

AUDITING

The word “**audit**” is derived from the Latin word “**audire**” which means “**to hear**”. In old days, whenever a businessman suspected any fraud or irregularity in the accounts, he used to appoint some expert whose duty was to hear the accounting statements read by the accountants and make necessary comments thereon.

The original object of auditing was to detect and prevent errors and frauds and to ascertain whether the accounts were “**true and correct**”. This emphasis in auditing was on arithmetical accuracy. However, now a day the object of auditing is to ascertain whether the financial statements reflect a “**true and fair view**” of the financial affairs or not.

Definition of Auditing

Taking a note of the increasing importance of auditing profession, the Chartered Accountants Act was passed in 1949. **The Institute of Chartered Accountants of India (ICAI)** was setup to regulate and promote this profession.

The Term ‘Audit’ has been defined by different authorities as follows

According to **L.R.Dicksee** defines audit as “An audit is an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they purport to relate”.

The Institute of Chartered Accountants of India, in its publication of Auditing and Assurance Standard – 1 (**AAS – 1**) on basic principles governing an audit, has defined audit as “Auditing is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to expressing an opinion thereon”.

Meaning of Auditing

In simple words, **auditing means checking the books of account**. As per the definition, it means an examination of the books of account in a critical and thorough manner with the supporting documentary evidences as will enable the auditor to report whether **the Balance sheet gives a true and fair view** of the state of affairs of the business and whether **the Profit and Loss account gives a true and fair view** of the profit or loss during the period under audit.

Auditing is the **systematic** and **scientific** examination of the accounts of a business by an independent qualified person or body of persons and a critical review of the system of accounting and internal control which is done with the help of vouchers, documents, information and explanations received from the authorities. It is the duty of the accountant to maintain accounts and prepare the Balance Sheet and Profit and Loss Account. Audit has to inspect, compare, check, review and scrutinize the vouchers supporting the transactions and report whether the final accounts exhibit a true and fair view of the state of affairs of the concern or not.

What are the advantages of Audit? Or what is the importance of Audit?

1. True and Fair View

Auditing enables the auditors to comment whether a true and fair view of the business is reflected by the final accounts or not. It helps in getting reliable and authentic Balance Sheet and Profit & Loss Account. All the parties willing to deal with the a company can study the audited final accounts of such company and on the basis of such authentic and reliable information they can decide whether to deal with such company or not.

2. Moral Check

It acts as a moral check on the employees which helps in keeping the accounts up-to-date and also in preventing frauds and errors. As the auditor visits at regular or irregular or sometimes gives a surprise

visit, the employees of the client cannot keep their work pending and as their work is constantly checked and supervised by the auditor they cannot dare to make any fraud.

3. Early Detection of Errors and Frauds

It helps in early detection of errors and frauds and in avoiding consequential wastage or loss by taking timely action. If there is no audit or checking of accounts then the employees of an organization can plan a fraud and cheat the company and it may continue for a long time and the loss to the company may run in crores of rupees.

4. Filing of Returns

It helps in filing of sales-tax and income-tax returns. Quick disposal of sales-tax and income-tax assessment is possible if the accounts are audited. Audited accounts are readily accepted by the tax authorities. When unaudited accounts are presented before the income-tax or sales-tax authorities, they have to check all the sales, purchases, incomes and expenses in detail as the final accounts without audit are not reliable.

5. Labour disputes and settlement of claims

It helps in quick disposal of labour disputes or settlement of claims against insurance companies or claims for damages against different parties. Labour Unions doubt unaudited accounts and workers feel that loss is shown deliberately for not giving increase in pay scale or bonus. Similarly, in case of fire insurance, cash in transit insurance and other claims of damage, settlement of claim is easy if the accounts are audited.

6. Basis for agreement

It helps in determining the correct worth of business at the time of admission, retirement or death of a partner or at the time of dissolution or sale of business or for valuation of goodwill, valuation of shares, calculation of purchase consideration etc. Financial statements audited by an independent expert are considered as reliable by different parties who are desirous of entering into an agreement with the company.

7. To Get Licences, Loan etc

Government sometimes requires audited and certified financial statements before it gives assistance or issues a licence for a particular trade. Past audited statement of account are required for getting loans or other financial assistance from different financial institutions or banks. Results shown by unaudited financial statements are meaningless and not reliable from the lender's point of view.

8. Advice and Suggestion

An auditor can provide suggestion and give advice on various matters which can improve company's performance in future. An auditor is generally a chartered accountant who is an expert in the field of accountancy and auditing. He also has knowledge in the fields of income-tax, sales-tax, company law matters, financial management, cost accounting, budget and price determination etc.

Distinguish between Book-keeping and Auditing

No.	Book-keeping	Auditing
1.	Nature It includes actual recording of transactions	It is analytical in nature. It is relating to verification of accounting records.
2.	Commencement It starts when business transactions take place.	It starts when account writing is over.
3.	Object The object is to record all the facts of business.	The object is to certify correctness of financial statements.
4.	Qualifications No formal qualifications are required for a book-keeper.	Formal qualifications must be possessed by an auditor.

5.	Reporting A book keeper is not required to submit a report unless specially called for.	An Auditor has to submit a report to the concerned authority.
6.	Status A Book keeper is an employee of an organisation.	An auditor is not an employee of an organisation.

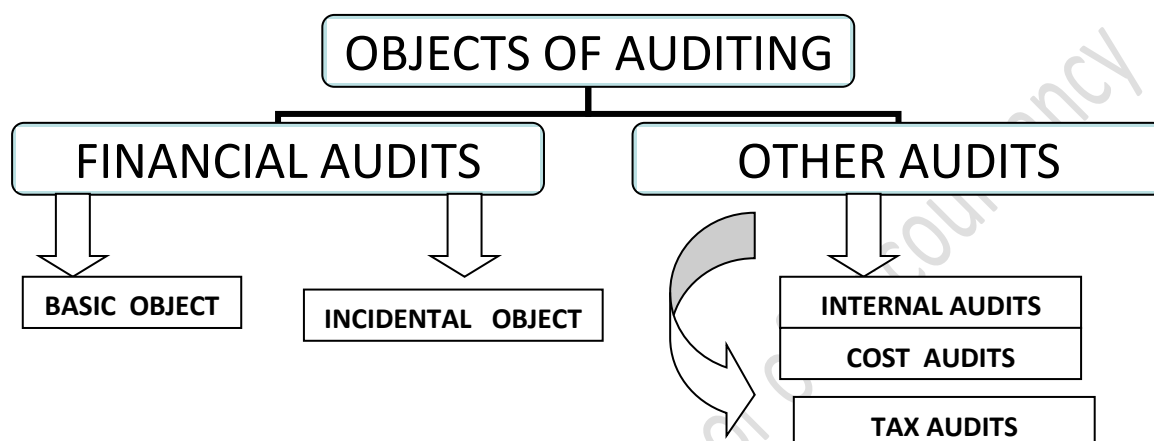
Distinguish between Accounting and Auditing

No.	Accounting	Auditing
1.	Meaning Accounting is writing books of accounts and preparing final accounts	Auditing is examination of accounts to report whether they are true and fair.
2.	Objective Object is to prepare Balance Sheet to show financial position as at the year end and Profit and Loss A/c to show Profit/loss for the year only.	Object is to examine and report if Balance Sheet shows true and fair financial position and if Profit and loss A/c shows true and fair amount of Profit/loss
3.	Scope Accounting is limited to book of accounts only.	Auditing is not limited to only books of accounts.
4.	Done By Accounting is done by employees who need not have any special qualification.	Audit is done by an independent expert who must be a practising chartered accountant.
5.	Responsibility Accountant is employed by and is responsible to management.	Auditor is appointed by owners/shareholders and reports to them.
6.	Nature of work Accountant records, posts and summarises current transactions. Accounts are checked by auditor.	Auditor analyses past transactions. Auditing is thus analytical. Once audited, accounts are not re-audited.

Distinguish between Auditing and Investigation

No.	Auditing	Investigation
1.	Meaning Auditing is examination of accounts to report whether they are true and fair.	Investigation is examination of accounts for specific purpose.
2.	Nature of Assignment Audit is an annual recurring assignment.	Investigation is a specific non-recurring assignment.
3.	Types Audit may be statutory or voluntary. It may be continuous, interim or final.	Investigation may be statutory under companies Act, Income Tax Act or voluntary for valuation of shares, goodwill, fixing purchase consideration, detection of fraud etc.
4.	Appointed By Auditor is appointed by owners or shareholders.	Investigator may be appointed by outsider. E.g. Income tax dept., Registrar of companies, investors, lenders, purchaser of business/shares.
5.	Scope Audit covers the entire	Investigation may be limited to a particular item in

	accounts	accounts or may go much beyond accounts depending upon its purpose.
6.	Compulsory Audit is compulsory for companies.	Investigation is not compulsory.



What are the objectives of Auditing?

OBJECTS OF FINANCIAL AUDIT

Financial Audit means an independent audit of the financial statements (i.e. balance sheet and Profit and loss account) of a concern. A financial audit has the basic object of examining whether the accounts are true and fair. It has an incidental object of detecting errors and frauds.

1. Basic Object – True and Fair View

The basic object of financial audit is to enable an auditor to express an opinion on the financial statements. The auditor gives an opinion on whether the final accounts give a true and fair view of the affairs of the concern i.e. whether the balance sheet gives a true and fair view of the financial position of the concern as at the end of the year and the profit and loss account gives a true and fair view of the profit or loss for the year.

- The financial position or the net worth is disclosed as it is; it is neither overstated nor understated.
- Similarly, the profit or loss for the year is disclosed as it is.
- All material items are disclosed.
- Final Accounts comply with the requirements of law.
- Final Accounts are made according to the recognised Accounting Principles and Auditing Standards laid down by professional bodies.

2. Incidental Object – Detection of Errors and Frauds

The main object of an audit is the detection of errors and frauds. But, this is only an incidental object of audit. Detection of errors or frauds is no doubt important. If the accounts are to be true and fair, they must be free from errors and frauds. While an audit is not intended to disclose all errors and frauds, their discovery may be incidental to audit. The main objective of a financial audit is to report on the truth and fairness of the final accounts. Since the final accounts are based on the books of accounts, the incidental objective of audit is to ensure that the final accounts tally with the books of account. While conducting the audit, the auditor has to vouch the transactions, verify the assets and liabilities.

OBJECTS OF OTHER AUDITS

1. Internal Auditing

- a. To examine the accounts to ensure that records are properly maintained
- b. To ensure that assets of the concern are safeguarded
- c. To check if the policies and procedures laid down by the management are complied with
- d. To review the operations of the concern to report on the efficiency of management.

2. Cost Audit

To ensure that cost statements tally with the cost records and give a true and fair view of the cost of production and cost of marketing of the product.

3. Tax Audit

Under the Income-tax Act aims to ensure that the income of the concern is computed in accordance with the provisions of the Income tax Act.

What is an Error?

One of the incidental objectives of auditing is to detect and to prevent errors. Errors are incorrect recording or non-recording of a transaction innocently, unintentionally or inadvertently. It is a result of a human lapse.

But the error committed willfully or intentionally or as a result of willful manipulations are frauds and not the errors.

Most of the errors are detected during the normal course of audit. However, certain errors may go undetected. Auditing is not an insurance against errors and frauds.



What are different types of “Errors”?

Following are the different types of errors:

1. Errors of Principle
2. Errors of omission
3. Errors of commission
4. Errors of duplication
5. Compensating errors

ERRORS OF PRINCIPLE :

Errors of Principle are those errors that occur for not recording a transaction according to the fundamental principle of book-keeping. The debit or credit is given to the wrong head of account. These errors do not affect the trial balance, but they affect the true and fair view of accounts.

Thus, due to such errors the accounts show a misleading picture of the assets, liabilities, profit or loss of the concern. Following are the examples of errors of principle.

1. Over valuation or under valuation of stock.
2. Over provision or under provision of depreciation.
3. Recording of capital expenditure as revenue expenditure.
4. Recording of revenue expenditure as capital expenditure.
5. Recording deferred revenue expenditure as revenue expenditure.
6. Recording revenue expenditure as deferred revenue expenses.
7. Incorrect provision of income accrued but not received outstanding income.
8. Incorrect adjustment of income received in advance.
9. Incorrect adjustment of prepaid expenses.
10. Incorrect provision of outstanding expenses or liabilities.
11. Wrong provision for bad and doubtful debts.

CLERICAL ERRORS

1. ERRORS OF OMISSION

The name itself suggests that the transaction is omitted fully or partially. One or more purchase invoices may be omitted to be recorded while recording the purchase transactions in purchase register. Similarly, one or more sales invoices are omitted while recording transactions in the sales register. Thus the debits and equivalent credits are omitted. Hence, both the sides of the trial balance will agree. It will, therefore, be difficult to locate such error. While scrutinizing the individual accounts of the suppliers and the customers and while examining confirmations of their balances, such errors can be located.

Such error can be detected only through

- a. Bank Reconciliation
- b. Confirmation of Bank Accounts
- c. Vouching cheque counter foils
- d. Scrutiny of creditors accounts
- e. Confirmation of Creditors Balances and so on.

2. ERRORS OF COMMISSION

An error of commission occurs when a transaction is entered in the books but wrongly. Such errors may be Mathematical Errors, Casting Errors and Posting Errors.

a. Mathematical Errors:

Mathematical Error of calculations may occur in voucher, books, ledger, trial balance and so on. Thus, in a sale, bill 100 no. * Rs.10 may be calculated as Rs.10000 instead of Rs.1000. Since the original entry itself is of wrong amount, the trial balance will tally. Such error can be detected by checking the calculations on the voucher, scrutiny of party accounts, obtaining statement of accounts from parties.

b. Casting Errors:

Casting Error i.e. errors in totaling, carry-forward, extension etc. may occur in Day Books, Ledgers or the Trial Balance. Thus, in Sales Register, while totaling all bills for a month a bill of Rs.1000 may be taken as Rs.10000. Thus the amount posted to sales account (Rs.10000) will be more by Rs.9000 as compared to the amount posted to the Debtors A/c (Rs.1000). This will lead to difference in the Trial balance and can be detected by checking the casting of the sales register.

c. Posting Errors:

Posting Error occur while posting amounts from Registers into the Ledgers. Thus, a sales Bill of Rs.1000 on Mr. A may be

- Posted to Mr. A A/c for Rs.10000.
- Posted on the credit side instead of Debit side of Mr.A's A/c
- Posted in Mr. B's A/c

The error of posting into wrong party a/c can be posting sales into purchase a/c can be detected through reconciliations, ratio analysis, comparison with previous year's figures etc.

3. COMPENSATING ERRORS:

Compensating Errors occurs when the effect of one error is compensated by another error. Thus one error cancels the effect of another error and there is no final net effect on the accounts. For example, one sales bill No.12 for Rs.1000 on A is posted into account of B, and another sales bill No. 22 for Rs.1000 on B is posted error in the second bill. These errors cancel each other and do not affect the trial balance. These errors, though difficult to trace, can be detected through vouching, obtaining statement of account or confirmations from parties etc.

4. ERRORS OF DUPLICATION :

Errors of Duplication occur when a transaction is recorded twice in the original books of entry. The posting is also done twice.

What is Fraud?

A fraud is an act of deception employed to deceive or cheat another person to get some gain or benefit. It is willful misrepresentation or a false suggestion or a suppression of truth or a deliberate concealment of truth. Here, the act of committing the fraud is willful. It may also involve misappropriation of money, goods or any property.

It may involve willful and intentional act of recording false entry in the books or altering, detecting or destroying the correct entry in the books or omitting to make a correct entry with an intention of defrauding some other persons.

What are the different types of Frauds?

Fraud can be grouped under three broad categories:

1. Misappropriation or embezzlement of cash
2. Misappropriation of goods
3. Fraudulent manipulation of accounts

1. Misappropriation or embezzlement of cash

Where the owner of a business has no direct control over the receipt and payments of cash, the cases of misappropriation or embezzlement of cash are more. In such a case, a cashier or such other person can misappropriate cash. This can take place at the time of receiving cash or at the time of disbursing cash.

a. At the time of receiving cash:

- Omission of cash receipt and pocketing it.
- Omission of recording cash sales and pocketing it.
- Recording amounts of receipts less than actually received.
- Write off a debt as bad debts and not recording cash actually received from that debtor.
- Not recording the transactions of receipt of casual or exceptional nature. E.g. receipt from sale of scraps, winning of cash award, receipt of cash from a debtor whose debt was written off previously.
- Teeming and lading.
- Not recording or short recording of sale of capital assets fully written off previously.
- Writing off debts or advances as bad though received or adjusted.
- Services rendered but not provided for.

b. At the time of payment of cash:

- Inclusion of fictitious payments for purchases or expenses.
- Entering the payments more than actually made.
- Altering the total of salary sheets or wages sheets or of a statement which includes payments to more than one person.
- Entering the names of dummy or ghost workers and employees and showing payments to such persons.

