. Replacement value

It is a price at which a particular asset can be replaced. The expenses such as commission, freight etc. are also included in such a value.

4. Book value

A value at which an asset appears in the books of accounts is known as its book value. It is usually the cost less depreciation written off so far.

5. Going concern value or Conventional value or Token value or Historical value

It is equivalent to the cost less a reasonable amount of depreciation written off. No notice is taken of any fluctuation in the price of the assets. Reason for this is that these assets are acquired for use in the business and not for resale.

9. Explain the techniques of verification.*Ans :***1. Inspection**

It means physical inspection of the assets i.e. company cash in the cash box, physical inventory, inspection of shares certificates, documents etc. Inspection provides reliable audit evidence about the existence of the tangible assets inspected but not necessarily as to the ownership or value of such assets. It involves examining records, documents or tangible assets and provides audit evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal controls over their processing. Inspection also provides three major categories of documentary audit evidence, listed in ascending degree of reliability, viz:

- (a) Evidence created and held by the entity;
- (b) Evidence created by third parties and held by the entity; and
- (c) Evidence created and provided to auditors by third parties

2. Observation

The auditor may observe or witness the inspection of assets done by others. The auditor, by observation, looks at a procedure being performed by others, for example the auditors observe the counting of stock by the entity's staff or the performance of internal control procedures as part of the conduct of an audit.

10. Powers of audit committee?*Ans :*

The following points depicts the powers of audit committee,

1. The audit committee has power to obtain data from any staff member.
2. It has power to enquire about any activity which comes under its control limits.

3. If required the audit committee should keep record of the presence of outsiders who possess related knowledge.

4. It has power to acquire legal or other professional advice from outside the organization.

11. Adverse Report*Ans :*

An adverse report is a negative report which is issued by an auditor in case when he is not satisfied with the overall financial performance of the concern which is presented to him. Usually, the financial statements of any concern must satisfy the Generally Accepted Accounting Principles (GAAP) and standards of India. Financial statements of any concern if in case does not satisfy the generally accepted accounting principles and standards, then the auditor has a right to issue adverse report for such financial statements.

Practically, adverse reports are issued very rarely when compared to the qualified report.

Choose the Correct Answers

1. The audit report should indicate the _____ or practice followed in conducting the audit. [b]
(a) Accounting standards (b) Auditing standard
(c) Auditing guidelines (d) Accounting policies
2. The audit report should be signed in the name of the – [c]
(a) Audit firm (b) Personal name
(c) Either ((a) or ((b) (d) None of the above
3. The date on auditor's report should not be: [d]
(a) The date of AGM
(b) later than the date on which the accounts are approved in boards's meet.
(c) earlier than the date on which the accounts are approved by the management
(d) Both ((a) and ((b)
4. The financial statement include- [d]
(a) Trading profit and loss accounts, balance sheet
(b) Statement of changes in financial position
(c) Cash flow statements
(d) All of the above
5. Accounts maintenance is the function of; [b]
(a) Auditor (b) Accountant
(c) Auditor staff (d) Practicing professionals.
6. Balance sheet audit does not include- [d]
(a) Vouching of income, expense, accounts related to assets and liabilities
(b) Examination of adjusting and closing enthes
(c) Verification of assets and liabilities
(d) Routine check

7. Primary responsibility for the adequacy of financial statement disclosures rest with the _____. [b]
- (a) Auditor (b) Management
(c) Auditor's Staff (d) Central Government
8. _____ is prepared at a regular intervals on the working of a section [a]
- (a) periodical report (b) performance report
(c) inspection report (d) progress report
9. _____ gives information about a task which is the process of being completed [d]
- (a) periodical report (b) performance report
(c) inspection report (d) progress report
10. _____ means providing true or confirmation of truth, these confirmation may be by competent examination. [a]
- (a) Verification (b) valuation
(c) both (d) none

Fill in the Blanks

1. _____ implies the critical examination and testing of determined values of assets by the auditor.
2. _____ price which is paid for acquisition of an asset
3. _____ value which will be realised in the market and received from the sale of an asset.
4. _____ is the value of reputation of the firm.
5. A _____ is the exclusive legal right to produce or reproduce some kind of literary work.
6. An _____ is a selected number of members of a company's board of directors whose responsibilities are included.
7. The _____ should contain a clear written expression of opinion on the financial statements taken as a whole.
8. _____ is the end product of every audit.
9. _____ liabilities which are expected to be settling with in a short period of time.
10. Copyright is an _____ asset.

