

SPECIAL AUDITS

BASIC CONCEPTS

Special Audits

The following are the major points that must be kept in mind while performing the audit:

1. Constitution of the organisation
 - a. Examine the constitution of the organisation.
 - b. Examine the bye laws or rules and regulations or trust deed.
 - c. Examine the powers of the members of the management and other officers.
 - d. Examine the minute books of managing committee and of members general meeting as the case may be.
2. Evaluate the internal Control System in the organisation.
3. Examine the accounting policies followed and the accounting records maintained.
4. Check the various receipts of the organisation in the form of fees, rent, income on investment, donations and grants.
5. Check the various expenditure of the organisation like to staff, common expenses.
6. Verification of assets and liabilities.

Government Expenditure Audit :

Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.

Auditing and Assurance

- (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
 - (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
 - (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
 - (v) **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.
- (b) **Role of C&AG in the Audit of a Government company:** The auditor of a government company is appointed by the C&AG. The C&AG have powers under section 619(3) of the Companies Act, 1956 as follows:
- (i) to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;
 - (ii) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order; direct.

In addition, the C&AG have a right to comment upon or supplement the audit report in such manner as he thinks fit.

Question 1

Mention the special steps involved in the audit of an Educational Institution.

Answer

The special steps involved in the audit of an educational institution are the following:

- (i) Examine the Trust Deed or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

Auditing and Assurance

- (xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any old heavy arrears on account of fees, dormitory rents, etc., to the Managing Committee.
- (xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- (xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

Question 2

Write a short note on- Performance Audit.

Answer

Performance Audit: The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit. Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e., the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner.

Economy audit looks into whether the entity has acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.

Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy and effectiveness. The procedure for conducting performance audit covers identification of topic, preliminary study, planning and execution of audit, and reporting. Normally speaking, the performance audit is conducted by the government in respect of various expenditure incurred. While the trend towards a comprehensive approach for conducting performance of full scope audit is visible, the coverage and depth of evaluation vary according to the statutory limitations, and the organisational constraints of C & AG.

Question 3

Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only Rs.500 per month from a student for his lodging/boarding.

Answer

1. *General*
 - (i) Study the constitution under which the charitable institution has been set up whether under the Society Registration Act, as a trust or as a company limited by guarantee. Verify whether it is managed as contemplated by the law and rules and regulations made thereunder.

Auditing and Assurance

- (ii) Examine the internal control structure particularly with reference to admission to hostel, expenses incurred on different kinds of activities.
 - (iii) Verify the broad nature of expenses likely to be incurred with reference to the previous year's annual audited accounts.
- 2. *Verification of the receipts*
 - (i) Check the amounts received on account of, monthly rentals, etc., and receipts issued for the same.
 - (ii) Ascertain that there is adequate internal control over the issue of official receipts, custody of unused receipt books, printing of receipt books, etc.
 - (iii) Cross - tally the rent received along with the number of students (from the student register) staying in the hostel during the year.
 - (v) Check the amounts received from additional services rendered like guest fees, receipts for breakage, fines, penalties, etc
- 3. *Verification of expenses*
 - (i) Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.;
 - (ii) Verify whether the expenses incurred are in conformity with the budgets prepared internally or filed with the relevant authorities.
 - (iii) Check the amount spent on provisions of hostel facilities with reference to bills, etc.
 - (iv) See that whenever heavy expenditure has been incurred on renovation of the hostel, computer centre, etc. the same is accounted for properly.(if such facilities are being provided by the hostel)
- 4. Verify investments made from surplus funds as well as existing investments by physically verifying the same and that they are in the name of the institution and that there is no charge/pledge against the same;
- 5. Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass, cutlery, kitchen utensils, liner, etc. are adequately depreciated.
- 6. *Library Facilities:* See that proper library register are maintained. The system regarding issue and receipt of books is in order. Late fee fines and money received on account of lost book is accounted for properly. Obsolete books are written off only

after proper authorisation. Expenses incurred on newspapers and weekly magazines as compared to Journals and periodicals have been accounted for properly.