- Not recording cash discounts and other benefit received at the time of making payments and then writing off and debit balances as bad.

2. Misappropriation of Goods:

- a. Misappropriation of goods by entering fictitious purchase invoices. Goods are shown as received and but not received in reality.
- b. Misappropriation of goods by entering larger quantities in the books but getting actual delivery of lesser quantity. Thus the balance quantity is received privately.
- c. Issuing quantities larger than invoiced in collusion with the other party. Excess goods delivered can be sold out and cash so received can be misappropriation.

3. Misappropriation of accounts :

- a. Showing better results to shareholders, bankers and creditors.
- b. Showing more profits to declare divided wrongly.
- c. Showing more profits to pay more remuneration and commission to directors or managers to deceive shareholders or to avoid tax liabilities.

What do you mean by window dressing?

(Fraud through manipulation of accounts i.e. window dressing)

It implies presentation of accounts more favorably than what they actually are. Window dressing means showing wrong picture. The fraud through manipulation of accounts is also known as window dressing because accounts are manipulated to show a wrong picture of the profit or loss of the business and its financial state of affairs. Generally, this type of a fraud is committed by the people at the top management level. It does not involve any misappropriation of cash or goods but it is either overstatement of profit or under-statement of the same.

What are the objects of window dressing?

1. To show more profits and to give the managerial personal more remuneration where remuneration is linked with profit.
2. To attract more loans, credits etc. from bankers and financial institutions.
3. To attract more applications for issue of shares.
4. To attract favorable credits from creditors, lenders and financial institutions.
5. To arrive at larger value of goodwill while admitting a new partner or in case of absorption and to evaluate goodwill in excess.

What are the principles of auditing?

According to the Webster's New international Dictionary, the word 'Principle' is defined as a fundamental truth; a primary or basic law or doctrine; a settled rule of action.

In auditing, 'principle' is the fundamental truth necessary for the accomplishment of the auditing objectives. The Institute of Chartered Accountant of India (ICAI) has laid down the basic principles which govern an audit. Basic principles of audit guide an auditor as to how to conduct an audit and give an audit report.

1. Principle of Independence

The Auditor should be honest and sincere in his audit work. He must be fair and objective. He should also be independent.

2. Principle of objectivity

Auditing should be conducted objectively. The auditor should be free and bias and emotion while conducting audit.

3. Principle of full disclosure

It implies that the client should provide to the auditor all the possible evidence, explanations and records. The auditor should make full disclosure of his findings.

4. Principle of materiality

According to this principle, the auditor should pay more attention to the items which are significant. Whether the items are materials or not should be decided according to the situations.

5. Principle of confidentiality

The auditor should keep the information confidential. He should not disclose any information to any one during the course of the audit. The auditor should keep his eyes and ears open his mouth shut up.

6. Skill and Competence

The auditor should have adequate training, experience and competence in auditing. He should have a professional qualification (i.e. be a Chartered Accountant) and practical experience. He should be aware of recent developments in the field of auditing such as statement of ICAI, changes in company law, decisions of Courts etc.

7. Work done by others

The auditor should direct, supervise and review the work done by his assistants. He should see that the work done by others is upto his satisfaction.

8. Working papers

The auditor should maintain working papers properly. The working papers prove that the work is done by the auditor.

9. Audit Evidence

The report of the auditor should be based on evidence obtained in the course of audit. The evidence may be obtained through vouching and verification of assets and liabilities etc.

Write a note on Materiality concept in audit

Concept and conventions in accountancy mean basic assumptions while recording transactions in the books of accounts. Auditor should have knowledge of different concept and conventions in accountancy such as ENTITY, MATERIALITY, GOING CONCERN, HISTORICAL COST, ACCRUAL, MATCHING COST AND REVENUE, ACCOUNTING PERIOD and CONSERVATION ETC.

In accountancy, materiality concept means it is assumed that all material items of expenses and incomes, assets and liabilities are shown separately in the final accounts and not grouped or clubbed or hidden in some other item. E.g. Directors' Remuneration is shown separately and not hidden in salaries; Audit Fees is shown separately and not clubbed in sundry expenses etc.

According to Standard of Auditing 320 (AAS – 13) issued by The Institute of Chartered Accountant of India, concept of materiality recognises that some matters, either individually or in aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices. Auditor must consider materiality while conducting audit. Any information is material if its misstatement could influence the economic decision of users.

Auditor should consider materiality at both the levels, overall financial information level and in relation to individual account balances and classes of transactions. Materiality is also influenced by legal and regularity requirements and considerations relating to individual account balances.

Legal and regularity requirement implies that auditor should see that financial statements disclose all material items, extraordinary items , prior period items , change in accounting policies and their effect on current profits. Financial statements should comply with all legal and regularity requirements.

In individual account balances, if auditor has come to a conclusion that the aggregate of uncorrected misstatements is causing financial information to be materially misstated, then he should request the management to rectify those misstatements and adjust financial information. Auditor may set acceptable cutoff level for verifying individual transactions. Whether a particular item is material or not is a matter of professional judgment.

In short auditor should ensure that all material misstatements in the financial information audited by him are rectified and if not then reported by him in his audit report.

Write a note on Going Concern concept in audit

Going Concern concept in accountancy means it is assumed that the organisation will be continued as a going concern for a long time and there is no intention to close it down in the near future. An entity's continuance as a going concern for foreseeable future i.e. generally a period of one year after balance sheet date, is assumed while preparing financial statements. This is why in case of fixed assets; valuation is made at written down values and not at current market values or prices.

Auditor should consider the risk going concern assumption may no longer be appropriate. In that case, showing assets and liabilities at book values will not show a true and fair view.

According to (AAS – 16) , Standard of Auditing 570 issued by the ICAI , there may be financial indicator, operating indicators or other indicators indicating that the organisation is not a going concern.

Indicators of Absence of Going Concern assumption-

1. Financial Indicators :

Negative Net worth, Negative working capital , Adverse key financial ratios, recurring operating and net loss, negative cash flow positive increasing unsalable stock, soaring unrealisable debtors etc.

2. Operating Indicators:

Loss of key personnel, Labour problems, Loss of major customer or supplier, Loss of infrastructure facilities like power, water, roads etc.

3. Other Indicators:

New legislation, change in Government policy, pending legal case, ban on products, change in technology etc.

When such indicators are present, auditor should gather sufficient audit evidence resolve the question regarding entity's ability to continue in operation for foreseeable future.

Fill in the blanks with appropriate word/words

1. Auditing is a _____ examination of banks.
2. The auditor has to _____ and _____ it.
3. Book keeping starts when business transactions _____.
4. A Book keeper is an _____ of an organisation.
5. Accounting _____ when book keeping _____.
6. Auditing _____ when accounting _____.
7. An auditor needs _____.
8. Investigation is _____ in scope.
9. Auditor's main duty is to report on _____.
10. Error arising by violating accounts principles is error of _____.
11. Complete _____ does not affect the agreement of trial balance.
12. Fraud is an _____.
13. _____ means showing cosmetic view of the state of affairs.
14. _____ issued by ICAI spells out the responsibility of an auditor.
15. Auditing exercises _____ checks on the employees.
16. Auditor should form his opinion about the accounts on the basis of _____.
17. Financial statement includes _____ and _____.
18. _____ A/C shows results of business activities.

Questions

1. What is Auditing? Explain the objectives of auditing? (April, 2015)
2. Explain the basic principles of auditing. (April, 2015, October, 2008)
3. Briefly explain different types of fraud. (April, 2015)
4. Short notes on Concept of Going Concern. (April, 2015)
5. Explain window dressing.
6. Explain the concept of true and fair view? (March, 2009)
7. Explain in brief, the different types of errors. (October, 2010)
8. Distinguish between "Auditing and Accounting" in brief. (April, 2014 , October, 2009, 2013)
9. Distinguish between "Auditing and Investigation" in brief (April, 2006)
10. Define Auditing (October, 2006)

ADVANTAGES OF AN INDEPENDENT AUDIT.

A. Businessman's point of view

- 1 Detection of errors and frauds
- 2 Loan from banks
- 3 Builds reputation
- 4 Proper valuation of assets
5. Government acceptance
6. Update accounts
7. Suggestions for improvement
8. Useful for agency
9. Ensures legal compliance
10. Settlement of disputes

B. Investor's point of view

- 1 . Protects interest
2. Moral check
3. Proper valuation of investments
4. Good security

C. Other Advantages.

1. Evaluate financial status
2. Listing of shares
3. Settlements of claims
4. Evidence in court
5. Settlement of accounts
6. Facilitates calculation of Purchase consideration
- 7 Facilitates taxation

The fact that audit is compulsory by law, in certain cases by it should show that there must be some positive utility in it. The chief utility of audit lies in reliable financial statement on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there is other advantage of audit. Some or all of these are of considerable value even to those enterprises and organization where audit is not compulsory, these advantages are given below:

- (a) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders.
- (b) It acts as a moral check on the employees from committing defalcations or embezzlement.
- (c) Audited statements of account are helpful in setting liability for taxes, negotiating loans and for determining the purchase consideration for a business.
- (d) This are also use for settling trade disputes or higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
- (e) An audit can also help in the detection of wastage and losses to show the different ways by which these might be checked, especially those that occur due to the absence of inadequacy of internal checks or internal control measures.
- (f) Audit ascertains whether the necessary books of accounts and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respects. (g) As an appraisal function, audit reviews the existence and operations of various controls in the organizations and reports weakness, inadequacy, etc., in them.
- (h) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.
- (i) Government may require audited and certificated statement before it gives assistance or issues a licence for a particular trade.

LIMITATIONS OF AUDITING

At this stage, it must be clear that the objective of an audit of financial statements is to enable an auditor to express an opinion on such financial statements. In fact, it is the auditor's opinion which helps determination of the true and fair view of the financial position and operating results of an enterprise. It is very significant to note that the AAS-2 makes it a subtle point that such an opinion expressed by the auditor is neither an assurance as to the future viability of the enterprise nor the efficiency or effectiveness with which management has conducted affairs of the enterprise. Further, the process of auditing is such that it suffers from certain inherent limitations, i.e., the limitation which cannot be overcome irrespective of the nature and extent of an audit procedure. It is very important to understand these inherent limitations of an audit since understanding of the same would only provide clarity as to the

1. First of all, auditor's work involve exercise of judgment, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgment and estimates made by the management in preparing the financial statements. Further much of the evidence available to the auditor can enable him to draw only reasonable conclusions there from. The audit evidence obtained by an auditor is generally persuasive in nature rather than conclusive in nature. Because of these factors, the auditor can only express an opinion. Therefore, absolute certainty in auditing is rarely attainable. There is also likelihood that some material misstatements of the financial information resulting from fraud or error, if either exists, may not be detected. II. The entire audit process is generally dependent upon the existence of an effective system of internal control. Further, it is clearly evident that there always be some risk of an internal control system failing to operate as designed. No doubt, internal control system also suffers from certain inherent limitations. Any system of internal control may be ineffective against fraud involving collusion among employees or fraud committed by management. Certain levels of management may be in a position to override controls; for example, by directing subordinates to record transactions incorrectly or to conceal them, or by suppressing information relating to transactions.

Such inherent limitations of internal controls system also contribute to inherent limitations of an audit. Generally following are the Limitations of auditing

- 1. Non-detection of errors/frauds:-** Auditor may not be able to detect certain frauds which are committed with malafide intentions.
- 2. Dependence on explanation by others:-** Auditor has to depend on the explanation and information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.
- 3. Dependence on opinions of others:-** Auditor has to rely on the views or opinions given by different experts viz Lawyers, Solicitors, Engineers, Architects etc. he cannot be an expert in all the fields
- 4. Conflict with others:-** Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal judgment plays an important role. It differs from person to person.
- 5. Effect of inflation :-** Financial statements may not disclose true picture even after audit due to inflationary trends.
- 6. Corrupt practices to influence the auditors :-** The management may use corrupt practices to influence the auditors and get a favourable report about the state of affairs of the organisation.
- 7. No assurance :-** Auditor cannot give any assurance about future profitability and prospects of the company.
- 8. Inherent limitations of the financial statements :-** Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgments of the owners. Certain non-monetary facts can not be measured. Audited statements due to these limitations cannot exhibit true position.
- 9. Detailed checking not possible :-** Auditor cannot check each and every transaction. He may be required to do test checking.

What is Audit Planning?

What are the objects of audit planning?

According to **Standard of Auditing 300** issued by the Institute of Chartered Accountants of India, "Audit Planning involves developing an overall plan for the expected scope and conduct of the audit and developing an audit programme showing the nature, timing and extent of audit procedures."

One of the auditing principles i.e. fundamental truths necessary for the accomplishment of the auditing objectives is "planning". An auditor must plan his audit work and while planning audit, he should consider following factors –

1. Complicity of audit
2. The environment in which the entity operates.
3. Previous experience with the client.
4. Knowledge of client's business.

An auditor should obtain preliminary knowledge of the client's business before he accepts the audit engagement and more detailed knowledge after the acceptance of audit engagement. This information helps the auditor in assessing risks and identifying problems, planning and performing audit effectively and efficiently and evaluating audit evidence. Knowledge of client's business can be obtained by the auditor from the following sources –

1. Client's annual report to shareholders.
2. Minutes of meeting of shareholders, board of directors etc.
3. Last year's working papers, budgets and projections.
4. Client's policy and procedures manual.
5. The journals, magazines, newspapers, text books, publications of professional bodies such as ICAI, industry publications etc. for understanding the state of the economy and its effect on client's business.
6. Discussion with the client about changes in the accounting policies and procedures, internal control system of the company etc.
7. Visit to client's premises to understand plant layout, manufacturing process etc.

Following are the objectives of Audit Planning –

1. To complete audit in time :

If audit is not planned properly then it may not be completed in time. Audit completed after due date is of no use.

2. To facilitate supervision :

If audit is well-planned, it facilitates supervision and direction by senior auditor. Work done by junior staff can be reviewed.

3. To coordinate with others:

Audit planning helps auditor to coordinate his work with joint auditors, experts and consultants of the company, internal auditors of the company, executives of the company etc.

4. To cover all important areas of audit :

Audit planning ensures that all important areas of audit are properly covered and no important audit requirement is missed out. Audit planning is done so that quality of audit is of high standard.

5. To utilise assistants properly :

Audit planning is done with the object of utilising audit staff properly, assigning them work as per their capabilities and competence.

What are the considerations in developing an Audit Plan?

What factors are to be considered by an Auditor while developing an Audit Plan? (April 2015)

While developing the overall audit plan, auditor should consider the following matters

1. Terms of engagements :

Auditor should obtain a letter of audit engagement specifying the scope of audit work. In case of audit of a company, Section 227 of the companies Act, 1956 lays down the scope of audit work. Auditor should keep in mind the scope of audit while preparing audit plan.

2. Nature and timing of reports :

Audit engagement makes it clear about the nature and timing of audit reports to be submitted. While planning audit work, auditor should keep in mind that audit report should be submitted by him in time.

3. Legal or statutory requirements :

Auditor should keep in mind legal or statutory requirements while developing audit plan. Reporting requirements for tax audit under section 44AB of the Income tax Act, 1961 or MVAT audit under Maharashtra Value Added Tax Act, 2002 or company audit under the companies Act, 1956 are different. The focus or stress of areas is different in different types of audit.

4. Accounting policies adopted by the client :

Auditor should note accounting policies adopted by the client while developing audit plan. He should also note the changes in those policies and change his plan accordingly. E.g. If it is the policy of the company to value stock on "First In First Out" method which changed to "Weighted Average Stock" method or Cost or Market price whichever is less" method then audit plan must consider this change.

5. Identification of significant audit areas :

Auditor should identify weak areas where more attention is required while auditing. Auditor should find out areas where internal control system is weak or not existing, exceptional transactions, payments to related parties etc. where audit should be made in a thorough manner.

6. Setting-up of materiality levels :

While developing audit plan, auditor should develop materiality levels after considering different factors such as size and nature of organisation, internal control system in the organisation etc. e.g. auditor may setup a level of checking all payments of expenses exceeding Rs.10000 in detail in case of one company whereas the level may be Rs. 5000 in case of another company.

7. Condition requiring special attention :

The auditor should give special attention to the area where there is possibility of material error or fraud. For example purchases from sister concern, loan taken on unusual terms

8. Audit evidence :

The auditor should consider the nature and extent of audit evidence which may be available to him to carry out compliance. In case it is necessary he should plan the details of corroborative evidence to verify the representations of the management.