ANSWERS

1. Valuation
2. Cost
3. Realisable
4. Goodwill
5. Copyright
6. Audit committee
7. Audit report
8. Audit report
9. Short term
10. Intangible

One Mark Answers

1. Verification

Ans :

To verify means to establish whether the actual facts or details are in agreement with those that are asserted. One of the important duties of an auditor during the course of audit is to verify the assets and liabilities appearing in the Balance Sheet.

2. Valuation.

Ans :

The fact has been established that the verification of assets also includes their proper valuation. The correct valuation of assets and liabilities is very important because the accuracy of the balance sheet of any concern also depends on it.

3. How often a meeting should be conducted in Audit Committee?

Ans :

The meeting of the audit committee should be conducted atleast 4 times in a year but there should not be more than four months gap between two meeting.

3. Define Fair Report.

Ans :

Fair audit report is also called as clean report. When an auditor gets completely satisfied about the fact that the financial statements i.e., profit and loss account and balance sheet presents a 'true and fair' view of the company and that the company is following the accounting principles and statutory requirements, then in such a case an auditor would give an unqualified or clean report or fair report.

4. What is the objective of Verification?

Ans :

The main objective of verification is to determine the correctness and accuracy in the value of assets and liabilities as being disclosed by the balance sheet.

5. What is Patent?

Ans :

An official document that grants exclusive rights to make use or sell an invention to the inventor is known as patent.

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
July - 2021
(Only for General)
AUDITING

Time: 2 Hours

Max. Marks: 80

PART – A (4 × 5 = 20 Marks)

Note: Answer any **FOUR** of the following questions.

- | | <u>ANSWERS</u> |
|---------------------|-----------------------|
| 1. Statutory Audit. | (Unit-I, SQA.15) |
| 2. Auditing. | (Unit-I, SQA.1) |
| 3. Audit Programme. | (Unit-II, SQA.1) |
| 4. Audit Note Book. | (Unit-II, SQA.2) |
| 5. Internal Check. | (Unit-III, SQA.1) |
| 6. Vouching. | (Unit-IV, SQA.1) |
| 7. Audit Committee. | (Unit-V, SQA.2) |
| 8. Clean Report. | (Unit-V, SQA.1) |

PART – B (4 × 15 = 60 Marks)

Note: Answer any **FOUR** questions.

- | | |
|--|---------------------|
| 9. Define Auditing. Explain the importance of Auditing. | (Unit-I, Q.No.1,5) |
| 10. Explain the procedure followed by AASB to issue Audit Standards. | (Unit-I, Q.No.22) |
| 11. What are the qualities of a Good Auditor? | (Unit-II, Q.No.5) |
| 12. What are the rights and duties of an Auditor? | (Unit-II, Q.No.8) |
| 13. Explain the differences between Internal Control and Internal Check. | (Unit-III, Q.No.22) |
| 14. Explain the objectives of Internal Control. | (Unit-III, Q.No.2) |
| 15. What is Vouching. Explain the objectives of Vouching. | (Unit-IV, Q.No.1,2) |
| 16. Explain the process of Vouching Trade transactions. | (Unit-IV, Q.No.8) |
| 17. Explain various types of Audit Reports. | (Unit-V, Q.No.19) |
| 18. Explain the verification process of Fixed Assets to be adopted by the Auditor. | (Unit-V, Q.No.9) |

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
November / December - 2020
AUDITING

Time: 2 Hours

Max. Marks: 80

PART – A (4 × 5 = 20 Marks)

Note: Answer any **FOUR** of the following questions.