7. Check the provision of other additional facilities like computer facilities, etc. Ensure that proper registers are maintained for charging fees, based on monthly or hourly basis. In case such facility is extended to each room, whether the charges are payable on lump-sum basis or on actual usage basis. Also ensure that amounts spent have been allocated properly.
8. Verify whether the institution is eligible for income tax exemption and if not, whether provision for taxation has been made.

Question 4

Mention the special points in the case of an audit of the entity from Incomplete Records.

Answer

The examination of records and documents is one of the most important techniques through which an auditor collects evidence. Therefore, in case the records and documents maintained by an enterprise are incomplete, it would prove to be a great handicap to the auditor.

An auditor may face the situation of incomplete records under the following circumstances:

- (i) Where records are kept on single entry basis; or
- (ii) Where records are kept on double entry basis, but some of the records are destroyed accidentally, or are seized by authorities, or are otherwise not available for the auditor's examination due to similar reasons.

Under the second circumstance, an ideal approach for carrying out audit would be that the auditor may direct the management of the enterprise to complete or reconstruct the accounting records, e.g., if vouchers are available but the cash book, journal and the ledger are not maintained, then the cash book, journal and ledger should be written up. However, if vouchers are also not available, then cash book/journal/ledger will have to be prepared by correlating the evidence available, e.g., memoranda records, bank statements, statements from outside parties, etc. Even though such books which are prepared may not be complete, but may still contain useful information for the auditor.

On the other hand, when books are maintained on single entry basis, then the management of the enterprise would be asked to write up the books, to the extent possible, as they would have been written up under double entry system.

In any case, the following steps would be required to conduct an audit:

Auditing and Assurance

- (i) Ascertain that the balance sheet or statement of affairs as at the beginning of the year should be prepared and all the relevant accounts should be opened in the ledger. Normally, under the single entry system, cash, bank, and personal accounts are maintained.
- (ii) Confirming that all entries on receipt side of the cash book are posted in the ledger, even by opening new account(s) wherever necessary.
- (iii) Check that all entries on the payment side of cash book are posted in the ledger.
- (iv) Confirming that all entries appearing in bank account are posted in the ledger.
- (v) Analyse personal accounts of debtors. This will provide vital information regarding credit sales, sales returns, discounts allowed, bills received, bills dishonored, etc. It would be necessary to post such items to relevant accounts, to complete the double entry from the debtor's accounts.

Similarly, it would be necessary to analyse the creditors' accounts and post entries relating to credit purchase made, discounts earned, purchases returns, bills payable issued to suppliers, bills payable dishonored, etc., to relevant accounts.

From an auditor's view point, the supervisory controls exercised by the owners are generally less reliable and hence while auditing incomplete records, auditor will largely depend on extensive substantive procedures and obtain external evidence, physical examination/observation, management representation and perform analytical procedures.

Question 5

- (a) *An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:*
 - (i) *Audit against Rules and Orders*
 - (ii) *Audit of Sanctions*
 - (iii) *Audit against Provision of Funds*
 - (iv) *Propriety Audit*
 - (v) *Performance Audit*
- (b) *What role is played by Comptroller and Auditor General of India in the audit of a Government company?*

Answer

- (a) **Government Expenditure Audit**

Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

- (i) *Audit against Rules & Orders:* The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
 - (ii) *Audit of Sanctions:* The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
 - (iii) *Audit against Provision of Funds:* It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
 - (iv) *Propriety Audit:* It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
 - (v) *Performance Audit:* This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.
- (b) **Role of C&AG in the Audit of a Government company:** The auditor of a government company is appointed by the C&AG. The C&AG have powers under section 619(3) of the Companies Act, 1956 as follows:
- (i) to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;

Auditing and Assurance

- (ii) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order; direct.

In addition, the C&AG have a right to comment upon or supplement the audit report in such manner as he thinks fit.

Question 6

Draft an Audit Programme to audit the accounts of a Recreation Club with facilities for indoor games and in-house eating.