What is Audit Programme? What factors should be kept in mind while preparing audit programme ? (March 2013)

Auditor should prepare a detailed audit programme for audit work. Prof. Meigs defines an Audit Programme as "a detail plan of the audit work to be performed specifying the procedures to be followed in verification of each item in the financial statements and giving the time required."

Audit programme can be a predetermined audit programme which is prepared **before the commencement** of audit or a progressive audit programme which is kept on modifying during the course of the audit. It should specify the allocation of work among the audit assistants as per their seniority and grade with clear instructions of time for completing each work. It should be in **writing** and should be **flexible**. It should be prepared in a **tabular format** and it should ensure that there is no chance for omission of any necessary audit work. Generally it is prepared by the **chief auditor**. It is also called as the **blue print** of audit

work. It is to be done by whom and how and in what time. It allocates duties and responsibilities of audit staff.

Factors in Audit Programme

1. Client's Business or activities :

Auditor must keep in mind the activities or business conducted by the client. Audit of a company of a cooperative housing society is different from audit of a company. Audit of a manufacturing company is different from audit of a bank or a cooperative credit society. The focus or the stress of audit is on different matters depending upon the type of the company and the type of audit to be conducted. While preparing an audit programme, auditor should keep in mind client's business or activities.

2. Internal control :

Auditor should make assessment of internal control system in the client's organisation. He should find out where it is strong and where it is weak. In those areas where internal control is strong, auditor can decide to do only test checking whereas in those areas where internal control is weak or not existing, auditor can decide to do detailed examination in a thorough manner.

3. Terms of engagement :

Auditor must keep in mind the terms of his audit engagements while preparing an audit programme. If it is only a partial audit where auditor is asked to check only cash transactions, his audit programme should cover audit of only cash receipts and cash payments.

4. Nature of evidence :

Audit programme should contain procedures and techniques to obtain audit evidence. E.g. Bank statements, Balance confirmation letter etc. Auditor should identify which is the best evidence and how it can be obtained. E.g. in case of vehicle purchase, purchase bill is not sufficient evidence but entry in R.C. book issued by R.T.O. and in insurance policy can be considered as the best evidence that the vehicle is owned by the client.

5. Possibilities of errors and frauds :

While preparing audit programme, auditor must take into account all possibilities of errors and frauds. He should allocate 100% checking of those areas where possibility of errors or frauds is there. E.g. full checking of extraordinary transactions of transactions with related parties etc.

6. Other auditors and experts involved:

If there are joint auditors, branch auditors, internal auditors or other experts, then auditor can rely on them and while preparing audit programme he should keep in mind this factor.

7. Assistants available :

While preparing audit programme, auditor should keep in mind the number of assistants available and their level of competence. He should allocate routine checking work to junior assistants and ledger scrutiny to senior assistants.

8. Time available :

While preparing audit programme, auditor should keep in mind the time during which he has to complete the audit and submit audit report. He should plan audit work by allocating time for every work to be done. It should be a time bound programme.

What are the Contents of Audit Programme ? (October, 2010)

Contents of Audit Programme

1. Name of the client
2. Accounting year in respect of which audit is to be conducted
3. Type of audit and scope of audit
4. Date of commencement of audit and date of completing the audit.
5. List of basic documents e.g. in case of a company – Memorandum of Association and Articles of Association , in case of a partnership – Partnership Deed, in case of a society – By –law copy, in case of a Trust – Trust Deed etc.

6. List of books of accounts to be examined.
7. Date wise schedule of work to be carried out – giving the names of persons who will do which job in what time.
8. Persons in charge of audit work.
9. Number of transactions and type of transactions to be selected for audit.
10. For vouching – nature of evidence or documents to be examined.
11. Instructions for verification and valuation of assets and liabilities.
12. Instructions for ledger scrutiny, comparison with previous year, ratio analysis, quantity details , reconciliations , certificates to be obtained from management and confirmations to be obtained from other parties.
13. Instructions for checking minutes book, resolutions authorisations etc.
14. Instructions for preparing and submitting audit report.

What are the advantages of Audit Programme?

1. Systematic work :

Audit programme ensures that audit is carried out systematically. There is proper flow in audit work and it becomes planned and methodical.

2. No omission of work :

Audit programme ensures that no important area or point is missed out or omitted while examining books of accounts. It also ensures that there is no repetition or duplication of work.

3. Guidance to audit staff :

Audit programme acts as a guide to the audit staff. Audit programme gives instructions about how vouching, verification and valuation should be done, what is the level of materiality, what is the best evidence, what is the time during which every work is to be completed etc.

4. Allocation of duties and responsibilities :

Audit programme allocates duties and fixes responsibilities on each audit staff in a very clear manner. This avoids confusion or misunderstanding and lapses in audit work. Everybody works in a responsible manner.

5. Timely completion :

Audit programme ensures that audit is completed in time. It facilitates timely preparation of audit report. If any audit is taking more time than the allotted time then the same can be reviewed and if there is a need, the more assistants can be sent or senior auditor can devote more time for that audit to ensure timely completion of audit.

6. Evidence in court :

Audit programme can be evidence in the court of law in case a suit is filed against the auditor for negligence. Auditor can prove that he was not negligent while conducting audit but in spite of due care taken by him some errors or frauds may remain undetected.

7. Enhances Efficiency :

Audit programme enhances the efficiency of audit staff and quality of audit is maintained at a high level. Junior audit staff can take guidance from audit programme as well as from senior audit staff to whom they have to report.

What are the disadvantages of Audit Programme?

1. Mechanical work :

Audit programme contains details time-bound instructions for all the audit assistants. It makes audit work mechanical and routine. It discourages audit staff to think on their own and there is no initiative.

2. Rigidity :

Audit programme becomes rigid and there is no scope for making changes. If the accountant was on

leave for two months wherein there are many mistakes and if audit programme contains instructions to check only 20% entries then it should be changed to 100% for those two months. Audit programme should be flexible and modified as per situation.

3. Work to Rule :

Audit programme contains so many detailed instructions for audit staff that many times it makes audit staff work as per the instructions only. They adopt "work to Rule" approach. It kills initiative and active involvement of audit staff in audit work. If seven days are allotted for a particular checking which can be completed in just four days, audit staff deliberately work slow and takes seven days for that work as per the programme.

4. Shelter for deficiencies :

Audit staff may have to hurry-up the work as audit programme is time-bound. This may result in poor quality of work. Similarly, audit staff may take shelter of audit programme to hide their inefficiency and deficiency in their work.

5. Insufficient evidence :

Audit programme is not considered as sufficient evidence in the court of law in case of a suit for negligence of auditor. It only proves that audit programme was there but whether work was done as per the programme or not and what was the quality of the work done is not clear.

6. Faulty Audit programme :

If Audit programme is not prepared properly some important areas or points may be missed out while doing audit. If by mistake checking bank reconciliation statement is missed out in audit programme, audit staff will also forget to check bank reconciliation statement and they may check only receipts and payments of bank book. Similarly, if audit programme is not changed as per the latest requirements, audit may become irrelevant and outdated.

What are audit working papers? (April, 2015)

What is their importance in audit? What are the functions of audit working papers?

The term audit working papers and audit note book are similar. Audit working papers means a record of the audit programme or audit plan, the audit procedures performed and the conclusions drawn from the evidence obtained. It is a written record kept by the auditor which contains information about important facts in connection with the accounts under audit.

These working papers are the property of the auditor and he should preserve these papers as confidential. He has right on his working papers. Working papers help the auditor to supervise and review the audit work, plan and carry out the audit in time, provide an evidence in the court of law that audit was conducted with due care and efficiency, in case a suit is filed for negligence against the auditor. Audit working papers are valuable document which should be systematically filed by the auditor.

Working paper include the following –

Trial Balance, Schedules to Balance Sheet, Bank Reconciliation Statements, Details of closing stock, confirmation letters from different parties, certificates issued by the management, extracts from minutes books, list of audit queries and answers received for queries etc.

Importance or Main functions of audit working papers

1. Auditor can protect himself in the court of law in case of suit against him for negligence.
2. It helps in finalizing audit fast. He can go through the working papers and see that all the queries are answered by the client and no important point is pending.
3. It helps in assessing assistant work. It also acts as a guide for new audit assistants. It fixes responsibility on audit on staff and hence quality of audit improves.
4. It helps as a guide for future planning of audit programme.
5. Auditor can understand the weaknesses of internal control system of the clients from queries raised during audit.
6. Auditor can modify audit programme from queries raised during audit, he can control audit work by going through working papers.

Write a note on audit notebook and explain its importance

Audit Note Book is a notebook maintained by the auditor for recording various matters observed by him during the course of his audit. It is in the form of a bound book or loose sheets. It is also known as Audit Memoranda. Audit Note Book is divided into following two parts –

- a. General information regarding nature of business carried on by the client, ownership and control, administrative organisation chart, principal officers and their duties and responsibilities, particulars of internal control system, accounting and financial policies, important documents such as Memorandum of Association, Articles of Association, Partnership Deed etc.
- b. Current information regarding current year's audit such as queries raised, explanations received, missing vouchers, error and frauds noticed and rectifying action taken, confirmations and certificates regarding important items etc.

Importance of Audit Note Book

1. Easy finalisation:

Audit Note Book facilitates easy finalisation of audit report ensures that all important points are covered in audit and that no important area or point is missed out or left out.

2. Helps in planning:

Audit Note Book helps in planning audit of the same company next year. Auditor knows the weak areas and the strong areas regarding internal control system of the client. It helps him in preparing audit programme of the client for next year.

3. Guide for assistants:

Audit Note Book of a company's audit acts as a guide for the audit assistants. They get an idea about the queries rose last year. Errors and frauds discovered last year etc. which is useful information for doing audit. They also know the flow of audit work and important information about the client and the business of client.

4. Protects auditor:

Audit Note Book acts as a proof that auditor has taken utmost care and used due diligence while doing audit. If suit is filed in the court of law for negligence, audit notebook protects auditor from such charges.

5. Review of audit work:

Audit Note Book helps auditor to review audit work and make changes in audit programme as per the requirements. This ensures audit of high quality and also completion of audit in time.

What do you mean by Current file and Permanent file ? (April, 2015)

Classification of working papers

Audit working papers are broadly classified as follows –

1. Current file -

In this file, working papers of the year under audit which are relevant only for that particular year are filed. E.g. Letter of appointment and acceptance, on objection certificate from the previous auditor, audit programme, details of audit procedures and tests performed, queries raised and answers received to the queries in the course of audit, trial balance, final accounts, schedules, groupings, letters of confirmation from different parties, bankers and lenders, correspondence with different parties and experts in fields, extracts of important resolutions from the minutes book, list of missing vouchers and bills, bank reconciliation statement, certificate from management regarding closing stock, cash-in-hand and verification of fixed assets, a copy of computation of income and income-tax, audit report etc.

2. Permanent file -

In this file, working papers of continuing importance affecting the company and the audit are filled. E.g. a certified copy of the Memorandum and Articles of association in case of a company, a certified copy of the partnership deed in case of a firm, a certified copy of the trust deed in case of a trust, certified copy of the

bye-laws in case of a society, a list of directors, partners, other important officers and their duties and responsibilities, organisation chart, a list of books of account maintained, a note on the nature of business carried on by the client, addresses of different offices and factories and branches of the company, a note on the system of internal control, a note on the accounting policies and method of depreciation, method of stock valuation, method of accounting followed by the client, details of holding company and subsidiary companies of the concerns etc.

Write a note on lien of auditor on book of accounts and working papers.

Ownership, custody and Access of working papers

Audit working papers are the property of auditor. He is the owner of these papers. He should keep these papers in his custody very safely for such time as per legal and professional requirement of record retention. Auditor may at his own discretion give copies or extracts of his working papers to his clients or other parties. He should keep these working papers confidential.

Lien on working papers and on client's books

Lien means the right of a person for keeping lawful possession of somebody else's property on which he has worked for satisfying a claim against that person.

If auditor is not paid his dues by the client for work done by him then even in such cases he cannot keep the books of accounts and documents of the client in his possession as he has no lien on such book or documents. It was held in R.D.Saxena V/s Balram Prasad Sharma (2000), 7 SCC, 264 by Supreme Court that auditor has no lien over books of accounts and records of his clients for unpaid remuneration.

However, working papers are documents prepared by auditor himself. It is his property and hence there is no question of lien on working papers. He can retain these working papers in case of non-payment of his dues. He can retain confirmation letters and certificates received from different parties in the course of audit as his property.

Select the appropriate option and rewrite the following sentences:

1. Audit Programme should be
a. Rigid b. oral c. **Written** d. confusing
2. Audit working papers is the property of
a. **auditor** b. Client c. Government d. ICAI
3. Materiality levels in audit are set while preparing
a. Audit Note Book b. **Audit Plan** c. Permanent file d. Current file
4. Permanent file in audit contains
a. Queries raised b. trial balance c. balance confirmations d. **organisation chart**
5. Current file in audit contains
a. organisation chart b. **Queries raised** c. List of directors d. list of books of accounts
6. Auditor has no lien over
a. Cash book b. BRS c. Balance confirmation from Bank d. Cash-book audit queries
7. Before commencing audit, auditor should obtain
a. Appreciation letter b. **appointment letter** c. balance confirmation letter from debtor
d. balance confirmation letter from creditor
8. Objective of audit plan to
a. delay audit report b. omit important areas of audit c. make material mis-statement d. **complete audit in time**
9. The considerations in developing audit plan are given by the –
a. SA - 200 b. **SA - 300** c. SA – 500 d. SA – 600
10. Auditor should ensure that financial statements audited by the –
a. **are free from errors and frauds** b. contain material mis-statement of facts
c. omit material information d. contain errors and frauds

11. Allocation of duties and fixing of responsibilities is done by
a. Audit programme b. audit report c. audit working papers d. audit note book
12. Noting of last transaction audited is made in
 a. audit permanent file b. audit report c. audit note book d. audit programme
13. Company's Bank balance certificate is the property of -
 a. auditor b. bank **c. company** d. accountant
14. A copy of society's bye law copy is filed in -
 a. current file b. box file c. flat file **d. permanent file**
15. Audit queries papers are preserved in
a. current file b. box file c. flat file d. permanent file
16. Audit programme is also called as
a. blue-print of audit work b. report of audit work
 c. post-mortem of audit work d. summary of audit work

Fill in the blanks

1. Audit ____ is a written timetable of audit work.
2. Audit ____ is the property of auditor which he should preserve.
3. Auditor has no lien on the ____ and documents of his client for nonpayment of his dues.
4. ____ file and permanent file are the types of audit working papers.
5. Auditor must setup ____ level while developing audit plan.
6. While developing audit plan, auditor should decide the nature and extent of audit ____ required for different matters.
7. Audit Note Book is also known as Audit ____.
8. Working papers of audit are the property of ____.
9. Working papers of continuing importance affecting the company and the audit are preserved in a file known as ____.
10. Working papers of the year under audit relevant only for that year are preserved in a file known as ____.
11. Working papers like Trial balance, Bank balance confirmation, Debtor's balance confirmation, creditor's balance confirmation are filed in ____.
12. Working papers like memorandum and articles of association, partnership deed, trust deed, bye law copy are filed in ____.
13. A detailed plan of the audit work to be performed, specifying the procedures to be followed in verification of each item in the financial statements and giving the time required is called as ____.
14. Auditor don't have ____ on the books of accounts of the company audited by him.
15. Auditor can keep the ____ of the audit with himself as his property.
16. Auditor should obtain ____ letter from the client before commencing the audit.
17. Auditor should find out the ____ and ____ of audit to be undertaken before commencing the audit.
18. Audit programme should be ____ and modified from time to time.
19. Audit programme should not be ____ and modified from time to time.
20. If there is a change in the auditor then auditor should obtain "No Objection Certificate" from the ____ before accepting the audit.

(A) Match the columns

A	B
1. Audit Planning	a. Property of auditor
2. Audit Programme	b. Standard of Auditing - 300
3. Audit working papers	c. Audit Memoranda
4. Audit Note Book	d. Current year's audit papers
5. Current file	e. Time-table of audit
6. Permanent file	f. No objection Certificate from previous auditor

7. Change of auditor	a. Memorandum of Association
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(B) Match the columns

A	B
1. Copy of Partnership Deed	✓ Audit plan
2. Bank Reconciliation Statement	b.No lien for auditor
2. Materiality Level	c.Permanent file
3. Books of accounts	d.current file
4. Appointment letter	e.Noting of audit observations
5. Audit Note Book	f.to complete audit in time
6. Objective of audit planning	g.Time table of audit work
7. Audit Programme means	h.Pre-commencement audit requirement

(C) Match the columns

A	B
■ Balance Sheet audit	➤ Generally applied in banks
■ Concurrent audit	➤ Useful for declaring interim dividend
■ Interim audit	➤ Final audit
■ Annual audit	➤ Audit carried out throughout the year
■ Continuous audit	➤ American concept
■ Concept of materiality	➤ Assumption that firm will continue forever
■ Going concern concept	➤ Disclose all material items separately

(D) Match the columns

A	B
✓ Constant moral check on accountant	✓ Concurrent audit
✓ Checking assets and liabilities	✓ Interim audit
✓ Checking on day to day basis	✓ Annual audit
✓ Quarterly audited financial results	✓ Going concern concept
✓ Audit beginning after final accounts	✓ Continuous audit
✓ Director's Remuneration	✓ Balance Sheet audit
✓ Assets not shown at market price	✓ Absence of Going Concern assumption
✓ Continuous negative net worth	✓ Material item to be shown separately

What are the techniques of Auditing?