ANSWERS

- | | |
|----------------------------|--------------------|
| 1. Balance Sheet Audit | (Unit-I, SQA.2) |
| 2. Audit Note Book | (Unit-II, SQA.2) |
| 3. Test Checking | (Unit-III, SQA.12) |
| 4. EDP | (Unit-IV, SQA.2) |
| 5. Role of Audit Committee | (Unit-V, SQA.3) |
| 6. Fair Audit Report | (Unit-V, SQA.1) |
| 7. Routine Checking | (Unit-IV, SQA.6) |
| 8. Importance of Audit | (Unit-I, SQA.3) |

PART – B (4 × 15 = 60 Marks)

Note: Answer any **FOUR** questions.

- | | |
|--|----------------------|
| 9. What do you understand by Auditing? Explain the various types of Audit. | (Unit-I, Q.No. 1,10) |
| 10. What are the objectives and functions of AASB? | (Unit-I, Q.No.23) |
| 11. Discuss the provisions of Companies Act regarding qualification and disqualifications of an Auditor. | (Unit-II, Q.No.4) |
| 12. What are the steps required by an Auditor before the commencement of audit in an organization? | (Unit-II, Q.No.13) |
| 13. Define Internal Audit. State the objectives of Internal Audit. | (Unit-III, Q.No.14) |
| 14. Describe a suitable Internal Check System for Purchases and Sales. | (Unit-III, Q.No.10) |
| 15. Write the note on the following: | |
| i) Outstanding Liabilities | |
| ii) Contingent liabilities | (Unit-V, Q.No.10) |
| 16. Discuss briefly about auditing in an EDP Environment. | (Unit-IV, Q.No.13) |
| 17. What are the differences between verification and valuation of Assets? | (Unit-V, Q.No.3) |
| 18. State the various types of Audit Reports. | (Unit-V, Q.No.19) |

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
November / December - 2019
AUDITING

Time: 3 Hours

Max. Marks: 80

PART - A (5 × 4 = 20 Marks)

Note: Answer any **FIVE** of the following questions.

ANSWERS

- | | |
|---------------------------|-------------------|
| 1. Government Audit | (Unit-I, SQA.5) |
| 2. Audit Program | (Unit-II, SQA.1) |
| 3. Internal Audit | (Unit-III, SQA.3) |
| 4. Importance of Vouching | (Unit-IV, SQA.4) |
| 5. Audit Committee | (Unit-V, SQA.2) |
| 6. Qualified Report | (Unit-V, SQA.5) |
| 7. Auditor's Lien | (Unit-II, SQA.6) |
| 8. Statutory Audit. | (Unit-I, SQA.15) |

PART - B (5 × 12 = 60 Marks)

Note: Answer **ALL** the questions.

- | | |
|---|---------------------|
| 9. (a) Define Auditing, What are the differences between Auditing and Accountancy? | (Unit-I, Q.No.1,9) |
| OR | |
| (b) Explain the objectives and importance of Auditing. | (Unit-I, Q.No.4,5) |
| 10. (a) State the provisions of Companies Act 2013 regarding appointment of the Auditors. | (Unit-II, Q.No.3) |
| OR | |
| (b) Discuss the various categories of liabilities of a Company Auditor in brief. | (Unit-II, Q.No.10) |
| 11. (a) What are the differences between External Audit and Internal Audit? | (Unit-III, Q.No.18) |
| OR | |
| (b) Describe a system of internal Check in respect of Wage Payments suitable for a large manufacturing concern. | (Unit-III, Q.No.11) |

12. (a) Define Vouching. What are the points an auditor should look into when examining vouchers?

(Unit-IV, Q.No.1,12)

OR

- (b) Explain the various problems of EDP Environment.

(Unit-IV, Q.No.14)

13. (a) What are the various elements of Audit Report?

(Unit-V, Q.No.15)

OR

- (b) State the various methods of Valuation.

(Unit-V, Q.No.2)

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
June / July - 2019
AUDITING

Time: 3 Hours

Max. Marks: 80

PART - A (5 × 4 = 20 Marks)

Note: Answer any **FIVE** of the following questions not exceeding 20 lines each.

