Basic concepts in auditing

Audit evidence

Audit evidence refers to any information, verbal or written, obtained by the auditor during the course of audit to arrive at the conclusion on which he bases his opinion on financial statements

The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions about the truthfulness and fairness of financial statements,

Here, sufficiency refer to the quantum of audit evidence obtained while,
Appropriateness relates to its relevance and reliability.

Methods of obtaining audit evidence

1. Inspection
   - Inspection refers to examining of records, documents, or tangible assets. Inspection provides evidence of varying degrees of reliability depending upon the nature and the source form which they have been obtained, and the effectiveness of internal control over their processing
2. Observation
   - Observation is nothing but witnessing a process or procedure being performed by others. It leaves no audit trail and so it is less reliable than inspection
3. Inquiry and confirmation
   - Inquiry involves seeking of appropriate information from knowledgeable persons inside or outside the entity
   - Confirmation involves is the response to an inquiry to correlate information contained in the accounting records.
4. Computation
   - Computation involves checking the arithmetical accuracy of source documents and accounting records are performing independent calculations
5. Analytical review
   - It consist of
     i. Studying significant ratios and trends
     ii. Investigation unusual fluctuations and items

Reliability on audit evidence

Factors:- the reliability of audit evidence is influenced by:
1. Its source
2. Its nature
3. Circumstances under which it is obtained
4. Consistency of evidence obtained from different sources or nature
5. Nature of assertion obtained and its materiality

Evidence based on sources is (in order of reliability)
1. External evidence :- generally from outside which is not passed through client's hand
2. External-internal evidence:- information generated by third parties and then processed and maintained by client
3. Internal-external evidence:- the date generated internally and given to independent third party for processing is called internal-external evidence
4. Internal evidence:- for examples sales invoice, material issue note etc.

Generalization is useful in assessing the reliability of audit evidence
1. External evidence is more reliable than internal evidence
2. Internal evidence is more reliable when related internal control is satisfactory
3. Evidence in the form of documents and written representations are usually more reliable than oral
4. Evidence obtained by the auditor himself is more reliable that obtained therough the entity

Analytical procedures

Analytical procedures means the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationship that are inconsistent with other relevant information or which deviate from predicted amounts

Analytical procedures are used for the following purposes

1. To assist the auditor in planning the nature, timing and extent of other audit procedures
2. As substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions and,
3. As an overall review of the financial statements in the final review stage of the audit.

Auditor should apply analytical procedures at the end of the audit when forming an overall conclusion As to whether the financial statements as a whole are consistent with the auditor's knowledge of the business.

However in some cases, as a result of application of analytical procedures, the auditor may identify areas where further procedures need to be applied before the auditor can form an overall conclusion about the financial statements

Reliance on analytical procedures

1. Materiality of items involved:- when inventory balances are material, analytical reviews alone will not be sufficient in forming the audit conclusion
2. Other audit procedures:- when other audit procedures are directed in the same area, analytical review may provide conformity evidence.
3. Accuracy of prediction:- if the expected result of analytical procedures can be predicted with reasonable accuracy, such procedures will be more reliable.
4. Nature of risks:- the effect of Analytical procedures also depends on the assessment of inherent and control risks. If internal control over sales order processing is weak, and hence, control risk is high, more reliance will be placed on tests of details of transaction and balances rather than on analytical procedures.

Concept of materiality

This concept is fundamental to the process of accounting. It covers all the stages from the recording to classification and presentation. It is therefore, an important and relevant consideration for an auditor who has constantly to judge whether a particular item or transaction is material or not.

SA 320 on materiality in planning and performing an audit deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.

Financial statements materially effected in such statement is erroneously stated or omitted to be stated therein and economic decision of the users taken on the basis of such information is influenced by such misstatement or omission.

How the work of an expert should be evaluated before accepting the same as an audit evidence

When auditor intends to use the work of an expert he should evaluate the following before accepting the same as audit evidence.

1. Professional qualification of the expert
2. Experience and reputation of expert in related field
3. Independence and objectivity of the expert
4. The objective and scope of the expert's work
5. Expert's relationship with the client, if any
6. The sources data used
7. Assumptions and method used
8. The result of the expert's work in the light of auditor's overall knowledge of the business and of the result of his audit procedure

External confirmation

It is the process of obtaining and evaluating audit evidence through a direct communication from a third party, which is not related to the entity, in responses to request for financial information about a particular item affecting assertions made by management on the financial statements

Following are the examples of situations where external confirmation may be useful

1. Bank balances and other information from bankers
2. Account receivables balances
3. Stock held by third parties
4. Account payable balances

Nature of auditing

Auditing

An audit is independent examination of financial statements of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion on thereon.