Auditing Techniques (SA – 500)

After deciding the nature and type of audit and after preparing audit programme, auditor should actually commence the audit. There are various techniques and procedures of auditing. A technique of auditing means the methods used by the auditor to obtain audit evidence. According to SA -500 and Auditing & Assurance Standard – 5 (AAS – 5) , audit techniques are as follows –

1. Inspection :

It consists of examination of records, documents and tangible assets. Physical examination of tangible assets ensures the existence and possession of assets and examination of documents ensures the ownership of assets. The auditor with reference to authenticity or genuineness, appropriateness or legitimacy, authorisation or proper and correct recording of the transactions examines documents and vouchers.

Documentary evidence is classified into four categories, from point of view of reliability:

- Evidence originating from and held by third parties.
- Evidence originating from the entity and held by the third parties.
- Evidence originating from the third party and held by the entity.
- Evidence originating from and held by the entity.

Physical examination of tangible assets provides reliable evidence as regards their existence.

Live examples in day to day life for inspection

- Students inspecting the mobile buying it.
- On line ticket booking (movies/ travels) , check availability / price etc.
- Professor checking the students Roll NO. / Seat NO. Signature on Answer book/ checking Hall Ticket during examination.
- Security person checking I.D.Cards before entry into college premises.

Practical examples during auditing

- Auditor present during physical checking of stock.
- New Asset purchased where installed/ working.
- Inspection of bill, challans, goods, purchased during the year.
- Checking of goods dispatched to customers, Quality, Quantity to be sent to whom.
- Verification of assets appearing in books of accounts and where located.
- Cash checking lying with the cashier at periodical intervals.
- Cancellation of blank cheques already signed by the owner but not used at year end.

2. Observation :

It consists of observing or witnessing a process or procedure performed by others. Auditor may observe the procedure of stocktaking done by the client's staff.

- Process of a admission (procedure) in college.
- Security observation.
- Fuel filling at petrol pumps.
- Examination time – observing students trying to copy.
- Observing – Selection – Buying – Packing – Delivery – goods in Departmental stores/ Mall.

Practical examples during Auditing

- Process of stock taking
- Observe how cash receipts and cash payments are certified and made.
- Observe how the employees are having enough work or are playing games on computers or are doing their personal work.
- Observe whether assets of the concern are used only for official purposes.

3. Enquiry :

It consists of seeking information from right persons. Auditor may seek information from the officers or workers of the clients or from outsiders such as bankers, customers, suppliers, lenders , consultants of the client.

4. Confirmation :

It consists of obtaining confirmation of balances. Auditor may contact banker, customers, suppliers, lenders etc. of the client and obtain confirmation of their balances with the concern.

5. Analytical Review :

It consists of studying various accounting ratios such as gross profit ratio, stock turnover ratio, debtor's turnover ratio etc., studying trend analysis, comparison of current year's figures with previous year's figures and investigating into unusual fluctuations. Auditor can scan various unusual transactions and marks detailed ledger scrutiny to examine and analyse accounts.

What is Test Checking and What are the features of Test-checking ?

According to Prof. Meigs – “ Test checking means to select and examine a representative sample from a large number of similar items.”

These days in case of big companies, the number of transactions is so large that it is physically impossible for the auditor to check each transaction and hence he has to apply test check in such cases.

After analyzing and evaluating the internal control system, internal check system and internal audit, auditor should decide the extent the test check he can apply. Auditor selects certain transactions for detailed examination and checks them in detail from their commencement to conclusion. In Test- Check, auditor checks some of the similar transactions to form an opinion about the whole of those transactions. AS per SA – 500, auditor can obtain audit evidence on a selective basis based on his personal judgment or statistical sampling technique.

Features of Test Checking

1. Few transactions are selected from large number of similar transactions for detailed examination or checking.
2. For non-similar transactions, extraordinary transactions, cash transactions test check is generally not applied.
3. Test checking covers all the types of expenses, incomes, assets and liabilities and the entire period of audit during a planned period. E.g. if printing and stationery account is checking thoroughly for April, June, August and so on in one year then during the next year thorough checking is done for May, July, September and so on.
4. Test checking is kept flexible and changed as per the information gathered during the course of audit. E.g. if lot of mistakes are detected in selected transactions then instead of test checking, all the transactions on that type should be checked.
5. Transactions selected for test-checking are examined thoroughly from their commencement to conclusion.
6. The method of test checking is changed suddenly during the course of audit with an element of surprise. E.g. if transactions above Rs.10000 are selected for test checking , then suddenly during a month transactions less than Rs.10000 may be selected for test checking.

What is Test Checking and What are the features of Test-checking ?

According to Prof. Meigs – “ Test checking means to select and examine a representative sample from a large number of similar items.”

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FEATURES OF TEST CHECKING

Test checking consists of selecting and checking a proportion of transactions selected by the Auditor. The salient features of Test Checking are –

1. Scientific:

It is a mathematical truth that a scientifically selected sample would reveal the features and characteristics of the population. The statistical theory of sampling is based on a scientific law. Hence, it can be relied upon to a greater extent than any arbitrary technique which lacks basis and acceptability.

2. Estimation Process:

Test Checking and Sampling can never bring complete reliability; it cannot give accurate results. It is a process of estimation. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular

3. Coverage of material items:

Entries involving large amounts or relating to material accounts are seen exhaustively and other entries are picked up for verification from the remainder according to a certain plan. Sometimes entries are checked for a few specified months exhaustively and the rest go unchecked.

4. Full Coverage over a time period:

Test Check is normally planned in such a way that the audit programmes for 3 to 5 years cover all types of transactions in case of a medium or large sized Company. Thus, if in one year the months of January, June and December are checked; April, July and September may be checked in the second year and so on.

5. Surprise Element:

The staff and management of the Auditee Company should not be able to anticipate the pattern of test checking; otherwise they will predict the areas and periods to be covered in any one year and will be careful regarding the same.

6. Flexibility:

If test checking becomes routine, predictable and mechanical, it loses its value. Hence, the Auditor should keep changing the methods of test checking at reasonably frequent intervals.

7. Judgment Based:

The extent of test checking would primarily depend on the Auditor's judgment of a particular situation. This judgment in turn depends on the previous experience of the Auditor, current developments and the efficacy of Internal Control System.

What do you mean by routine checking?

Routine checking means checking of arithmetical accuracy of books of original entry and ledgers with a view to detecting clerical errors and simple frauds.

Routine checking is the detailed checking of all transactional aspects such as casts, sub – casts, carry-forwards, extensions and calculations etc. in subsidiary books, checking of posting into the ledgers, casting of ledger accounts and extraction of their balances etc.

What are objects of routine checking?

Routine checking is of a mechanical nature. But it should be done thoroughly and intelligently as it will help to discover many errors of posting, wrong totals etc. The main objects of routine checking are

- (a) to verify the arithmetical accuracy of the entries,
- (b) to verify the accuracy of posting to ledgers.
- (c) to check that the ledger accounts have been correctly balanced, and
- (d) to ensure that no figures are altered after checking.

Advantages routine checking

- (a) Checking of posting and ledgers.
- (b) Arithmetical accuracy can be checked.
- (c) Trial balance tallying is facilitated.
- (d) Easy detection of errors and frauds.
- (e) Delegation of audit work to junior staff.

Dis-advantages routine checking

- (a) It is mechanical and boring work.
- (b) it is unnecessary in case of large business using information technology.
- (C) It is detect only simple arithmetical errors and small frauds.
- (d) It is time consuming and expensive.

What do you mean by Test checking?

Test checking

Prof. Meig defines

“Test Checking means to select and examine representative sample from a large number of similar items.”

Test check may be define to mean checking certain selected transactions with a view to proper accounting of the transactions and to draw conclusion about all the transactions of the same kind.

In a large sized organisation, where the number of transactions to be checked is very large and the auditor has a little time at his disposal, a few transactions may be selected on random basis and checked. Such a check is called as “Test Check”. All the transactions need not be checked. This type of check minimizes the work of the auditor.

FEATURES OF TEST CHECKING

Test checking consists of selecting and checking a proportion of transactions selected by the Auditor. The salient features of Test Checking are –

- 1. Scientific:** It is a mathematical truth that a scientifically selected sample would reveal the features and characteristics of the population. The statistical theory of sampling is based on a scientific law. Hence, it can be relied upon to a greater extent than any arbitrary technique which lacks basis and acceptability.
- 2. Estimation Process:** Test Checking and Sampling can never bring complete reliability; it cannot give accurate results. It is a process of estimation. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular
- 3. Coverage of material items:** Entries involving large amounts or relating to material accounts are seen exhaustively and other entries are picked up for verification from the remainder according to a certain plan. Sometimes entries are checked for a few specified months exhaustively and the rest go unchecked.
- 4. Full Coverage over a time period:** Test Check is normally planned in such a way that the audit programmes for 3 to 5 years cover all types of transactions in case of a medium or large sized Company. Thus, if in one year the months of January, June and December are checked; April, July and September may be checked in the second year and so on.
- 5. Surprise Element:** The staff and management of the Auditee Company should not be able to anticipate the pattern of test checking; otherwise they will predict the areas and periods to be covered in any one year and will be careful regarding the same.
- 6. Flexibility:** If test checking becomes routine, predictable and mechanical, it loses its value. Hence, the Auditor should keep changing the methods of test checking at reasonably frequent intervals.
- 7. Judgment Based:** The extent of test checking would primarily depend on the Auditor's judgment of a particular situation. This judgment in turn depends on the previous experience of the Auditor, current developments and the efficacy of Internal Control System.

ADVANTAGES OF TEST CHECKING

The advantages of Test Checking include –

- 1. Audit Objective:** The Auditor is required to form an opinion on the Financial Statements. Even after 100% checking, he may not derive absolute satisfaction. Hence, proper and careful test checking serves the audit objective in obtaining reasonable audit assurance.
- 2. Expertise:** Application of test check principles involves the application of mind and intelligent judgment. It enables the Auditor to use his expertise effectively.

3.Exception Principle: Test Checking adopts the principle of exception in control. If certain aspects of internal control do not create suspicion, there is no need to verify all those transactions exhaustively.

4. Scientific Assessment of Risk: The Auditor assesses the risk of material misstatements in the Financial Statements in a scientific manner by drawing suitable samples and studying the same in detail.

5. Saving in time: As fewer transactions are verified, time is saved to a great extent. This, in turn, enables completion of all the audits / verification procedures in time.

6. Reduction in Work: Volume of work is reduced by test checking methods. Audit processes are not carried out mechanically on all transactions.

DISADVANTAGES

The disadvantages of Test Checking are –

1.Naive and Biased: The extent to which test checking can be resorted to is a matter of Auditor's personal assessment. It does not ensure selection of representative samples of adequate size and offers opportunities for bias to enter into selection process.

2. Unauthentic : Test Checking lacks authenticity, precision and an acceptable basis. It does not give the Auditor an idea about the degree of reliability that can be placed on the findings for application to the whole set of entries.

3. Higher Risk: runs the risk that some of the material error may not be discovered and some of the important areas may go unaudited. Sometimes, it may increase the level of inherent Audit Risk.

4. Unscientific: It involves lot of arbitrariness on the part of the Auditor in determining and selecting the number of transactions. Therefore, the approach cannot be considered as a scientific one.

5.Difference in activity levels: Where activity levels vary in a year, e.g. a few months of peak production and sales seasons, the Auditor cannot draw reasonable conclusions about the transactions of the whole year merely by checking transactions of a few specified months.

6. Lack of Surprise Element: If the surprise element is absent, the client may predict the pattern of checking.

AUDIT SAMPLING

MEANING:

1. The purpose of this Auditing and Assurance Standard (AAS) is to establish standards on the design and selection of an audit sample and the evaluation of the sample results. This AAS applies equally to both statistical sampling methods. Either method, when properly applied, can provide sufficient appropriate audit evidence

2. When using either statistical or non-statistical sampling methods, the auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence.

3. "Audit sampling" means the application of audit procedures to less than 100% of the items within an account balance about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population.

4. It is important to recognise that certain testing procedures do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population but would not necessarily be the basis for a valid conclusion about the remaining portion of the population.

FACTORS IN DETERMINING SAMPLE SIZE- SAMPLING RISK

(1) When determining the sample size, the auditor should consider sampling risk, the tolerable error, and the expected error. Examples of some factors affecting sample size are contained in Appendix 1 and Appendix 2.

SAMPLING RISK

(2) Sampling risk arises from the possibility that the auditor conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.

(3) The auditor is faced with sampling risk in both tests of control and substantive procedure as follows:

(a) **Tests of control:**

- (I) Risk of under reliance: The risk that, although the sample result does not support the auditor's assessment of control risk, the actual compliance rate would support such an assessment.
- (II) Risk of over reliance: The risk that, although the sample result supports the auditor's assessment of control risk, the actual compliance rate would not support such an assessment.

(b) **Substantive procedures:**

- (I) Risk of incorrect rejection: The risk that, although the sample results support the conclusion that a recorded account balance or class of transactions is materially misstated, in fact it is not materially misstated.
- (II) Risk of incorrect acceptance: The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is not materially misstated.

(4) The risk of under reliance and the risk of incorrect rejection affect audit efficiency as they would ordinarily lead to additional work being performed by the auditor, or the entity, which would establish that the initial conclusions were incorrect. The risk of over reliance and the risk of incorrect acceptance affect audit effectiveness and are more likely to lead to an erroneous opinion on the financial statements than either the risk of under reliance or the risk of incorrect rejection.

(5) Sample size is affected by the level of sampling risk the auditor is willing to accept from the results of the sample. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

Tolerable Error

Meaning : Tolerable error is the maximum error in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved the audit objective.

Relationship : Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditor's judgement about materiality. The smaller the tolerable error, the greater the sample size will need to be.

Interests of control: the tolerable error is the maximum rate of deviation from a prescribed control procedure that the auditor would be willing to accept, based on the preliminary assessment of control risk.

Substantive procedures: the tolerable error is the maximum monetary error in an account balance or class of transactions that the auditor would be willing to accept so that when the results of all audit procedures are considered, the auditor is able to conclude, with reasonable assurance, that the financial statements are not materially misstated.

Expected Error

Meaning If the auditor expects error to be present in the population, a larger sample than when no error is expected ordinarily needs to be examined to conclude that the actual error in the population is not greater than the planned tolerable error.

Relationship Smaller sample sizes are justified when the population is expected to be error free.

Factors In determining the expected error in a population, the auditor would consider such matters as error levels identified in previous audits, changes in the entity's procedures, and evidence available from other procedures

What are the methods of selecting sample items?

SELECTION OF THE SAMPLE

The auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected. While there are a number of selection methods, **three methods** commonly used are:

(1) Random selection method:

Random selection, which ensures that all items in the population have an equal chance of selection, for example, by use of random number tables. The samples should be selected at random. It means that each transaction has a known and equal chance of being included in the sample. Random sampling could be either simple or stratified sampling.

Today, many computer programs for generating random numbers are available, for example, Microsoft spreadsheet software Excel has a function that can generate random number. These computer program save time, reduce the possibility of errors and provide an automatic documentation of the selected numbers.

(2) Systematic selection Method:

Systematic selection, which involves selecting items using a constant interval between selections, the first interval having a random start. The interval might be based on a certain number of items (for example, every 20th voucher number) or on monetary totals (for example, every Rs 1,000 increase in the cumulative value of the population).

When using systematic selection, the auditor would need to determine that the population is not structured in such a manner that the sampling interval corresponds with a particular pattern in the population.

For example, if in a population of branch sales, a particular branch's sales occur only as every 100th item and the sampling interval selected is 50, the result would be that the auditor would have selected all, or none, of the sales of that particular branch.

(3) Haphazard selection Method:

Haphazard selection, which may be an acceptable alternative to random selection, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units. When the auditor uses this method, care needs to be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

How would you evaluate sample result?

EVALUATION OF SAMPLE RESULTS

After carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the auditor should evaluate the result:

Analysis of errors in the sample:

In analyzing the errors detected in the sample, the auditor will first need to determine that an item in question is in fact an error. In designing the sample, the auditor will have defined those conditions that constitute an error by reference to the audit objectives.