Answer

- (i) Examine the constitution, powers of governing body and relevant rules relating to preparation and finalisation of accounts. In case, it is constituted as a company limited by guarantee, application of provisions of the Companies Act, 1956 should also be seen.
- (ii) Vouch the receipt on account of entrance fees with members applications, counterfoils issued to them, and minutes of the Managing Committee.
- (iii) Vouch Members' subscription with the counterfoils of receipts issued to them. Trace receipts for a selected period to the Register of members; reconcile the amount of total subscription due with the amount collected and the outstanding. Check totals of various columns of the Register of Members and tally them across. See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery. The amount considered irrecoverable, if any should be written off.
- (iv) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscription received in advance have been correctly adjusted.
- (v) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests as well as with the fees chargeable for the special service rendered such as billiards, tennis, etc. Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

- (vi) Vouch purchase of sports items, furniture, crockery, etc., and trace their entries into the respective stock registers. Vouch purchases of food-stuffs, cigars, wines, etc. and test their sale price so as to confirm that the normal rates of profit have been earned on their sales.

The stock of unsold provisions and stores, at the end of the year should be verified physically and its valuation checked.

- (vii) Check the stock of furniture, sports material and other assets physically with the respective stock registers or inventories prepared at the end of the year.
- (viii) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts, also ascertain that the arrangements for their safe custody are satisfactory, check the accrual of income therefrom and provision of income tax thereon. .

Question 7

Explain the audit procedure for conducting the audit of a Non-Governmental Organisation (NGO).

Answer

Audit Procedure for Conducting the Audit of Non-Governmental Organisation

NGO's can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives. Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 25 of the Companies Act, 1956. While planning the audit of a Non-Governmental Organisation (NGO), the auditor may concentrate on the following;

- (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
- (ii) Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations.
- (iii) Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.

Auditing and Assurance

- (iv) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- (v) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

- (i) *Corpus fund:* The contributions/grants received towards corpus are vouched with reference to the letters from the donor(s). The interest income is checked with investment Register and physical investments in hand.
- (ii) *Reserves:* Vouch transfers from projects/programmes with donor's letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
- (iii) *Ear-marked Funds:* Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- (iv) *Project/Agency Balances:* Vouch disbursements and expenditures as per agreements with donors for each of the balances.
- (v) *Loans:* Vouch loans with loan agreements receipt counter –foil issued.
- (vi) *Fixed Assets:* Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
- (vii) *Investments:* Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- (viii) *Cash in Hand:* Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
- (ix) *Bank Balance:* Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- (x) *Stock in Hand:* Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
- (xi) *Programme and Project Expenses :* Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of

programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.

- (xii) *Establishment Expenses*: Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

The receipt of income of NGO may be checked on the following lines:

- (i) *Contribution and Grants for projects and programmes*: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
- (ii) *Receipts from Fund arising programmes*: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
- (iii) *Membership Fees*: Check fees received with membership register; ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
- (iv) *Subscription*: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine/circulars/periodicals. Check the receipts with subscription rate schedule.
- (v) *Interest and Dividends*: Check the interest and dividends received and receivable with investments held during the year.

Question 8

Explain in detail the duties of Comptroller and Auditor General of India.

Answer

Duties of C&AG: The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under:

- (i) *Compile and submit Accounts of Union and States* - The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.
- (ii) *General Provisions Relating to Audit* - It shall be the duty of the C&AG –

Auditing and Assurance

- (a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
 - (b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
 - (c) to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.
- (iii) *Audit of Receipts and Expenditure* - Where any body or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.
- (iv) *Audit of Grants or Loans* - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.
- (v) *Audit of Receipts of Union or States* - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.
- (vi) *Audit of Accounts of Stores and Stock* - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union or of a State.

- (vii) *Audit of Government Companies and Corporations* - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956.

Question 9

Mention any eight special points which you as an auditor would look into while auditing the books of a partnership firm.

Answer

Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under:

- (i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
- (ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.
- (iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.
- (iv) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
- (v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
- (vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.
- (vii) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.

Auditing and Assurance

- (viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

Question 10

Describe the salient features of Financial Administration of Local Bodies.