Qualities of auditor

- The auditor should possess specific knowledge of accountancy, auditing, taxation, and company law matters etc. which is required by him during the course of his theoretical question
- The auditors should also have sufficient knowledge of general principles of law of contracts, partnership, specific statutes and provision applicable
- In short all those personal qualities that goes to make a good person contribute to the making of a good auditor.
- In addition, he must have shine of culture for attaining a great height. He must have the highest degree of integrity, objectivity and independence as one of the basic principal.

'Doing a statutory audit is full of risk" narrate the function which cause the risk

An independent audit whether performed in terms of relevant statutory legislation or in terms of the engagement, the auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements.

Factors which may cause

1. <u>Exercising judgment on the part of the auditor</u>
   - The auditor's work involves exercise of judgment, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgments and estimates made by management in preparing the financial statements
2. <u>Nature of audit evidence</u>
   - The auditor normally relies upon believable evidence rather than conclusive evidence. Even in circumstances where conclusive evidence is available, the cost of obtaining such an evidence may far exceeds the benefits
3. <u>Inherent limitation of internal control</u>
   - Internal control can provide only reasonable, but not absolute assurance on account of several inherent imitations such as potential for human error, possibility of circumstances of control through collusion etc.

On account of above, it is quite nature that an audit suffers from control risk on account of inherent limitations of internal control risk and detection risk on account of test nature of audit and judgment and estimates involved in formulating accounting policies

Errors of commission

When a transaction has been misreported either wholly or partially it is called as a error of commission. Error of commission can happen in the following ways

Error in posting
Errors in casting
Errors in carrying forward
Errors occurring during extraction of balance etc.

Operational Audit

Operational audit involves examination of all operations and activities of the entity

The object of operational audit include the control structure and of the relation of department controls to general policies.

It provides an appraisal of whether the department is operating in conformity with prescribed standards and procedures and whether standards of efficiency and economy are maintained.

‘The auditor’s responsibilities relating to fraud in audit of financial statements.’ Define fraud and error

Fraud: - fraud is an intentional misstatement or omission or disclosure of the financial statements
Error: - error may be defined as the unintentional misstatements or omissions of amounts or disclosure in financial statements.

Auditor’s responsibility

- The responsibility for the prevention and detection of fraud and errors primarily rests with the management through the implementation and continued operation of an adequate system of internal control. But it does not eliminate the possibility of fraud and error
- Thus the auditor should plan his audit so that he has a reasonable expectation of detecting material misstatement in the financial information resulting from fraud and error.
- Auditor’s responsibility must be viewed after considering the following points
  a. Inherent limitations of internal control
  b. Professional skepticism. –auditor is entitled to accept the record and documents is genuine
  c. Discussion of audit planning
  d. Inquires to management
  e. Discussion with those charged with the management
  f. Audit risk and its assessment
- In planning and performing his examination of auditor should take into consideration risk of material misstatement of the financial information caused by fraud and error. He should enquire with the management as to any fraud or significant error, which has occurred in the reporting period, and modify his audit procedures, if necessary
- The auditor also has the responsibility to communicate the misstatement to the appropriate level of management on a timely basis and consider the need to report to it then changed with governance.
- He may also obtain legal advice before reporting on the financial information or before withdrawing from the management.
- The auditor also should consider the implication of the frauds and error, and frame his report appropriately. In case of a significant fraud, the same should be disclosed in the financial statement. If adequate disclosure is not made, there should be a suitable disclosure in his audit report.

Comment on “auditor’s professional responsibilities are governed by basic principles which should be complied with whenever an audit is carried out”?

Basic principles for governing an audit:-

1. Integrity, objectivity and independence
   - The auditor should be straight forward, honest and sincere in his approach to his professional work. He should maintain an impartial attitude and both be and appear o be free of any interest which might be regarded, whatever is actual effect, as being incompatible with integrity and objectivity.
2. Confidentiality
   - The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose
3. Skills and competence
   - The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing

4. Work performed by others
   - When the auditor delegated work assistants to uses work performed by other auditor and experts, he continues to be responsible for forming and expression his opinion on the financial information.
5. Documentation
   - The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles
6. Planning
   - The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business
7. Audit evidence
   - The auditor should obtain sufficient appropriate evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information
8. Accounting system and internal control
   - The auditor should gain an understanding of the accounting system and related controls and should study and understanding of the accounting system and related controls and should study and evaluate the operation of those internal controls upon which he wises to rely in determining the nature, timing and extent of other audit procedures
9. Audit conclusion and reporting
   - The auditor should review and assess the conclusions drawn from the audit evidence obtained from his knowledge of business of the entity as the basis for the expression of his opinion on his financial information.

Principles aspects to be covered in audit

1. Internal control system
2. Review
3. Arithmetical accuracy
4. Vouching
5. Accounting principles
6. Financial statements and books
7. Assets and liabilities
8. Fairness of P & L a/c.
9. Statutory requirements
10. Report

Independent audit

Independent audit is generally conducted to ascertain whether the balance sheet and profit amd loss account present a true and fair view of the financial position and working results.