For example, in a substantive procedure relating to the recording of accounts receivable, a misposting between customer accounts does not affect the total accounts receivable. Therefore, it may be appropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of doubtful accounts.

When the expected audit evidence regarding a specific sample item cannot be obtained, the auditor may be able to obtain sufficient appropriate audit evidence through performing Alternative procedures. For

example, if a positive account receivable confirmation has been equated and no reply was received, the auditor may be able to obtain sufficient appropriate suit evidence that the receivable is valid by reviewing subsequent payments from the ;customer. If the auditor does not, or is unable to, perform satisfactory alternative procedures if the procedures performed do not enable the auditor to obtain sufficient appropriate audit evidence, the item would be treated as an error.

In analysing the errors discovered, the auditor may observe that many have a common feature, for example, type of transaction, location, product line, or period of time. In such circumstances, the auditor may decide to identify all items in the population which possess the common feature, thereby producing a sub-population, and extend audit procedures in this area. The auditor would then perform a separate analysis based on the items examined for each.

Projection of Errors

The auditor projects the error results of the sample to the population from which the sample was selected. There are several acceptable methods of projecting error results. However, in all the cases, the method of projection will need to be consistent with the method used to select the sampling unit. When projecting error results, the auditor needs to keep in mind the qualitative aspects of the errors found. When the population has been divided into subpopulation, the projection of errors is done separately for each subpopulation and the results are combined.

Reassessing Sampling Risk

The auditor needs to consider whether errors in the population might exceed the tolerable error. To accomplish this, the auditor compares the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or financial statement assertion. The projected population error used for this comparison in the case of substantive procedures is net of adjustments made by the entity. When the projected error exceeds tolerable error, the auditor reassesses the sampling risk and if that risk is unacceptable, would consider extending the audit procedure or performing alternative audit procedures.

What is internal control? (April, 2015)

Internal control:

Internal control is another important area of auditing. Internal control refers to a number of checks and controls exercised in a business to ensure its efficient and economic working. In this unit you will learn the meaning and objectives of internal control and internal check. You will also learn various system of internal check and generally understand audit in respect of computer environment.

SA 400 issued by ICAI deals with the study and evaluation of Internal Control with an audit. It defines Internal Control as " all the policies and procedures adopted by the management of a concern to ensure the orderly and efficient of its business."

The Institute of Chartered Accountants of England and Wales defines internal control as "internal control means not only internal check or internal audit, but the whole system of control financial and otherwise, established by management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible accuracy and reliability of its records".

Objectives of internal control

1. all transactions are duly authorized
2. All transactions are properly recorded.
3. All transactions are recorded promptly as soon as they occur.
4. All accounting policies adopted by the management in respect of stock valuation.
5. The assets of the concern are safeguarded; the assets are not used or sold without proper authorization and are verified regularly.
6. Errors and frauds are prevented and detected.
7. The books of accounts are complete and accurate.
8. The final accounts are reliable and ready in time.

What are the limitations of internal control? (April, 2015)

Internal control can provide only reasonable, but not absolute, assurance that the objectives stated above are achieved. This is because there are some inherent limitations of internal controls, such as:

(a) Potential of human error:

Employees carelessness, misunderstanding of instructions and errors in judgment has an impact on the effectiveness of internal control system.

(b) Break down :

Due to simple errors breakdown may occur.

(c) Collusion:

Segregation of duties of employees is the fundamental principle in the design of internal control system. Effectiveness of the system will be compromised if two or more employees recording different aspects of a transaction collude.

(d) Manipulations by management:

Internal control system is maintained by management. Manipulation and misappropriations by members of management cannot be detected or prevented by the control system.

(e) Management discretion:

Management makes decision regarding design and implementation of control which may not be adequate.

State whether following statements are true or false:

1. Test checking is checking of all the books of original entry.
2. Routine checking saves time.
3. Test checking is mechanical.
4. Test checking depends on the judgment of the auditor.
5. Test checking adopts the principle of exception.
6. Audit sampling is an important
7. SA 530 deals with Audit sampling.
8. There is no risk involved in Audit sampling.
9. Stratification is the process of dividing the population into different strata.
10. Internal control is a sort of vigilance on transactions.

Internal Check, Internal Control and Internal Audit

Point	Internal Check	Internal Audit	Internal Control
Meaning	It is an arrangement of duties in such a manner that work of one employee is checked by the work of another employee.	It is a review of operational and records by a special staff.	It is a plan of the organisation to safe guard its assets, check accuracy and reliability of its accounting data.
Objective	To prevent errors and frauds	To review the operations and records of the organisation.	To promote operational efficiency.
Relationship	It is automatic and continuous	Checking is done by internal auditor.	It includes implementation of internal checks and internal audit.
Nature of checks	It is objective	It is subjective	It includes internal
Scope for Suggestions	There is no scope for suggestions.	There is a scope for suggestions	It includes both internal check and internal audit.

Point	Test Check	Internal Check
Meaning	It stands for the method of auditing when instead of a complete examination of all the transaction recorded in the books of account only some of the transaction are selected and verified.	It refers to a system of book-keeping and arrangement of staff duties in the organization in such a manner that no one person can completely carry through a transaction and record every aspect thereof.
Objective	The purpose is to aid auditors to check and draw conclusions about the voluminous transactions.	Its objective is to facilitate management functions.
Errors and Frauds	It helps the auditor to unearth frauds and errors without checking all the transactions.	It is instituted to prevent frauds and errors.
Management Control	Management has no control over the test checks carried out by the auditors.	Internal controls are subject to review, appraisal and changed by the management.
2. INSTITUTED BY	It is an audit procedures performed by the auditor in respect of only selected group of transactions.	It is a series of procedures laid down by the management.

AUDITING IN DEPTH

Taylor and Perry have defined Auditing in Depth as : “the examination of the system applied within a business entailing the tracing of certain transactions from their origin to their conclusion, investigating at each stage the records created and their authorization”.

Audit in depth does not mean 100% checking. It is a detailed examination of the selected transactions from the beginning to the end. Thus, it is used along with test checking. For example, if the auditor has decided to check 25% of purchase transactions, these transactions should be checked in depth. Auditor should check the Purchase Requisition, Tenders, Purchase Orders, Purchase Bills, Goods Received Note, Inspection Note, Purchase Journal, Stock Register, Bin Card and so. on.

Thus, the auditor should check the purchase transaction right from the beginning to the end. This enables him to evaluate the accounting system and internal controls.

Fill in the blanks with appropriate word

1. Routine checking is highly ____ process.
2. In test checking clients' staff becomes ____.
3. ____ is checking selection transactions.
4. ____ decides the extent of test checking.
5. ____ of the organisation decides the size of samples.
6. ____ is an important Audit technique.
7. SA ----- deals with Audit samples.
8. ____ is the maximum error in population.
9. ____ is the process of dividing a population into different classes.
10. Under ____ all items in the population have equal change of selection.
11. ____ is a wide term which includes all types of management control.
12. Internal control is instituted by the ____.
13. Under internal control in purchases the orders should be placed with ____ suppliers.
14. Accounts of various suppliers should be ____ periodically.
15. Audit by staff with the organisation is called ____ audit.
16. Statuary auditor is appointed under ____.

Pankaj Pandagale, Assistant Professor of Accountancy

VOUCHING

What is Vouching?

Meaning:

Vouching means the examination of documentary evidence in support of entries to establish the arithmetic accuracy. When the auditor checks the entries with some documents it is called vouching. Vouching is **the acid test of audit**. It tests the truth of the transaction recorded in the books of accounts. It is an act of examining documentary evidence in order to ascertain the accuracy and authenticity of the entries in the books of accounts.

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

Voucher

Any documentary evidence supporting the entries in the records is termed as a voucher. Any document, which supports the entries in the books of accounts and establishes the arithmetical accuracy, is called a voucher.

Examples of vouchers:

A bill, a receipt, an invoice, goods received note, salaries and wages sheets, goods inward and outward register, stores records, counterfoil of a cheque book, counterfoil of pay-in-slip book, bank statement, bank pass book, delivery challans, agreements, a material requisition slip, copy of purchase order, minute book, memorandum and articles of association, partnership deed, trust deed, prospectus etc. are the examples of vouchers.

What is the importance of vouching?

IMPORTANCE OF VOUCHING

It is rightly said that vouching is an essence of auditing. Success of an audit work depends upon the manner in which vouching is done. The auditor should not only check the arithmetical accuracy of transactions but also he should go through the source of a transaction.

- **Ensures genuineness of the transactions**

It enables the auditor to ascertain that entries recorded are in respect of those transactions which have actually taken place.

- **Enables to know transactions**

Auditor can check the nature of transactions and he can be sure that whatever transactions are recorded is not only genuine but also they relate to the nature and type of business, carried on by the client.

- **Helps to know relevance of the transaction**

Generally accepted accounting principle requires that only those transactions which pertaining to that accounting period only should be considered and included in the Profit and Loss Account of the period.

- **Facilitates proper allocation of capital & revenue, expenditure**

Vouching helps the auditor to determine the proper allocation of capital and revenue expenditure and receipts.

- **Detects frauds and errors**

It enables the auditor to detect the existence of frauds and errors in time.

- **Decides authenticity of transactions**

It ensures the auditor that the transactions recorded are not only genuine but they are duly authorized by some responsible officials and they are complete in all respects.

- **Ensures proper accounting**

Vouching enables the auditor to verify whether accounting has been done as per recognized accounting policies and practices and the vouchers verified are properly accounted in the books.

- **Compliance with law**

Vouching ensures that the transactions are complying with the previous of law i.e. Indian Companies Act, 2013.

The special considerations to be borne in mind by the auditor in the course of vouching.

1. Date of the voucher
2. The name of the party
3. Tick and audit rubber stamp
4. Authorisation by the authorised person
5. Revenue stamp of Re. 1 if it exceeds Rs.5000/-
6. Transaction relates to business
7. Revenue and capital 8. Amounts in words and figure
9. Account head
10. No assistance of member of client's staff to be taken for checking receipts
11. Not to accept receipted invoice
12. Missing vouchers
13. Important documents
14. Vouching of cash transaction
15. Proper filing
16. Signature of payee
17. Nature of payment
18. Noting in the audit note book
19. Alteration
20. Voucher control number

What are the objectives of vouching?

Objectives of vouching

The basic objectives of vouching are as under:

1. To ensure that all the transactions are properly recorded in the books of accounts.
2. To see the proper evidence supports all the entries of the transactions.
- 3 To make it sure that fraudulent transactions are not recorded in the books of accounts.
- 4 To see that all transactions relating to business are recorded in the books of accounts.
5. To see that all transactions are properly authenticated by a responsible person.

How would you vouch cash sales and credit sales?

Cash sales

The auditor should take the following steps to vouch cash sales:

a. Internal check

Examine the system of internal check

b. Daily cash summary

A summary of daily cash should be checked. The cash sales register should be fully checked with the carbon copies of the cash sales bill. Particular attention should be given to first and last month of accounting year.

c. Proper entry

See that total of daily cash sales as per salesman's abstract is properly entered on the receipt side of cash book. If they are deposited into bank, check the same with counterfoil of pay-in-slip book and Bank pass book.

d. Documentation

Check the relevant documents cash memo, Delivery challans, Excise gate pass, octroi receipt. In case of export, Bill of lading, custom duty receipt, Airway bill, Proof of delivery etc.

e. Authority for discount

Where it is a policy of the company to allow a discount, it should be seen that uniform policy is followed.

f. Reconciliation

Test check the reconciliation between sales and stocks.

g. Posting

Test checks the posting from cash book into ledger.

h. Sale of Fixed assets

Ensure that sale of fixed asset is not included in sales.

i. Sales of scrap

See that sale of scrap is recorded separately.

J. AS 9

See that AS9 is complied with.

Sales on approval Basis or Sale or Return Basis

	Document to be seen	Aspect to be verified / Auditor's duties
1.	Sale or return day book	<ul style="list-style-type: none"> a. Examine the sale or return day book for the manner of accounting. b. Check actual movement of goods from dispatch register/ goods outward book. c. Note the period of approval in the case of different goods/ customers. d. Verify whether goods returned have been properly reversed in the day book.
2	Order book or confirmation book	Examine this register to verify sale confirmed by customers and goods held by customers at their end as sale or return stock.
3	Sales register	Ensure that sales have been recognised whenever- (a) approval is received from the party; or (b) goods are appropriated by the party; or (c) period of approval has expired and goods have not been returned.
4	Stock registers and statements	Ensure that closing stock includes goods lying with customers in respect of which period of approval has not expired. • Ensure that goods validly returned by customers are duly accounted in stock.

Good sent on consignment

	Document to be seen	Aspect to be verified / Auditor's duties
1.	Consignment agreement	Ascertain and note the following terms and conditions- • Commission due- manner of payment, adjustment, etc. • Risk of bad debts- in case of del—credere commission, consignee has to bear the risk of bad debts; else bad debts are borne by the consignor. • Reimbursement of consignment expenses- eligible expenses, extent of reimbursement
2	Goods outward book	Verify goods despatched by reference to the proforma invoice, consignment day book, goods outward book, transport documents, acknowledgement of the goods by the consignee and the account sales.
3	Stock registers	Ensure that the stock lying with consignee at the year end is be taken in the balance sheet at cost on a consistent basis and credited to the consignment a/c to arrive at the result of consignment transactions. Ensure that no profit is taken for the profit on goods remaining in the hands of the consignee.
4	Account sales	Verify whether consignment sales are accounted by crediting consignment account and debiting the consignee's account. • See whether the summery of transactions reported i.e. sales made, expenses incurred, commission due, remittance made, balance stock, and amount due from / to either party is properly disclosed in the general ledger..
	Consignment account	When the goods are consignment above cost, ensure that necessary adjustments to remove the loading are made at the end of the year. • Verify whether necessary adjustments are made at the year – end in respect of unsold goods, commission and expenses incurred by the consignee.
	Confirmation	Obtain confirmation of the account balance from the consignee.

Sales return

1. Internal Check

Enquire into the system of internal check as regard sales returns.

Pankaj Pandagale, Assistant Professor of Accountancy

Pankaj Pandagale, Assistant Professor of Accountancy

Verification

What do you mean by Verification?

As per SA – 500 verification means to obtain and examine evidence in respect of an item of asset that:

- (i) The asset exists on a given date
- (ii) The asset is legally owned by the concern
- (iii) There are no unrecorded assets
- (iv) The assets are disclosed, classified and presented in accordance with recognised accounting policies and the requirements of law

According to Spicer and Peglar – “Verification of assets implies an inquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets.”

Verification is a process by which an auditor satisfies himself about the accuracy of the assets and liabilities appearing in the balance sheet by inspection of the documentary evidence available.

What are the objects of verification of assets?

- (1) To find out whether the assets were in existence.
- (2) To find out the ownership and title and possession of the assets.
- (3) To show correct valuation of assets and liabilities.
- (4) To know whether the Balance Sheet exhibits a true and fair view of the state of affairs of the business or not.
- (5) To detect errors and frauds, if any.
- (6) To verify arithmetical accuracy of the books of accounts.
- (7) To find whether is an adequate internal control regarding acquisition, utilization and disposal of assets and regarding rising of loans and discharge of liabilities.
- (8) To ensure that the assets and liabilities have been properly recorded and properly disclosed in the Balance sheet.

What points should be considered by an Auditor while conducting Verification?

1. Existence: The auditor should confirm that all the assets of the company physically exist on the date of Balance Sheet. It is quite possible that machinery is destroyed by an accident and it is scrapped but still appears in the books. On verification only the auditor can find out that it does not exist. Then it can be rectified.
2. Possession: The auditor has to verify that the assets are in the possession of the company on the date of Balance Sheet. An old machinery is sold for Rs.70,000. It is not recorded in the books of accounts. In verification, the auditor can check up the possession of the machinery. Then the error can be rectified.
3. Ownership: The auditor should confirm that the asset is legally owned by the company. If a vehicle is the name of the employee as per the Registration Book, it cannot be treated as an asset of the company. The invoice and entry in the Registration Book should be in the name of the company to establish right of ownership.
4. Authorisation: Auditor should verify that the assets have been acquired under a proper authority.
5. Purpose: Auditor should see that the assets are used for business purposes only and not for personal purposes.
6. Charge or Lien : Auditor should verify whether the assets of the company are subject to any charge, lien or encumbrance. If they are subject to any charge or lien then this fact should be properly disclosed in the final accounts.
7. Audit report : Under CARO 2003, the auditor has to report whether the management has conducted physical verification of fixed assets and stock and the differences, if any, between the physical inventory and the inventory as per the books.
8. Events after Balance Sheet date: The auditor should find out whether any event after the date or Balance Sheet has affected any items of assets and liabilities.