ANSWERS

- | | |
|--------------------------------|-------------------|
| 1. What is Auditing? | (Unit-I, SQA.1) |
| 2. What is Continuous Audit? | (Unit-I, SQA.4) |
| 3. Internal Control | (Unit-III, SQA.2) |
| 4. Auditing in EDP Environment | (Unit-IV, SQA.2) |
| 5. What is Audit Planning? | (Unit-II, SQA.7) |
| 6. Internal Check | (Unit-III, SQA.1) |
| 7. Vouching | (Unit-IV, SQA.1) |
| 8. Audit Report. | (Unit-V, SQA.4) |

PART - B (5 × 12 = 60 Marks)

Note: Answer the following questions not exceeding four pages each.

9. (a) How did auditing evolve? Explain the procedure for issue of standards by AASB. (Unit-I, Q.No.3,22)
- OR
- (b) Define Auditing. Explain the objectives of Auditing. (Unit-I, Q.No.1,4)
10. (a) State the qualifications and disqualifications of company auditor. (Unit-II, Q.No.4)
- OR
- (b) Define Audit Programme. What are its merits and demerits? Explain. (Unit-II, Q.No.15)
11. (a) What do you mean by the term Internal Control? Discuss about its objectives. (Unit-III, Q.No.1,2)

OR

(b) Explain the differences between Internal Check and Internal Audit. **(Unit-III, Q.No. 19)**

12. (a) What is Vouching? Explain its importance and write about types of vouchers. **(Unit-IV, Q.No.1,3,6)**

OR

(b) What is vouching of cash transaction? What are the points which need to be verified by the auditor while vouching the cash receipts and payments? **(Unit-IV, Q.No.10)**

13. (a) What do you mean by Verification? Distinguish between Verification and Valuation. **(Unit-V, Q.No.1,3)**

OR

(b) What is an Audit Report? Explain the contents of a Company Audit Report. **(Unit-V, Q.No.14)**

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Common Paper for General/Computers/Computer Applications/
Foreign Trade and Tax Procedure Courses)
November / December - 2018
AUDITING

Time: 3 Hours

Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any **FIVE** of the following questions.

ANSWERS

- | | |
|---------------------------------|-------------------|
| 1. What is Continuous Audit? | (Unit-I, SQA.4) |
| 2. What is Auditing? | (Unit-I, SQA.1) |
| 3. Internal Check | (Unit-III, SQA.1) |
| 4. What is an Audit Note Book? | (Unit-II, SQA.2) |
| 5. Internal Control | (Unit-III, SQA.2) |
| 6. Objectives of Vouching | (Unit-IV, SQA.3) |
| 7. Civil Liabilities of Auditor | (Unit-II, SQA.14) |
| 8. Audit Report. | (Unit-V, SQA.4) |

PART – B (5 × 12 = 60 Marks)

Note: Answer **ALL** the questions.

- | | |
|---|---------------------|
| 9. (a) What is Auditing? Explain the objective of Auditing. | (Unit-I, Q.No.1,4) |
| OR | |
| (b) What is Continuous Audit? State its advantages. | (Unit-I, Q.No.14) |
| 10. (a) What are the rights and duties of an auditor? | (Unit-II, Q.No.8) |
| OR | |
| (b) What is an Audit Note Book? Explain the contents of an Audit Note Book. | (Unit-II, Q.No.16) |
| 11. (a) List out the advantages and disadvantages of Internal Control. | (Unit-III, Q.No.3) |
| OR | |
| (b) Bring out the differences between Internal Control and Internal Audit. | (Unit-III, Q.No.21) |

12. (a) What is meant by routine checking? Distinguish between vouching and routine checking. (Unit-IV, Q.No.4)

OR

- (b) What is Vouching? Explain the precautions to be taken by an auditor while vouching, trading transactions. (Unit-IV, Q.No.1,9)
13. (a) Define Valuation. Explain the verification and valuation of various assets appearing in the balance sheet. (Unit-V, Q.No.1,9)

OR

- (b) Explain the contents of an Audit Report. (Unit-V, Q.No.14)

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Regular Examination
November / December - 2018
AUDITING

Time: 3 Hours

Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer all the following questions.