Answer

Salient Features of Financial Administration of Local Bodies

- (i) **Budgetary Procedure:** The objective of local bodies budgetary procedure are financial accountability, control of expenditure, and to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or Council. Different aspects covered in budgeting are determining the level of taxation, fees, rates, and laying down the ceiling on expenditure, under revenue and capital heads.
- (ii) **Expenditure Control:** At the State and Central level, there is a clear demarcation between the legislature and executive. In the local body, legislative powers are vested in the Council whereas executive powers are delegated to the officers, e.g., Commissioners. All matters of regular revenue and expenditures are generally delegated to the executive wing. For special situations like, reduction in property taxes, refund of security deposits, etc., sanction from the legislative wing is necessary.
- (iii) **Accounting System:** Municipal Accounting System has been conventionally prepared under the cash system. In the recent past however, it is being changed to the accrual system of accounting. The accounting system is characterized by (a) subsidiary and statistical registers for taxes, assets, cheques etc., (b) separate vouchers for each type of transaction, (c) compulsory monthly bank reconciliation, (d) submission of summary reports on periodical basis to different authorities at regional and state level.

Question 11

What are the special steps involved in conducting the audit of an Educational Institution?

Answer

The special steps involved in the audit of an educational institution are the following:

- (i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

- (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
- (xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

Auditing and Assurance

- (xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- (xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

Question 12

With reference to Government Audit, what do you understand by "Audit of Commercial Accounts"?

Answer

Audit of Commercial Accounts: The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

- (i) Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defence factories, mints, etc.
- (ii) Statutory corporations created by specific statutes such as LIC, Air India, etc.
- (iii) Government companies, set up under the Companies Act, 1956.

All aforesaid entities are required to maintain accounts on commercial basis. The audit of departmental entities is done in the same manner as any Government department, where commercial accounts are kept. Audit of statutory corporations depends on the nature of the statute governing the corporation. In respect of government companies, the relevant provisions of Companies Act, 1956 are applicable. As per section 619 of the Companies Act, 1956 the statutory auditor of a Government company shall be appointed or re-appointed by the CAG. Such an auditor must be a chartered accountant. Further, the Companies Act, 1956, provides that the CAG shall have the powers:

- (i) to direct the manner in which the company's accounts shall be audited by the auditor, and to give the auditor instructions in regard to any matter relating to the performance of his functions; and
- (ii) to conduct a supplementary or test audit of the company's accounts by such person, as he may authorise in this behalf, and for the purposes of such audit to require information or additional information to be furnished to any person or persons, so authorised on such matters by such person or persons, and in such form as the CAG may direct.

The statutory auditor shall submit a copy of his audit report to the CAG, who shall have the right to comment upon or supplement the audit report in such manner he may think fit.

Any such comments upon or supplement to the audit report shall be placed before the company, at the same time, and in the same manner, as the audit report. Thus, it is seen that there is a two layer audit of a Government company, by the statutory auditors, being qualified chartered accountants, and by the CAG. The general standards, principles, techniques and procedures for audit adopted by the C&AG are a mixture of government audit and commercial audit as known and practiced by professional auditors. The concepts of autonomy and accountability of the institution / bodies / corporations / companies have influenced the nature and scope of audit in applying the conventional audit from the angle of economy, efficiency and effectiveness.

Auditing and Assurance

Question13

What special steps will you take into consideration in auditing the accounts of a hotel?

Answer

The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

- (i) *Internal Control:* Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:
 - (a) Effectiveness of arrangement regarding receipts and disbursements of cash.
 - (b) Procedure for purchase and stocking of various commodities and provisions.
 - (c) Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
 - (d) System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.
 - (e) Ensure that trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.
- (ii) *Room Sales and Cash Collections*
 - (a) There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct numbers of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.
 - (b) The total sales reported with the total bills issued at each sales point have to be reconciled.
 - (c) Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

- (iii) *Stock*: the stocks in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:
 - (a) All movement and transfer of stocks must be properly documented.
 - (b) Areas where stocks are kept must be kept locked and the key retained by the departmental manager.
 - (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
 - (d) Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.
 - (e) The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the year end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories
- (iv) *Fixed Assets*: The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.
- (v) *Casual Labour*: In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.
- (vi) The compliance with all statutory provisions, and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.
- (vii) Other special aspects are to be verified as under
 - (a) Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
 - (b) All payments to the foreign collaborator, if any, are to be checked.
 - (c) Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
 - (d) Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.
 - (e) In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.