What can be the basis of valuation?

- a. Cost Price: Assets are valued at actual cost which includes the installation charges.
- b. Replacement value : It is a price at which a particular asset can be replaced.
- c. Market Value: It is a price at which a particular asset can be sold out in the open market.

- d. Book Value: It is the value at which an asset appears in the Balance Sheet.
- e. Realisable Value: It is the price which is likely to be fetched if an asset is sold in the market
- f. Scrap value : It is the price likely to be realized from sale of an asset at the end of its useful life.
- g. Going concern value: It is the value which is equal to cost less depreciation.

What do you mean by Valuation of Assets?

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

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

The auditor has also to see that the principle of valuation of assets is consistently adopted and is based on established principles of accountancy. For the purpose of convenience, those assets are classified as under to determine their value.

1. Fixed Assets
2. Current Assets or Floating Assets
3. Wasting Assets
4. Intangible Assets
5. Fictitious Assets.

Distinction between verification and valuation :

1. **Meaning** : verification establishes existence, ownership and acquisition of assets whereas valuation certifies correctness of the value of assets and liabilities.
2. **Time** : Verification is done at the end of the year whereas valuation is done during the year.
3. **Personnel** : Verification is done by auditor whereas valuation is done by the proprietor himself.
4. **Evidence** : The title deeds, receipts of payments constitute documentary evidence for verification where as certificate given by the proprietor is the documentary evidence for valuation.

How would you verify 'Plant and Machinery'? (Semester VI October, 2015, 7 Marks)

The auditor should take the following steps:

- (1) **Plant Register:** See whether a Plant Register is maintained which gives details of the plants and machinery or equipments. If not, suggest that the same be maintained, since it is compulsory for limited companies to have a fixed asset register.
- (2) **Adequate Depreciation:** From details, ascertain the life of the assets. See that depreciation is provided and also see that the depreciation is fair and adequate.
- (3) **Consistency in depreciation:** See that the method of depreciation adopted is followed consistently from year to year.
- (4) **Separate Reserve:** Where any item of plant and machinery is revalued or devalued where the asset is acquired from a foreign country or upon reduction of share capital, a separate reserve account is created.
- (5) **Machinery on hire:** Machinery brought for use in the business on hire basis should not be shown as asset.
- (6) **Sale of Plant and Machinery:** Where any plant or item of machinery is sold, scrapped or transferred, check the entries and find out the profit or loss on such transfer or sale.
- (7) **Entry for depreciation:** Even the client can be asked to prepare a schedule of fixed assets showing the total cost and depreciation charged and verifies the normal entry recorded for depreciation.
- (8) **Opening balance:** Verify opening balance from last year's Balance Sheet.
- (9) **Physical Verification:** The auditor, if possible, should physically examine plant and machinery periodically i.e. at least once in three or five years.

- (10) **Proper Authority:** see that the sale and additions are made by a proper authority. Refer to the minutes books, agreement of purchase or sale, entry in cash book and any other correspondence.

How would you verify Sundry Debtors?

Accounts Receivable (Book Debts or Sundry Debtors)

Sundry Debtors represents the amount recoverable from the customers for sale of goods or rendering of services. The undermentioned procedure should be applied for verification of 'Book Debts' or 'Sundry Debtors' after receiving a schedule or list of debtors from the client.

(1) Confirmation of balances

The auditor should arrange to send the letter of confirmation of balances by the client as per client's records and see that the reply of confirmation is forwarded to his office directly. Usually this should be sent within 15 or 20 days of close of the year under the supervision of the audit staff. After the reply is received, the same should be tallied with the balances shown in the Debtors Ledger and difference properly reconciled.

(2) Scrutiny of Ledgers

After the said procedure is carried out, he should carry out a thorough scrutiny of the debtor's individual accounts. Wherever the number of debtors is very large, Test Checks can be applied. While scrutinizing the ledger, the auditor should focus the light on discounts, returns, cash received, rebates allowed, goods returned etc.

(3) Verification of the position of debtors

On ascertaining the balances of the debtors as genuine and correct, the auditor has to verify the debtors to find out bad or doubtful debts to make a provision for the same. If the debts are bad and irrecoverable or doubtful and they are not provided for properly, the financial statements will not properly, then the financial statements do not provide a 'True and Fair' view.

Hence, appropriate provision is to be made by considering the age of the debtor, scrutiny of payments received, management opinion and any other information like financial position of debtors.

(4) Compliance of legal requirements

After ascertaining the position of bad or doubtful debts, he should see that the legal requirements of Schedule VI to the Companies Act, 1956 are complied with. For this purpose, the debtors are to be classified as other non-current assets with the classification:

- (a) Secured, considered good
- (b) Other considered good
- (c) Doubtful

The debtors are to be classified as :

- (a) Outstanding for a period of more than six months ; and
- (b) Other debts.

Over and above this, other requirements like debts considered as good and which are fully secured, debts due from the officers, directors, managers of the company, etc., are to be ascertained for disclosure.

(5) Disclosure of Hire Purchase debtors

If the customers have purchased the goods on hire purchase system and some of the instalments are not due, the same is not to be shown as 'stock out on hire purchase'.

(6) Disclosure of customers who have purchased goods on approval basis

Likewise, if the goods are sold on 'return or approval' basis, such customer cannot be shown as a debtor at the close of the year.

(7) Disclosure of Credit balances on debtors account

Further, whenever there are credit balances in some debtors account, the same are not to be deducted from other debtors debit balances and net balance is not to be shown in the assets side, but former is to be shown as Sundry Creditors.

As an auditor, how would you proceed with Verification of investments?

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

1. **Investment Register**
Obtain a schedule of investment in shares etc. in hand at the beginning of the audit period. Obtain the following details from the investment register:
Description of investments, face value, date of purchase, book value, rate of interest, date of payment of interest or date around which dividend is declared etc. with also details of interest or dividend received along the tax deducted at source.
2. **Investment in Subsidiaries**
See the regarding the investment in subsidiaries, disclosure requirements of section 219 of companies Act 2013 are complied with.
3. **Investment in the name of the client**
Balance this schedule and compare the balance with general ledger and balance sheet. See that investment are in the name of the client.
4. **Sanction of Board**
Where investment stand in the name of persons other than that of company they are to be confirmed by appropriate sanction of the board of directors.
5. **Company Law**
See the investments made by Joint stock company are not contrary to the provisions of section 186 of the Indian Companies Act, 2013.
6. **Application money**
In case of application money paid for shares which are still to be allotted, the fact is to be specifically disclosed in balance sheet.
7. **Accrued Income**
Compare the income received with amount due and adjust the accrued income.
8. **Market value**
Check the market value of investments on balance sheet date and see that it is disclosed in balance sheet.
9. **Provision for short fall**
See that adequate provision is made for any short fall in the book value of investment shown in the balance sheet.
10. **Contingent Liability**
Confirm that uncalled amount on partly paid shares held as investment is shown as contingent liability in balance sheet.
11. **Certificate from the bank**
Where investments are lodged with banks as security, obtain a certificate to this effect.

How would you verify Loose Tools?

Loose Tools at the end of the year should be checked by the auditor as follow

1. **Cost of loose tools**
The auditor should see that the cost of Loose tools is properly determined and certified by the Chief Engineer.
2. **Certification of the value**
If the loose tools are manufactured by the organisation, the authorised officer should certify the value of such tools.
3. **Physical Verification**
He should physically verify these tools or obtain a list of any discrepancies should be investigated.
4. **Proper valuation**
Ensure that the closing stock of tools is valued at cost.
5. **Disclosure**
See that loose tools are disclosed in the Balance Sheet on asset side under the head Current Assets.

How would you verify 'Public Deposits'/ Unsecured Loans?

(October, 2015)

The auditor should see that:

1. Authority
The auditor should see the ordinary resolution is passed in the general meeting.
2. Provision of law
All the provision of section 73A of the companies Act, 2013 are respected.
3. Proper Record
Proper receipts are issued, registers are maintained, repayment is made on maturity, necessary returns are filed and interest is paid regularly.
4. Disclosure
Public deposits are disclosed as Long Term or Short Term Borrowing depending upon the period in the Balance Sheet as per schedule III of the Companies Act, 2013.
5. Adequate provision for interest
Adequate provision is made for outstanding interest.
6. Acceptance of deposit rules
The auditor should ensure that the terms of issue with regard to period of deposit, rate of interest are in conformity with Acceptance of Deposit Rules 2014.
7. Limit
The auditor should see that the quantum of total deposits is within the limits prescribed by the Central Government.
8. Deposit Insurance
Companies Act, 2013 makes deposit insurance compulsory for acceptance of deposits from the public or members.

How would you verify 'Outstanding Expenses'?

1. List of outstanding expenses
Obtain the list of outstanding expenses classified by nature of expenses.
2. Material Variances
Compare current year's outstanding expenses with that of the previous year and enquire into the material variations if any
3. Documentary Evidence
Examine the documentary evidence supporting the outstanding expenses. For example light bill, telephone bills, rent receipt, loan agreement etc.
4. Payment of outstanding expenses
See that the usual outstanding expenses are paid off by the time of audit.
5. Estimate of outstanding expenses
Verify carefully the estimates of outstanding expenses.
6. Adequate provision
Make sure that provision has been made for all the usual outstanding e.g. last month salary, wages, rent, interest on loans, interest on debentures etc.
7. Correspondence
Examine the correspondence, minutes book etc.
8. Service contract
Verify the service contracts made by the company and see that all outstanding expenses have been provided for.

How would you verify 'Bills Payable'?

1. Internal control
The auditor should study and review the internal control system for acceptance and payment of Bills payable.
2. Statement of Bills Payable
Obtain a detailed statement of bills payable which are outstanding on the balance sheet date. Check opening balance from the Balance Sheet.
3. Scrutiny
Compare the outstanding bills with the bills payable book.

4. Verification
Verify payment against bills on the basis of cash book entries after the date of Balance Sheet.
5. Test check posting
6. Test check posing from bills payable book to bills payable account in the ledger.
7. Confirmation
Obtain confirmation from the drawers or holders of the bills irrespective of the amount due on them and compare them with bills payable book.
8. Dishonour
See the entries regarding dishonour of bills on due dates.
9. Disclosure in Balance Sheet
See that Bills payable is disclosed under current liabilities 'Trade Payable' as per schedule III.

Questions

Short Questions

- a. How would you verify 'Inventory'? (April, 2015)
- b. How would you verify 'Mortgage Loan'? (April, 2015)
- c. Distinguish between verification and valuation?
- d. Explain the term verification.
- e. How will verify Plant and Machinery

Write short note on

1. Verification
2. Valuation
3. Audit of Outstanding expenses

State with reasons whether following statements are true or false:

1. Verification is wider in scope than vouching.
2. Valuation is no part of auditor's duty.
3. In order to verify fixed assets he should observe the physical verification done by the management.
4. Vouching subsequent collection of debtors provides evidence as to their valuation.
5. In order to verify cash the auditor should physically count the cash at the close of the year.
6. Inspection report supports entries in sales book and purchase return book.
7. The auditor should confirm that the asset is legally owned by the co.
8. Verification avoids manipulation of accounts.
9. Fixed assets should be shown as market value.
10. Internally generated goodwill is recognized by AS10.
11. Machinery should be valued at cost less depreciation.
12. As per AS 26 ten year is considered as useful life for patents.
13. AS14 deals with accounting for investment.
14. Stock taking involves actual verification and counting. (April, 2015)
15. There is no need of Board verification for issue of debentures.
16. Dividend must be paid within 30 days from the date of declaration of dividend.
17. Vouching includes verification.
18. Verification protects against misuse of assets.

Pankaj Pandagale, Assistant Professor of Accountancy

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The auditor should keep in mind the recommendations of the ICAI while auditing investments.

Pankaj Pandagale, Assistant Professor of Accountancy

Why is appointment of an auditor vital in case of limited company?

According to section 224 of the companies Act, 1956, every company shall appoint an auditor or auditors to audit its books of accounts. After the completion of audit, the auditor has to submit his report to the shareholders, who are the owners of the company. These shareholders are scattered all over the country. They do not take part in the day to day management of the company. The auditor is, therefore, an agent of the shareholders. The position of an auditor is, therefore, very vital. He reports reason why the audit of the books of account of a limited company is compulsory.

Is Auditor an officer of the company?

The companies Act, 1956, does not give any definition of the term "auditor". But section 2(30) of the Act defines the term "Officer". According to this definition, the term "Officer" includes any director, manager or secretary or any person in accordance with whose directors or instructions the Board of Directors or any one or more of the directors is/are accustomed to act.

What are the Qualifications and Disqualifications of Auditors of a limited company?

Section 226 of the Companies Act, 1956, lays down the qualifications and disqualifications of auditors of a limited company.

1. Qualifications

- i. person should be a chartered accountant within the meaning of the Chartered Accountant Act, 1949. Nationality is not important.
- ii. A firm whereof all the partners practising in India are qualified for appointment, all being chartered accountants, may be appointed by its firm name. in such a case any partners so practising may act in the name of the firm.
- iii. The holder of a certificate under the Restricted Auditors Certificates (Part B States) Rules, 1956, shall be entitled to the appointment to act as an auditor of companies. Central Government may, however, by notification in the official gazette, make rules providing the grant, renewal, suspension or cancellation of certificates of such auditors and may prescribe conditions and restrictions for such a grant, renewal, suspension or cancellation.

2. Disqualifications

Section 226 (3) of the Companies Act, 1956, lays down the disqualification of an auditor. According to this section, none of the following persons shall be qualified for appointment as an auditor of a company.

- i. **A body corporate**
- ii. An officer or employee of the company,
- iii. A person who is a partner, or who is in the employment, of an officer or employee of the company.
- iv. A person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees.
- v. A person who is a director or a member of a private company.

- vi. A person holding any security of that company after a period of one year from the date of commencement of the companies Act, 2000.
- vii. A person disqualified to be appointed as auditor of any other body corporate which is that

Security means an instrument which carries voting rights. If a person is disqualified for appointment as a statutory auditor of a holding company on any of the above ground, he is also disqualified for appointment as a statutory auditor of subsidiary company or vice versa. For example : Mr. X , who is a practising Chartered Accountant has taken a loan or has purchased goods on credit for Rs.5000 from ABC Ltd. which is the holding company of S Ltd. , is disqualified for appointment as statutory auditor of not only ABC Ltd. but also of S Ltd.

company's subsidiary or a holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company.

An auditor, who after his appointment, becomes subject to any of the above disqualifications, shall be deemed to have vacated his office as an auditor.

How are the auditors of limited company appointed?

Section 224 of the Companies Act, 1956, deals with the appointment of an auditor.

Appointment of First Auditor Sec. 224 (5)

The first auditor in the case of a newly formed company can be appointed by the Board of Directors within a period of one month (30 Days) from the date of registration (incorporation) of the company. Directors get this right only once in their life time which they have to exercise within a period of one month from the date of incorporation of the company. If they fail to exercise this right, the appointment of first auditor will be done by shareholders in a general meeting.

The term of office of the first auditor appointed by the Board if from the date of appointment until the conclusion of the next annual general meeting, unless he is removed by the shareholders in the general meeting before the next annual general meeting.

Appointment and Reappointment by Shareholders

Except in case of the first auditor, every company shall, at each annual general meeting appoint an auditor who will hold office from the conclusion of the meeting until the conclusion of the next annual general meeting.

At any annual general meeting, a retiring auditor, by whatsoever authority appoint, shall be reappointed unless:

1. He is not qualified for reappointment
2. He has given the company a notice in writing of his unwillingness to be reappointed.
3. A resolution has been passed at the meeting appointing somebody else instead of him or providing expressly that he shall not be reappointed; or
4. Where notice has been given of an intended resolution to appoint some person in place of a retiring auditor, and by reason of death, incapacity or disqualification of that person, the resolution cannot be proceeded with.

Appointment by Central Government

1. Where no auditors are appointed at an annual general meeting, or appointed by an ordinary resolution even though a special resolution as necessary within seven days of such a meeting the company shall intimate this information to the Central Government which may appoint a person to fill the vacancy.
2. Under section 619, the Comptroller and Auditor General of India may appoint or reappoint the auditor of a Government Company.

Casual Vacancy

1. Where a vacancy is caused by the resignation of an auditor, the vacancy shall be filled by the company in a general meeting.
2. The Board of Directors may fill any other casual vacancy (e.g. arising due to death, disqualification etc.) in the office of an auditor.
3. While any such vacancy continues, the remaining auditor or auditors, if any, may continue to act as the auditor or auditors.
4. Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

Appointment by Special Resolution

In the case of a company in which not less than 25% of the subscribed share capital is held, whether singly or jointly by:

1. A public financial institution, or a Government company or the central government or any state government.
2. Any financial or other institution established by any provincial or state Act in which a state government holds not less than 51% of the subscribed share capital.
3. A nationalized bank or an insurance company carrying on general insurance business,

The appointment or re-appointment at each annual general meeting of an auditor or auditors shall be made by a special resolution (which must be approved by 75% of member present).