It must be kept in mind that detection of frauds and errors is not the objective of independent financial audit.

Distinguish between Investigation and Auditing

Particulars	Investigation	Auditing
Meaning	Investigation implies systematic, critical and special examination of the records of a business for a specific purpose	An audit is independent examination of financial information of any entity, when such an examination is conducted with a view to expressing an opinion thereon
compulsory nature	Voluntary	compulsory for companies, for other it is voluntary
Conducted by	Any person, who may not be a CA	A Chartered Accountant within the meaning of CA act 1949

Appointing agency	Owners or management even third parties may appoint the investigator	Owners/shareholders of the enterprise
Protection of Interests	Work is carried out from the view point of the appointing agency	Work is carried out on behalf of the owners, even of the power of appointment is delegated to say, BOD
Scope and coverage	To answer any those question laid done in the engagement letter	When compared to investigation- seeks to form an opinion on financial statement
Period covered	Not necessarily restricted to a financial year. It consist for number of years	Generally a period of financial year
Evidence	Its essence lies in going into the matter with some pre-conceived notion suited to the objective	Audit is not based on suspicion unless circumstances exist to arouse suspicion
Extent of checking	Detailed, exhaustive and through checking is called for	Much of audit evidence is believable rather than conclusive
Form of reporting	There is no statutory form of investigation report	The matters to be covered in the audit report are sometimes prescribed by law.

Fundamental accounting assumption

1. Going concern:- the enterprise is generally viewed as a going concern, that is continuity in operation for the foreseeable nature.
2. Consistent:- it is assumed that accounting policies are consistent from one period to another
3. Accrual:- revenues and costs are recognized as and when they are earned or incurred in the financial statements of that period to which they relate.

Preparation for an audit

Audit Engagement Letter

- To avoid misunderstanding between clients and the auditor, the auditor should send a letter called audit engagement letter to the client before starting the audit.
- Content of letter
  i. Objective of the audit of financial statements
  ii. Responsibility of management in relation to financial statements
  iii. Management responsibility regarding the following
    1. Selection of accounting policies
    2. Consistent following of accounting policies
    3. Maintenance of adequate accounting records
    4. Arrangement concerning the involvement of internal auditors and the staff of the client
  iv. The scope of audit including reference to applicable laws and regulations and the pronouncement of ICAI
  v. Test nature of audit, frauds and error may remain undetected
  vi. The fact that audit process may be subjected to a peer review under CA act, 1949.

Continuous audit

a continuous audit is one in which the auditor's staff engaged continuous checking the accounts of the client the whole year around.

But when auditor's staff attends the audit work t fixed interval it may be strictly called **internal audit.**
in continuous audit most of the time, the audit staff is present at the location

Advantages of continuous audit

1. Error are disclosed earlier due to is adequate time for making the necessary rectification
2. Because of the frequent attendance of the auditor, the chances of committing frauds are reduced.
3. The attendance of the audit staff acts a moral check on the client's staff.
4. The accounts are always maintained up to date
5. Since audit can be carried on through the year, there is more time for detail checking of the accounts.
6. If the audit of routine transaction is completed before the close of the year, the final accounts can be prepared and reported upon much earlier.
7. If the auditor carries on a continuous audit, he can obtain detail knowledge of clients' business thereby able to carry out his duties effectively.

Disadvantage of continuous audit.

1. There Is a danger that the records of transaction after they have been audited may be altered either innocently or fraudulently.
2. The examination of an item left incomplete on a visit for being undertaking on the next visit may be overlooked.
3. A continuous audit may involve good deal of waste of time and effort if the size of the concern is small.

Distinguish between audit procedures and audit techniques

Particulars	Audit procedures	Audit techniques
Meaning	They represent the board frame of the manner of holding the audit work. Procedure may comprise number of techniques	Techniques refer to the methods employed for carrying out the procedure. For example, in vouching procedure, the technique is employed are inspection and checking computation of documentary evidence.
Types	Two types: 1. Compliance procedure and	Audit techniques are generally inter-dependent. A combination of techniques is applied in a

	2. Tests of detail Tests of detail includes a. Substantive audit procedures, b. Analytical review procedure	particular procedure. For example, in verification of assets, the audit technique involved are physical examination, confirmation from third parties etc.

Audit process

Audit planning is one of the basic principles governing an audit. The auditor should plan work to eneble him to conduct an effective audit in an efficient and timely manner. Planning should be based on knowledge of the clients business.

Audit programme

Audit programme is detailed plan of work, prepared by the auditor for carrying out an audit, t constitutes the plan of the work and also provides basis for the supervision and control of the audit work. It consists of a set of techniques and procedure, which the auditor plans to apply in the given audit for forming an opinion about the financial statement.