Auditing and Assurance

- (f) The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.
- (g) Expenses for painting, decoration, renovation of building, etc. are to be properly checked.
- (h) It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.
- (i) Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.
- (j) The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).
- (k) The auditor should ensure that all taxes have been included in the client's bills.
- (l) Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

Question 14

- (a) *An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.*
- (b) *What special steps will you take into consideration in auditing the receipts from entry fees of an amusement park? Mention any four points specific to the issue.*

Answer

(a) Receipt of Donations

- (1) *Internal Control System:* Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (2) *Custody of Receipt Books:* Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified

physically including checking of number of receipt books and sequence of numbering therein.

- (3) *Receipt of Cheques*: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (4) *Bank Reconciliation*: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (5) *Cash Receipts*: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (6) Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of donations to different NGOs

- (1) *Mode of Sending Remittance*: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (2) *Confirming Receipt of Remittance*: All remittances are supported by receipts and acknowledgements.
- (3) *Identity*: Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (4) *Direct Confirmation Procedure*: Send confirmation letters to entities to whom donations have been paid.
- (5) *Donation Utilisation*: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (6) *System of NGOs' Selection*: System for selecting NGO to whom donations have been sent.

(b) Audit of receipts from Entry Fees of an Amusement Park

- (1) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.
- (2) Ensure that tickets are pre numbered.

Auditing and Assurance

- (3) Ensure that the deposit of cash collected into the bank account very same next day.
- (4) Compute analytical ratios in respect of the receipts pattern i.e. on week ends, holidays, etc. and make comparisons to draw conclusions.

Question 15

How the audit is advantageous to Sole Trader?

Answer

Advantages of Audit to a Sole Trader

Although sole traders are not required by any law (except u/s 44AD, 44AE, 44AF, 44AB and other provisions of the Income-tax Act, 1961) to have their accounts audited, yet it has become customary for many of them who derive their large incomes from numerous sources and whose expenditure is vast and varied to get their accounts audited. Also, sole traders, get their financial statements audited due to regulatory requirements, such as stock brokers or on a specific instructions of the bank for approval of loans, etc. The sole trader can determine the scope of the audit as well as the conditions under which it will be carried out. For example, he can stipulate that only a partial audit shall be carried out or certain parts of the accounts shall not be checked. It will also be decided that the audit will be carried out continuously or at the end of the year. Thus, the duties and the nature of auditor's work will depend upon the agreement that he has entered into with the sole trader. But he must obtain clear instructions from his clients in writing as to what he is expected to do. The following are some of the advantages that can be derived from an audit of this nature:

- (i) The individual is assured of having his accounts properly maintained and his expenditure vouched.
- (ii) He is also assured of not being defrauded by the accountant and his agents. Even if they have done some defalcations, etc.; these may be discovered by the auditors.
- (iii) The audited accounts are reliable and are generally accepted by the Income-tax Department and hence, individuals do not feel any difficulty for taxation assessments, etc.
- (iv) The audited accounts of a deceased are very helpful for executors and administrators.

Question 16

What special steps are involved in audit of a Cinema Hall?

Answer

Special steps involved in audit of a Cinema Hall

- (i) Verify
 - (a) that entrance to the cinema hall is only through printed tickets;
 - (b) tickets are serially numbered and bound into books;
 - (c) that the number of tickets issues for each show and class are different;
 - (d) that for advance booking a separate series of tickets is issued and
 - (e) stock of tickets is kept in proper custody.
- (ii) If tickets are issued through computer- audit the system to ensure its reliability and authenticity of data generated by it.
- (iii) System should provide that at the end of each show a proper statement should be prepared and cash collected be tallied.
- (iv) Cash collected is deposited in banks partly on the same day and rest on the next day – depending upon the banking facility available.
- (v) Verify that proper record is kept for free passes issued and the same are issued under proper authority.
- (vi) Cross check the entertainment tax deposited.
- (vii) Verify the income from advertisements and slides showed before the show.
- (viii) Vouch the expenditure incurred on publicity of picture, maintenance of hall, electricity expenses etc.
- (ix) Vouch recoveries of advertisement expenses etc from film distributors.
- (x) Vouch payment of film hire with reference to agreement with distributor or producer.
- (xi) Verify the basis of other incomes earned like restaurant, car and scooter parking and display windows etc.
- (xii) Confirm that depreciation on machinery and furniture has been charged at appropriate rates which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.