ANSWERS

- | | |
|------------------------------------|-------------------|
| 1. Importance of Audit | (Unit-I, SQA.3) |
| 2. Audit Programme | (Unit-II, SQA.1) |
| 3. Internal Control | (Unit-III, SQA.2) |
| 4. Vouching of Trading Transaction | (Unit-IV, SQA.5) |
| 5. Audit Committee. | (Unit-V, SQA.2) |

PART – B (5 × 12 = 60 Marks)

Note: Answer all the following questions.

- | | |
|---|------------------------|
| 6. (a) Explain the meaning and objectives of Audit. | (Unit-I, Q.No.1,4) |
| OR | |
| (b) Explain the various types of audits and standards of audit in detail. | (Unit-I, Q.No.10,21) |
| 7. (a) Explain the appointment, qualification and disqualification of auditors. | (Unit-II, Q.No.3,4) |
| OR | |
| (b) Describe the civil and criminal liabilities of an auditor. | (Unit-II, Q.No.10) |
| 8. (a) Describe the meaning and objectives of Internal Control. | (Unit-III, Q.No.1,2) |
| OR | |
| (b) Explain the similarities and differences between Internal Check and Internal Audit. | (Unit-III, Q.No.19,20) |
| 9. (a) Explain the meaning and objectives of Vouchers. Explain the various types of vouchers, | (Unit-IV, Q.No.1,2,6) |
| OR | |
| (b) Write about vouching of cash transactions in detail. | (Unit-IV, Q.No.10) |

10. (a) Explain the methods of verifications of fixed assets. **(Unit-V, Q.No.9)**

OR

(b) What is a Audit Report? Explain the qualities of a good audit report. **(Unit-V, Q.No.14,16)**

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
Model Paper - I
AUDITING

Time: 2 Hours

Max. Marks: 80

PART – A (4 × 5 = 20 Marks)

Note: Answer any **FOUR** of the following questions.

ANSWERS

- | | |
|----------------------------|-------------------|
| 1. Define Auditing. | (Unit-I, SQA. 1) |
| 2. Statutory audit. | (Unit-I, SQA. 15) |
| 3. Define audit programme. | (Unit-II, SQA.1) |
| 4. Define Auditor's Lien. | (Unit-II, SQA.6) |
| 5. Define internal check. | (Unit-III, SQA.1) |
| 6. Internal Control. | (Unit-III, SQA.2) |
| 7. Define vouching. | (Unit-IV, SQA.1) |
| 8. Qualified Audit Report. | (Unit-V, SQA.5) |

PART – B (4 × 15 = 60 Marks)

Note: Answer any **FOUR** questions

- | | |
|--|----------------------|
| 9. (a) Explain the Objectives of Auditing. | (Unit-I, Q.No.4) |
| OR | |
| (b) Briefly discuss the various types of Audit. | (Unit-I, Q.No.10) |
| 10. (a) Discuss the provisions relating to appointment of a company auditor. | (Unit-II, Q.No.3) |
| OR | |
| (b) What are the steps required by an auditor before the commencement of audit in an organization? | (Unit-II, Q.No.13) |
| 11. (a) Define internal check. What are the objectives of internal check? | (Unit-III, Q.No.7) |
| OR | |
| (b) Define internal audit. State the objectives of internal audit | (Unit-III, Q.No. 14) |

12. (a) What is meant by routine checking? Distinguish between vouching and routine checking.

(Unit-IV, Q.No.4)

OR

- (b) Explain the various types of vouchers.

(Unit-IV, Q.No.6)

13. (a) What are the differences between verification and valuation of assests?

(Unit-V, Q.No.3)

OR

- (b) Define Audit Committee. Explain its merits and demerits.

(Unit-V, Q.No.11)

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
Model Paper - II
AUDITING

Time: 2 Hours

Max. Marks: 80

PART – A (4 × 5 = 20 Marks)

Note: Answer any **FOUR** of the following questions.