If the company fails to pass such a special resolution, the Central Government may appoint the auditor of that company.

How can the auditors of limited company be removed?

Provisions of Section 224 and 225 regarding the removal of auditors are mainly designed to safeguard the independence of auditors and to see that conscientious and independent auditors are not just removed. The removal of the auditor can be studied under two heads:

1. Removal of auditor before the expiry of the term :

According to Section 224(7) , any auditor appointed under section 224 , may be removed from office before the expiry of his term only by the company in a general meeting, after obtaining the previous approval of the Central Government. Thus, there must be adequate grounds for removal of auditors, otherwise the Central Government may not accord its approval.

The first auditor who is appointed by the Board of Directors can be removed at a general meeting before the expiry of his term. In this case, the previous approval of the Central Government is not necessary. Only a nominal notice of at least 14 days is required for the appointment of another auditor in his place.

In the case of the removal of an auditor before the expiry of his term, provision of section 225, relation to the right of the auditor to make written representations, to get the representation circulated among the shareholders and the right of being orally heard at the annual general meeting, shall apply.

2. Appointing a new auditor in place of a retiring auditor:

Section 225 prescribes the following procedure regarding the appointment of a new auditor in place of a retiring one, **whether on or before the expiry of his term.**

1. Special Notice :

Firstly, a special notice is required for such a resolution. Such notice must be given to the company at least 14 days before the date of the meeting.

2. Copy of Notice to Retiring Auditor :

The company shall send the copy of notice to the retiring auditor and also to each member.

3. Written representation by retiring auditor:

1. Written representation of Reasonable length :

The retiring auditor can make written representation of a reasonable length, to the company and request its notification to the members of the company.

2. Company to send copy to members :

The company shall, unless it is too to do so , in any representation having been made and send a copy of the representation to every member of the company.

3. Read out at meeting:

In case the copies are not sent to all members, the auditor may require that the representation shall be read out at the meeting.

4. Auditor to be heard at meeting:

In any case, the auditor has the right to be heard at the general meeting.

5. Court's orders on Defamatory representation:

The copies of the representation need be circulated or read out in the meeting if, on the application of the company or any other aggrieved person, the court is satisfied that the auditor is misusing his rights to secure needless publicity for defamatory matters.

Multiple choice questions

Select appropriate option and rewrite the following sentences:

1. The first auditors of a company are appointed
 - a. By the shareholders in their first meeting to be held within 30 days of the incorporation of the company.
 - b. By the directors within 30 days of their first meeting held after the incorporation of the company.
 - c. By the directors in the first meeting of the Board of Directors to be held within 30 days of the incorporation of the company.
 - d. Through the appointment clause in the memorandum of association.
2. Every company shall, at each annual general meeting, appoint an auditor who will hold office
 - a. From the conclusion of the meeting until the beginning of the next annual general meeting.
 - b. From the conclusion of meeting until the conclusion of the next accounting year.
 - c. From the beginning of the accounting year until the end of the accounting year.
 - d. From the conclusion of the meeting until the conclusion of the next annual general meeting.
3. The auditor of a Government company is appointed by-
 - a. The Shareholders
 - b. The Board of Directors

- c. The Comptroller and Auditor General of India d. The Central Government
4. Any auditor appointed in a casual vacancy shall hold office
- Until the end of the accounting period during which he is appointed.
 - Until the end of the immediately succeeding accounting period during which he is appointed.
 - Until the conclusion of the next annual general meeting.
 - Till the date of termination as mentioned in the letter of appointment.
5. In the case of a company in which not less than 25% of the subscribed share capital is held by any of The specified financial institutions.
- The appointment of an auditor shall be made by an unanimous resolution
 - The appointment of an auditor shall be made by a special resolution
 - The appointment of an auditor shall be made by such financial institution
 - The appointment of an auditor shall be approved by the central government.
6. Who is primarily responsible for the appointment of statutory auditor of a limited company?
- Managing Director of the company
 - Member of the company
 - The Central Government
 - All the above
7. Which of the following section of the companies act deal with qualification of the auditor?
- Section 226(1) and Section 226 (2)
 - Section 224(1) and Section 224 (2)
 - Section 226 (3) and Section 226 (4)
 - Section 224(3) and Section 224
8. Which of the following statement is not true?
- A partnership firm can be appointed as a statutory auditor of limited company.
 - Appointment can be made in the name of the firm
 - Majority of the partners should be practising India.
 - All partners should be chartered accountants.
9. As per the requirements of section 226(3) and 226(4) a person is disqualified from being appointed as a statutory auditor if he holds
- Debentures of the company
 - Equity shares of the company
 - Preference shares of the company
 - Security carrying voting right of the company
10. The Board of directors shall appoint first auditor of a company
- Within 30 days of the first shares issue of the company
 - Within 30 days of the payment of registration fees of the company
 - Within 30 days of the commencement of the business of the company
 - Within 30 days of incorporation of the company
11. If a casual vacancy in the office of auditor arises by his resignation it should only be filled by the company in a
- Board meeting
 - Extraordinary general meeting
 - general meeting
 - Annual General meeting
12. The authority to remove the first auditor before the expiry of term is with
- The shareholders in a general meeting
 - The shareholders in the first annual general meeting
 - The board of directors
 - The Central Government
13. Which of the following statements is not correct regarding removal of first auditor before expiry of the term?

- a. He is removed at a general meeting
 - b. The shareholders are authorised to do so
 - c. The approval of the Central Government is required for such removal
 - d. The directors are not authorised to do so
14. The retiring auditor does not have a right to
- a. Make written representations
 - b. Get his representations circulated
 - c. Be heard at the meeting
 - d. Make defamatory statement in his written representation
15. Who out of the following cannot be appointed as a statutory auditor of the company?
- a. Retiring auditor
 - b. Internal auditor
 - c. Tax consultant
 - d. First auditor
16. The remuneration of an auditor of a company may be fixed by the board of directors in case of
- a. The first auditors
 - b. The retiring auditors who are re-appointed
 - c. The auditors appointed in any casual vacancy caused by resignation
 - d. The auditor appointed in place of the retiring auditors
17. The remuneration of an auditor of a company may not be fixed by the shareholder in case of
- a. The first auditors
 - b. The auditors appointed in any casual vacancy caused by resignation
 - c. The retiring auditors who are re-appointed
 - d. The auditor appointed in place of the retiring auditors

Fill in the blanks

1. The first auditors of a company are appointed by the directors in the first meeting of the Board of Directors to be held within ____ days of the incorporation of the company.
2. The provisions of law relating to appointment and removal of auditor ensure the independence of ____
3. A ____ auditor is the only non-chartered accountant who can be appointed as the auditor of a company.
4. The auditor of a Government company is appointed by the ____
5. Any auditor appointed in a casual vacancy shall hold office until the ____ of the next annual general meeting.
6. In the case of a company in which not less than 25% of the subscribed share capital is held by any of the specified financial institutions, the appointment of an auditor shall be made by a ____ resolution.
7. A partnership firm ____ appointed as a statutory auditor of limited company.
8. If a casual vacancy in the office of auditor arises by his resignation it should only be filled by the company in a ____ meeting.
9. The approval of the Central Government ____ required for the removal of first auditor.
10. A person who has given any guarantee in connection with the loan of any third persons to the company for an amount exceeding one thousand rupees ____ qualified to be appointed as an auditor of that company.
11. A director or a member of the private company ____ qualified to be appointed as an auditor of that company.

Match the following columns

Column A	Column B
1. First Auditor	a. C & AG

2. Re-appointment of Auditor	b. Must be approved by Central Government
3. Re-appointment of Auditor when 25% shareholding with specified financial institutions	c. Board of Directors
4. Failure of shareholders to re-appoint auditor	d. Special Resolution
5. Auditor of Government Company	e. Need not be approved by Central Government
6. Removal of first auditor appointed by Board	f. Shareholders at Annual General Meeting
7. Removal of subsequent auditor by shareholders	g. Central Government

How would you classify the Audits as per the organizational structure of business?

A business unit may be corporate body or a non-corporate body. It may be run by the Government or by Private individuals. Depending on the audits can be classified as under:

What is statutory Audit?

Audit of limited companies is compulsory according to the companies Act, 1956. Accounts of charity trust are to be audited under contain state laws like BPT Act in Maharashtra and Gujarat. These acts and certain other acts lay down the provisions regarding audit of the books of account. Such audits are known as statutory audit.

Following is the illustrative list

Acts	Types of Audit
1. Companies Act, 1956	Audit of Limited Companies
2. Banking Regulation Act, 1949 read with the companies Act, 1956	Banking Companies
3. Electricity Supply Act, 1948	Electricity Companies
4. Indian Trust Act, and state laws regarding charitable trusts	Public Charity Trusts
5. Co-operative Societies Act, as applicable to various states	Co-operative Societies
6. Societies Registration Act	Societies registered under societies Registration Act
7. Life Insurance Corporations and such other Corporations set up under the Acts of Parliament or state legislators	General Insurance Corporation, General Insurance Corporation, Unit Trust of India etc.

What is Private Audit?

For all the types of organisations, audit of books of accounts is not compulsory. However, in order to have, the benefits and advantages of audit and for the satisfaction of the owners, they get their books of accounts audited. Such audit is known as a private audit. Private audits can be enumerated as under:

- a. Audit of an Individual

- b. Audit of Sole-traders
- c. Audit of Partnership firms and
- d. Audit of other organisations not covered under statutory audit e.g. family trusts, private trusts etc.

Certain individual with large income and heavy expenses may get their books of accounts audited. An individual having number of buildings may appoint rent-collectors. Such an individual can get his books audited for his own satisfaction that all the rents are properly collected or for the purpose of income tax. Similarly, sole-proprietors or partnership firms or such other organisations where audit is not compulsory, may get their books of accounts audited to avail of the advantages of audit.

What is a Continuous audit?

The name itself suggests that the audit is done not at the end of the year, but continuously during the year. The auditor visits the client more than once for the audit. The auditor and his staff take up the audit of the firm on a continuous basis.

Continuous audit is defined by R.C.Williams as one where the auditor is constantly or at (regular or irregular) intervals engaged in checking the accounts during the period.

Continuous audit means an audit at regular intervals throughout the accounting year.

What are its advantages and disadvantages?

Advantages of Continuous Audit

1. Quick Preparation of Final Accounts :

Since, the routine audit is done continuously; the Final accounts can be prepared immediately after the year

2. Early Dividends to Shareholders :

The shareholders would be happy as they receive dividends soon after the end of the financial year. The company can prepare interim accounts and pay even dividends to the shareholders.

3. Up-to-date Accounts for Banks/Investors:

The up-to-date final accounts are useful to bank and investors for taking decisions regarding loans and investments.

4. Prevents Errors and Frauds:

Constant checking by the auditors helps to detect and even prevent errors and frauds.

5. Familiarity with Client's Business:

Since the auditor spends more time at the client's place, he becomes familiar with all the aspects of client's business. This is a great help in audit work.

6. Utilisation of Audit Staff:

Audit staff can be kept busy throughout the year. Audit work can be evenly distributed to avoid overwork after year end.

Disadvantages of Continuous Audit

1. Disruption of accounts work :

As auditor gives frequent visits during the year, there is disruption and dislocation of accounts. Accounts people have to attend to auditors and their routine work suffers.

2. Costly or expensive :

As audit is conducted during the year continuously it is more expensive or costly as compare to Balance Sheet audit or Final audit which is conducted after the year is over and after the Balance sheet is prepared.

3. Possibility of alternation of figures :

As there are intervals in the visits of audit staff and auditor , there is possibility that the accounts people may change the figures which are already audited. To overcome this , auditor can keep a note of important figures in his audit note book or create such system in computerised accounts that without his permission and information alteration in figures is not possible.

4. Possibility of missing a query :

As auditor is not coming continuously but in intervals, a query remaining unanswered may be missed by the auditor in his next visit. To overcome this, auditor should note down all his queries in his audit notes and make sure that all his queries are properly answered and solved.

5. Dependence on auditor :

As audit staff is continuously doing audit during the year with regular intervals, accounts people of client become more dependent on audit staff of their work. They take help of audit staff in doing their work such as bank reconciliation, finalisation of accounts etc.

6. Collusion between audit and accounts staff :

Constant visits by audit staff may create friendship between them and accounts staff of the client. This may lead to covering up errors and frauds without reporting to higher authorities. Errors and frauds may be neglected or audit staff also may be a party in fraud with the accounts staff of the client. To overcome this, auditor should change his staff by rotation, give them different duties, auditor should also give surprise visits and tell his staff not to compromise on account of friendship or relations while doing audit.

Select the appropriate option and rewrite the following sentences:

1. Financial statement need to be prepared in accordance with
 - a. Relevant statutory requirements
 - b. Accounting standards issued by the ICAI
 - c. Guidance notes issued by the ICAI
 - d. All the above
2. Objective of an audit of financial statement is to enable the auditor to express an opinion
 - a. Whether the financial statements are prepared in accordance with the system of double entry book-keeping.
 - b. Whether the financial statements are prepared in accordance with accounting policies laid down by the management.
 - c. Whether the financial statements are prepared in accordance with an identified financial reporting framework.
 - d. Whether the financial statements are prepared in accordance with the provisions of the Income-Tax Act.
3. If the financial statements are prepared as per the financial reporting framework, the auditor gives an opinion that the financial statements
 - a. Are true and correct
 - b. Are correct and fair
 - c. Give "a true and fair view"
 - d. Are reliable
4. The term "General Purpose Financial Statements" never includes
 - a. A cash flow statement
 - b. Statement by chairman
 - c. Statement and explanatory notes which form part thereof
 - d. Supplementary schedules and information base on such statements
5. Which of the following errors is an error of omission?
 - a. Sale of Rs.500 was written in the purchase journal
 - b. Wages paid to Mohan have been debited to his account
 - c. The total of the sales journal has not been posted to the sales account
 - d. None of these
6. Which of the following errors is an error of principle?
 - a. Rs.600 received from Ganpat has been debited to his account
 - b. Purchase of Rs.2000 has been entered in the sales journal
 - c. Repairs to building have been debited to Building account

- d. None of these
- 7. Errors of recording do not allow
 - a. Correct totaling of the Balance Sheet
 - b. The Trial balance to agree
 - c. Correct totaling of the trial balance
 - d. None of these
- 8. Which of the following errors will affect the Trial Balance?
 - a. Repairs to buildings have been debited to buildings
 - b. The total of purchases journal is Rs.2000 short
 - c. Freight paid on new machinery has been debited to the Freight account
 - d. None of these
- 9. Which of the following errors will not affect the Trial Balance?
 - a. Wrong balancing of an account
 - b. Writing an amount in the wrong account but on the correct side
 - c. Wrong totaling of an account
 - d. None of these
- 10. The total of sales book was not posted to the ledger. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 11. Sales book was overcast by Rs.500. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 12. The total of a folio in the sales book Rs.1000 was carried forward as Rs.100. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 13. Sales to Ram Rs.143 posted to his account as Rs.134. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 14. Sales to Meena Rs.143 posted to Meenu as Rs.143. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 15. Goods of the value of Rs. 376 were returned by Ram and were taken into stock on the same date but no entry was made in the books. This is
 - a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
- 16. A credit sale wrongly passed through the purchase book. This is
 - a. Error of omission
 - b. Error of commission

- c. Error of principle
 - d. None of the above
17. Repairs of newly purchased second-hand machinery debited to Repairs Expenses Account.
- a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
18. Repairs of Machinery has been charges to Machinery A/c. This is
- a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
19. Cartage paid for newly purchased machinery, posted to cartage Account. This is
- a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
20. Goods taken away by the Proprietor for personal use not recorded anywhere. This is
- a. Error of omission
 - b. Error of commission
 - c. Error of principle
 - d. None of the above
21. _____ is basically responsible for prevention and detection of errors and frauds.
- a. Auditor
 - b. Accountant
 - c. Management
 - d. Cashier
22. Audit of banks is an example of
- a. Statutory audit
 - b. Balance sheet audit
 - c. Concurrent audit
 - d. All of the above
23. Balance Sheet audit includes verification of
- a. Assets
 - b. Liabilities
 - c. Income and expense accounts where appropriate
 - d. All the above
24. Which of the following statement is not true about continuous audit?
- a. It is conducted at regular interval
 - b. It may be carried out on daily basis
 - c. It is needed when the organisation has a good internal control system
 - d. It is expensive
25. Balance sheet audit does not include
- b. Verification of assets and liabilities
 - c. Vouching of income and expenses accounts related to assets and liabilities
 - d. Examination of adjusting and closing entries
 - e. Routine checks

Write a note on Balance Sheet audit

What are the advantages and disadvantages of Balance sheet audit?