Question 17

What are the focus points in doing propriety audits by C&A G as regards government expenditure?

Auditing and Assurance

Answer

Focus points for doing propriety audits of government expenditure: The Propriety audit is to vet the expenditure in the annals of financial wisdom and uprightness. It is to check to bring out the improper, avoidable, or in fructuous expenditure even though such expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit in so far as the various formalities regarding rules and regulations are concerned but may still be highly wasteful. It is not audit of sanction or against norms. It is a qualitative, opinion-based expression of auditor's findings as regards the efficiency, effectiveness and economy dimensions of expenditure.

In this regards, the following main points should be kept for consideration:

- (1) The expenditure should not be prima facie more than what the occasion demands. Public money should be spent by the officers as of his own with utmost diligence and care.
- (2) No order for sanction of expenditure should be made by an authority which results in pecuniary gains directly or indirectly.
- (3) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
 - (i) the amount of expenditure involved is insignificant; or
 - (ii) a claim for the amount could be enforced in a Court of law; or
 - (iii) the expenditure is in pursuance of a recognised policy or custom; and
 - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.
- (4) There should not be profiteering by the authority or anybody where the expenditure is in the nature of compensating.
- (5) Wastages are avoided in expenditure. The cost of administering should not eat off the benefits of the expenditure.
- (6) The expenditure should percolate down the beneficiary without corruption.
- (7) The expenditure should bring out optimum, enduring benefits instead of mere frittering away the public money on meeting day to day needs repeatedly.

Question 18

Mention any ten special points to be examined by you in the audit of Income and Expenditure of a Charitable institution running a hospital.

Answer

While auditing the Income and Expenditure Account of a charitable institution running a hospital, following special points may be examined:

- (i) Verify the register of patients with duplicate copy of bills and patients admission record to see that bills have been properly and correctly prepared for all the services, tests and treatments.
- (ii) Check cash collections from patients by tracing the receipt issued into cash book.
- (iii) Check receipt of interest, rent, dividend etc., with receipt counterfoil into cash book and bank book and ensure that all such income has been duly accounted for.
- (iv) Check collection of subscription, donations from the receipt issued, correspondence etc., into cash book.
- (v) Verify that all grants from government and other bodies have been duly accounted for and have been applied in the manner as specified.
- (vi) Verify all recurring nature of revenue expenditure, with necessary evidence like bill, authority, period etc.
- (vii) Examine the internal check as regards the receipt and issue of stores, medicines, linen etc., to ensure that these have been properly recorded and issued/consumed only on proper authorisation.
- (viii) See that depreciation has been written off in respect of all the assets at appropriate rate and method as in the earlier year.
- (ix) Verify the receipts from supply of food and canteen receipts and compare the same with previous year as regards number of patients.
- (x) Ensure that all outstanding liabilities have been adequately provided for and similarly all accrued incomes and receipts have been duly accounted for.
- (xi) Obtain inventory of stock and stores as at the end of the year and physically check a percentage of items.

EXERCISES

Question 1

Mention the special points to be examined by the auditor in the audit of a Charitable Institution running a dispensary in a small village which charges Rs.1 per patient per visit irrespective of the disease.

Question 2

What considerations are to be kept in mind while conducting audit of the leasing transactions of a Leasing Company?

Question 3

As an auditor, how will you react to an expenditure incurred by a government department which was sanctioned by a fellow officer of the competent authority as the concerned officer was on leave. State your views, if you were entrusted to carry out an audit of receipt of the said assessing department.

Question 4

Discuss the provision of the Constitution of India to safeguard the independence of the Comptroller and auditor General of India.