ANSWERS

- | | |
|--|-------------------|
| 1. Government Audit | (Unit-I, SQA.5) |
| 2. What are the features of Auditing? | (Unit-I, SQA. 6) |
| 3. What is an audit note book? | (Unit-II, SQA.2) |
| 4. Audit markings. | (Unit-II, SQA.11) |
| 5. What are the different types of internal control. | (Unit-III, SQA.5) |
| 6. Objectives of internal audit. | (Unit-III, SQA.7) |
| 7. Explain the objectives of vouching. | (Unit-IV, SQA.3) |
| 8. Verification | (Unit-V, SQA.6) |

PART – B (4 × 15 = 60 Marks)

Note: Answer any **FOUR** questions

- | | |
|--|----------------------|
| 9. (a) Explain the difference between accounting and Auditing. | (Unit-I, Q.No.9) |
| OR | |
| (b) Explain the concept of Standards of Auditing. | (Unit-I, Q.No. 19) |
| 10. (a) What are the rights and duties of an auditor? | (Unit-II, Q.No.8) |
| OR | |
| (b) Define audit programme. What are its merits and demerits? | (Unit-II, Q.No.15) |
| 11. (a) Describe a Suitable Internal Check System for Purchases and Sales. | (Unit-III, Q.No.10) |
| OR | |
| (b) What are the difference between internal audit and external audit? | (Unit-III, Q.No. 18) |

12. (a) Explain the process of vouching trading transactions (Unit-IV, Q.No.8)

OR

- (b) What is vouching of cash transaction? What are the points which need to be verified by the auditor while vouching the cash receipts and payments (Unit-IV, Q.No.10)

13. (a) Explain the verification and valuation of various assets appearing in the balance sheet. (Unit-V, Q.No.9)

OR

- (b) What are the points to be included in audit report? (Unit-V, Q.No.14)

Rahul Publications

FACULTY OF COMMERCE
B.Com. III Year V-Semester(CBCS) Examination
(Only for General)
Model Paper - III
AUDITING

Time: 2 Hours

Max. Marks: 80

PART – A (4 × 5 = 20 Marks)

Note: Answer any **FOUR** of the following questions.

ANSWERS

- | | |
|---|--------------------|
| 1. Final Audit | (Unit-I, SQA.8) |
| 2. Explain the Importance of Auditing. | (Unit-I, SQA.3) |
| 3. Duties of an Auditor. | (Unit-II, SQA.12) |
| 4. Define audit planning. | (Unit-II, SQA.7) |
| 5. Objectives of internal control. | (Unit-III, SQA.4) |
| 6. Explain the differences between internal control and internal check. | (Unit-III, SQA.11) |
| 7. Vouching trading transactions. | (Unit-IV, SQA.5) |
| 8. Define Audit Committee. | (Unit-V, SQA.2) |

PART – B (4 × 15 = 60 Marks)

Note: Answer any **FOUR** questions

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|--|---------------------|
| 9. (a) What is continuous audit? State its advantages and disadvantages. | (Unit-I, Q.No.14) |
| OR | |
| (b) Explain the Procedure followed by AASB to issues audit standards. | (Unit-I, Q.No.22) |
| 10. (a) Describe the civil and criminal liabilities of an auditor. | (Unit-II, Q.No.10) |
| OR | |
| (b) What is an audit note book? Discuss its contents. | (Unit-II, Q.No. 16) |
| 11. (a) Bring out the differences between internal check and internal audit. | (Unit-III, Q.No.19) |
| OR | |
| (b) What is test checking? explain the precautions which are to be taken while applying test checking in auditing. | (Unit-III, Q.No. 5) |

12. (a) What are the points an auditor should look into while examining vouchers? **(Unit-IV, Q.No.12)**

OR

- (b) Discuss in detail the audit approach in an EDP environment and the impact of computerization on audit approach. **(Unit-IV, Q.No.15)**

13. (a) Discuss the verification and valuation of liabilities. **(Unit-V, Q.No.10)**

OR

- (b) Explain the kinds of audit reports. **(Unit-V, Q.No.19)**

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