Balance sheet audit is an American concept. In this type of audit, auditor makes a detailed scrutiny of Balance Sheet items. Verification and valuation of all the assets and liabilities is made thoroughly. Profit and Loss Account is not given much importance. Only those items of Profit and Loss Account which are directly related to Balance Sheet items are checked in detail. For example : Depreciation, Bad debts written off, Provision for Tax, Outstanding Expenses, Prepaid Expenses etc.

Balance Sheet audit should be applied only if internal control system of the company is very strong. If there are proper internal checks, internal audit is highly strict, accounts are computerized then only such audit can be applied.

Advantages of Balance Sheet Audit

1. Speedy completion :

As auditor checks only internal control system and Balance sheet items thoroughly and other things are checked randomly, audit is completed fast.

2. Less Expensive :

As audit is completed in less time, it is less expensive.

3. No disruption of accounts work :

As audit is started after the final accounts are prepared, there is no disruption of accounts work.

4. Less errors and frauds :

As audit is done at a stretch without any interval, there is no scope for changing figures. Auditors checks internal control system thoroughly and if it is strong then only this audit is conducted and hence there are less chances of errors and frauds.

5. Improves internal control system :

As auditor checks internal control system thoroughly, he gives valuable suggestions from time to time which make internal control very strong. This makes accounting free from errors and frauds as there is prevention of errors and frauds.

Disadvantages of Balance Sheet Audit

1. Errors and frauds remain undetected :

As auditor examines only Balance Sheet items in detail and vouch and post audit is not conducted, some errors and frauds may remain undetected.

2. Not suitable :

If internal control system is not present or very weak then this type of audit cannot be applied.

3. No moral check :

As audit begins after the preparation of Balance sheet, there is no moral check on employees of the client during the year.

4. Delay in final accounts and audit :

As there is no continuous audit throughout the year, there might be delay in preparation of final accounts. This audit begins after the preparation of final accounts and hence audit will also be delayed due to late finalization of accounts. Such delayed audit report may be of no use.

5. Pressure of work on audit staff after year end :

As no audit is done during the year but audit begins after the year is over and final accounts are prepared, there is no work for audit staff during the year and there is pressure of work after the year is over on the audit staff. It may result in mistakes and lapses in audit work.

Write a note on Interim audit

What are the advantages and disadvantages of Interim audit?

It is conducted between two annual completed audits. The purpose of this audit is to find out the interim profit and loss and to know the financial position at the end of a part of the accounting year. It is necessary when quarterly results are to be declared , interim dividend is to declared , on sale of a running business or when there is admission, retirement or death of a partner.

Advantages of Interim audit

1. Quarterly Results :

All Public limited companies which are listed on the stock exchange are required to publish their quarterly results. Interim audit helps to comply with this legal requirement as audited results are reliable.

2. Interim Dividend :

When a company wants to declare interim dividend, it can be sure that company is really making good profits to declare interim dividend only when its accounts are audited by interim audit.

3. Sales of business :

When a running business is to be sold during the year, interim audit helps in fixing the purchase consideration.

4. Changes in Firm :

When there is admission, retirement or death of a partner or dissolution of a firm during the year, interim audit helps in valuation of goodwill.

5. Detection and prevention of errors and frauds :

Interim audit helps in detection of errors and frauds at an early stage and it also helps in prevention of errors and frauds.

6. Moral check :

As audit begins along with the accounts to certify quarterly or half yearly results, there is a constant moral check on the employees of the clients.

7. Quick finalisation :

Interim audit helps in quick finalisation of accounts. There is no pressure at the end of the year of the year as interim audit takes care of much of the audit during the year itself.

8. Utilisation of audit staff :

As audit is done during the year, audit staff is utilised throughout the year in a better manner. Interim audit can be taken-up when audit staff is relatively free.

Disadvantages of Interim audit

1. Expensive :

As audit is conducted during the year more or less continuously, it is expensive as compared to Balance Sheet audit which is done after the Balance Sheet is prepared.

2. Disruption of accounts work :

As audit is conducted during the year in different intervals, there is disruption and dislocation of accounts work. Accounts staff has to leave their routine work and attend auditors. This disrupts their work and creates backlog.

3. Possibility of alteration of figures :

As there are intervals in the visits of audit staff and auditor, there is a possibility that the accounts people may change the figures which are already audited. To overcome this, auditor can keep a note of important figures in his audit note-book or create such system in computerised accounts that without his permission and information alteration in figures is not possible.

4. Possibility of missing a query :

As auditor is not coming continuously but in intervals, a query remaining unanswered may be missed by the auditor in his next visit. To overcome this, auditor should note down all his queries in his audit note book and make sure that all his queries are answered and solved.

Write a note on Concurrent Audit

What are the advantages and disadvantages of Concurrent Audit?

This audit is carried out on a day to day basis. Every day transactions are checked on that day itself to ensure that prescribed systems and procedures are followed. Irregularities and mistakes are detected fast and timely action can be taken to rectify such mistakes and irregularities. It helps in early detection and prevention of frauds. Generally, this type of audit is adopted in banks. It is done by internal inspection or audit staff or external professionally qualified person.

Advantages of concurrent audit

1. Speedy completion :

As auditor is coming every day to check the transactions, it becomes very easy to complete the final statutory audit fast and in time.

2. Quick Detection of errors and frauds :

Checking the transactions along with the accounts help in quick detection of errors, frauds and irregularities. Timely verifying the advances and deposits of bank as per the guidelines of the Central office and Reserve Bank of India helps any irregularity in this behalf.

3. Quick finalisation :

As auditor is coming continuously during the year, at the end of the year finalisation of accounts becomes easy and fast. Final accounts of the branch and main bank can be prepared in time.

4. Moral Check :

As auditor checks transactions and accounts every day the staff of the client is under constant moral check. They work very carefully and competently. Accounts work is kept up to date and it is free from errors, frauds and irregularities.

Disadvantages of Concurrent Audit

1. Expensive :

As audit is conducted during the year continuously, it is more expensive and costly.

2. Dependence of auditor :

As audit is continuously doing audit during the year, accounts people of clients become more friendly with them and they depend on audit staff for their work.

3. Collusion between audit and accounts staff :

Constant visit by audit staff may create friendship between them and accounts staff of the client. This may result in non-reporting of errors, frauds and irregularities by the audit staff to proper authorities.

Write a note on FINAL OR PERIODIC OR ANNUAL AUDIT

What are the advantages and disadvantages of ANNUAL AUDIT?

Spicer and Pegler define, 'an audit which is not commenced until after the end of the financial year and then carried on until completed.'

Final or periodic audit means an audit taken up after the end of the accounting year. The audit work begins only after the accounting year is over.

Advantages of Annual audit

1. Less expensive :

As audit is completed in less time, it is less expensive as compare to continuous audit.

2. No alteration of figures :

As audit is done at stretch without any interval, there is no scope for changing the figures. Auditor checks internal control system thoroughly and if it is strong then only this audit is conducted and hence there are less chances of errors and frauds.

3. No disruption of accounts work :

As audit is started after the final accounts are prepared, there is no disruption of accounts work.

4. No possibility of missing a query :

As auditor is coming continuously without any break, there is no possibility of missing a query. The link or thread of audit is not lost.

Disadvantages of Annual Audit

1. Delay in Final Accounts :

Since the routine audit is done after the year end, the Final Accounts may be delayed and ready long after the year end.

2. Late dividend to Shareholders :

The shareholders would be unhappy as they receive dividends long after the end of the financial year. It would be difficult for a company to prepare interim accounts and pay interim dividends to the shareholders during the financial year.

3. Stale Accounts for Bank and investors :

The final accounts are available long after the end of accounting year. Such stale accounts are not useful to banks and investors for taking decisions regarding loans and investment.

4. No Moral Check on Employees :

Since the auditors visit only at the end of the year, dishonest employees have a chance to commit frauds during the year and clean up the accounts just before the auditor arrive.

5. No Familiarity with client's Business :

Since the auditor spends little time at the client's place, he cannot become familiar with all the aspects of client's business. This may affect the quality of audit.

6. Sample check :

Since the auditor has to complete the audit in a short time, he has to resort to sample checking. This increases the risk of missing material items.

7. Uneven work load for Audit staff :

Audit staff is overworked immediately after year end and comparatively less busy at other times.

Fill in the blanks –

1. _____ audit is conducted between two annual completed audits.
2. Balance sheet audit gives stress on checking _____ items.
3. _____ audit is carried out continuously during the year with regular or irregular intervals.
4. _____ audit is generally carried out in banks.
5. _____ audit is completed at a stretch without any interval or break.
6. An audit which is not commenced until after the end of the financial year and then carried on until completed is called as _____.
7. An audit which is carried out on a day to day basis is called as _____.
8. The purpose of _____ audit is to find out the interim profit or loss and to know the financial position at the end of a part of the year.
9. An audit where auditor and his staff conduct the audit throughout the year continuously at regular or irregular intervals is called as _____ audit.
10. An auditor must not _____ what he does not believe to be true.
11. Any information is _____ if its misstatement could influence the economic decisions of users.
12. _____ concept in accountancy means it is assumed that the organisation is not a going concern for a long time.
13. Negative Net Worth is a _____ indicator that the organisation is not a going concern.
14. Loss of key personnel, customers and suppliers are _____ indicators that the organisation is not a going concern.
15. Balance sheet audit is an _____ concept.
16. Continuous audit is _____ expensive than annual audit.
17. Balance sheet audit is not suitable if internal control is _____.
18. _____ audit is required for declaring interim financial results.
19. In annual audit, alteration of audited figures is _____.

20. In continuous audit, collusion between audit staff and account staff is ____
21. Annual audit is also known as periodic audit, completed audit or ____ audit.
22. For declaring quarterly results and declaring interim dividend ____ audit is used.

Multiple choice questions

Select appropriate option and rewrite the following sentences:

1. In concurrent audit, auditor checks transactions
 - a. After the year end
 - b. after every quarter
 - c. half-yearly
 - d. every day
2. For declaring quarterly financial results, the useful audit is
 - a. Interim audit
 - b. Balance sheet audit
 - c. Annual audit
 - d. Final audit
3. If there is material misstatement in the financial information, auditor should
 - a. give resignation
 - b. ignore it
 - c. get it rectified
 - d. should not allow to rectify
4. Annual audit is suitable
 - a. for big companies
 - b. where interim dividend is to be declared
 - c. where internal control is weak
 - d. for small companies where internal control is strong.
5. Auditor should be
 - a. attractive
 - b. talkative
 - c. competent
 - d. rich
6. For declaring interim dividend, the useful audit is ____
 - a. Final audit
 - b. Social audit
 - c. Interim audit
 - d. Proprietary audit
7. Continuous audit is carried out
 - a. after preparing final accounts
 - b. after the year end
 - c. after six months
 - d. throughout the year
8. Continuous audit is suitable
 - a. for big companies
 - b. where internal control is strong
 - c. where possibility of fraud is remote
 - d. for small companies
9. Concurrent audit is
 - a. not suitable for banks
 - b. very cheap
 - c. suitable for banks
 - d. suitable for very small companies

Distinction between Continuous Audit and Interim audit.

Point of Difference	Continuous Audit	Interim Audit
1.Nature	It is carried out throughout the year	It is carried out upto a fixed date.
2.Scope	It has a wider scope.	It has a narrow scope.
3.Trial Balance	It is not prepared.	It is prepared after the completion of interim audit
4.Object	Its object is to complete the audit work at the end of the year without any delay.	Its object is to know the trading results at the end of the stipulated period.
5.Period	It is as per the convenience of the auditor.	As per the instructions given.
6.Final Accounts	It is not necessary to examine the final accounts.	It is necessary to examine final accounts upto a certain date.

Distinction between Continuous Audit and Balance audit.

Point of Difference	Continuous Audit	Interim Audit
1.Nature	The audit staff is continuously engaged in checking the accounts during the year	Audit takes place at the end of the year.
2.Thoroughness	It involves detailed and exhaustive checking of accounts.	It involves audit of items in Balance sheet.
3.suitability	It is suitable to big organisations.	It is suitable to those organisations which have efficient system of internal control.

4.Verification of assets	All assets and liabilities are fully verified cash and inventory are verified at every visit.	All assets and liabilities are fully verified.
5.Popularity	It is widely used in India, England and European countries.	It is most popular in America.

What is cash audit?

It is a partial audit and not a complete audit. In this type of audit, the auditor examines only the cash transactions. He examines cash receipts and cash payments. The receipts and payments may be capital or revenue in nature. Cash transactions are checked with the help of receipts and vouchers and other evidences.

What is Operational audit?

Operational audit is conducted to see that the business operations are improved in future. Operational audit goes beyond financial audit. It is conducted for the following purposes:

1. To improve the profitability.
2. To guide the management in achievement of organisations objectives.
3. To examine the efficiency of the management in conducting various operations.
4. To evaluate the management policies and procedures.
5. To advice the management on business operations.

Select the appropriate option and rewrite the following sentences:

1. The following points should be noted or checked by the auditor in vouching:
 - a. Checking the Voucher
 - b. Checking the supporting Documents
 - c. Checking the Entry in the Books
 - d. All the above
2. Checking serial no. of vouchers during vouching helps the auditor to
 - a. Detect errors of principle
 - b. Detect errors of omission
 - c. Detect compensating errors
 - d. None of the above
3. Checking the head of account debited or credited during vouching helps the auditor to
 - a. Detect errors of principle
 - b. Detect errors of omission
 - c. Detect compensating errors
 - d. None of the above
4. Checking the amount in words during vouching of cash transactions helps the auditors to
 - a. Detect errors of principle
 - b. Detect errors of omission
 - c. Detect compensating errors
 - d. None of the above
5. Verifying the signature of the authorised official on the voucher during vouching helps the auditor to check the
 - a. Occurrence of the transaction
 - b. Validity of the transaction
 - c. Amount of the transaction
 - d. Period of the transaction
6. Checking the serial no. of vouchers on the voucher during vouching helps the auditor to obtain evidence that
 - a. The transaction took place
 - b. There are no unrecorded transactions
 - c. The transaction is recorded in the books on the right date
 - d. The transaction is valid
7. Checking the date of voucher on the voucher during vouching mainly helps the auditor to obtain evidence that
 - a. The transaction relates to current year

- b. The transaction is legal
- c. All the transactions are recorded in the books
- d. Transactions take place every day
8. Verifying the signature of the person preparing the voucher help the auditor to
 - a. Fix responsibility for errors in making entry of the voucher
 - b. Fix responsibility for errors in preparing the voucher
 - c. Ensure that the voucher is posted in the ledger
 - d. Ensure that the voucher has proper supporting documents
9. The auditor will examine Bill of Lading in order to vouch
 - a. Sales within the state
 - b. Sales outside the state
 - c. Exports
 - d. Sales on approval
10. The auditor will examine Bill of Entry in order to vouch
 - a. Local purchases
 - b. Purchases on Consignment basis
 - c. Imports
 - d. Cash Purchases
11. The following points should be notes or checked by the auditor in verification of an asset
 - a. Checking the voucher
 - b. Checking the transactions
 - c. Checking the Entry in the books
 - d. Checking existence, ownership, non-omission and disclosure
12. _____ Asset, which is not subject to physical verification.
 - a. Cash
 - b. Debtors
 - c. Stock
 - d. Furniutre

(March, 2012)

(March, 2012)

State whether the following statements are TRUE or FALSE. (March 2012)

1. Internal Auditor can be appointment by the management.
2. While checking dividend received auditor should check dividend warrant.
3. Systematic selection method of sampling is also known as interval sampling.
4. An Error of principle will not affect the Trial Balance.
5. Audit plan should be primarily based on knowledge of clients business.
6. Compliance procedures are the steps taken to obtain the evidence regarding internal control.
7. Verification protects against misuse of assets.

Match the following column and rewrite (March 2012)

Column 'A'	Column 'B'
■ Confirmation	➤ Can be removed without prior approval of Central Government
■ Window Dressing	➤ The work begins after the end of accounting year.
■ Continuous audit	➤ From auditor to management about internal control.
■ Cash payments exceeds Rs.5000	➤ Making less provision for Bad Debts
■ A person who is a partner of an office of the company	➤ Signature of authorised official on Revenue stamp
■ Concurrent audit	➤ One of the disqualifications for an appointment of auditor of the company.
■ Letter of weakness	➤ Signature of a payee on Revenue stamp
	➤ Similar to internal audit.

Pankaj Pandagale, Assistant Professor of Accountancy