Advantages of audit programme

1. It provides the assistant carrying out the audit with total and clear set of instructions od the work to be done
2. Election of assistance for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
3. Under a properly framed programme, the danger of ignoring or overlooking certain books and records is significantly lets and the audit can processed systematically.
4. The principal can control the progress of the various audits in hand by examination of audit programme.
5. It serves as a guide to be carried out in the succeeding year.

Disadvantages of audit programme

1. A hard and fast audit programme may kill the initiative of efficient and expressing assistants.
2. Make the audit exercise rigid and mechanical.
3. Inefficient assistants may take shelter behind the program saying the matter does not contain any instruction.
4. Procedure may be undertaken which may be appropriate to the circumstances of the client's business.

In performing an audit of financial statements the auditor should have or obtain knowledge of the business.

- The auditor needs to have a level of knowledge of the clients business and industry that will enable him to identify the events, transactions and practices that, in his judgment may have significant effects on the financial information. "Otherwise he may not be able to assess the adequacy or otherwise of the internal control system prevailing in client's business.
- Knowledge of client's business helps the auditor to
  a. Prepare the overall audit plan
  b. Identify areas for special audit consideration
  c. Evaluate the reasonableness both of accounting estimates and management representation
  d. Make judgment regarding the appropriateness of accounting policies and disclosure.

Audit papers

Documentation refers to the working papers prepared or obtains by the auditor as retained by him in connection with the performance of his audit.

Contents of audit papers

1. Basic constitutional documents e.g. partnership deed, AOA, trust deed etc.
2. Contents of the minute book
3. Contents of the balance sheet and P & L account
4. Letter of engagement

Functions of audit papers

1. Means of controlling current audit work
2. Supervision and review of the audit work
3. Evidence of audit work performed to support auditor's opinion
4. Information about the business being audited and recent history.
5. Proper delegation of work while providing a means to control quality of work performed

Contents of permanent audit file

1. Information concerning the legal organizational structure of the entity
2. Extracts of copies of important legal documents, agreements and minute relevant to the audit.
3. A record of the study and revaluation of internal controls related to the accounting system.this might be in the form of narrative descriptions, questionnaires of flow charts, or some combination therof.
4. Copies of audited financial statements of previous years.
5. Analysis of significant ratios and trends.
6. Copies of management letters issued by the auditor if any,
7. Record of communication with retiring auditor, if any before acceptance of the appointment as auditor.
8. Notes regarding significant accounting policies
9. Significant auditing observations of earlier years.

Contents of current audit file

1. Correspondence relating to acceptance of appointment
2. Extracts of minutes of board meetings and general meetings, as are relevant to the audit.
3. Evidence of the planning process of the audit and audit programme
4. Record of the nature, timing and extent of audit procedures performed, and results of such procedures
5. Evidence that the work performed by assistants was supervised and reviewed
6. Copies of communication with other auditors, experts and other third parties
7. Copies of letter or notes concerning audit matters communicated to or discussed with the client, including the terms of engagement and material weaknesses in relevant internal controls
8. Letters of representation or confirmation received from the client
9. Copies of the financial information being reported on and related audit reports.

Auditor's lien on client's books

The auditor can exercise his lien on client's books and documents, in terms of general principles of law of subject to the following condition

1. Documents retained must belong to the client who owes the money
2. Such documents must have come into the auditor's possession on the client's authority and not acquired through irregular or illegal means
3. Some work has been done in relation to such documents
4. The fees for work performed must be outstanding.

Audit note book

A audit note book is a bound book in which variety of matters observed during the course of audit are recorded.

It is a notebook containing points or queries that require clarification, explanation and investigation and the manner in which they are finally settled.

Parts of audit book

1. **General information containing**
   a. Nature of business carried in
   b. Important provisions affecting its functioning: MOA. Partnership Deed
   c. Structure of the financial and administrative organization
   d. A list of the books of accounts
   e. Name of principle officers, their duties and responsibilities
   f. Particulars of the system of accounts and those of internal check which are in operation
   g. Particulars of the accounting and financial policies followed
   h. Important contracts to which the client is party such as collaboration contracts, royalty contract etc.
2. **Current Information containing**
   a. Audit queries not cleared immediately. E.g. missing receipts, vouchers etc
   b. Mistake or irregularities observed during the course of audit e.g. failure to provide depreciation
   c. Unsatisfactory book keeping arrangements and costing method
   d. Important information about the company which is not apparent from the accounts
   e. Special points requiring consideration at the time of verification of final accounts
   f. Important matters for future reference.

Surprise check

Audit procedures can not be rottenly and mechanically applied as a set of ruled in an and every situation.

There must be flexibility and a sense of surprise in the manner certain checks are carried out. E.g. cash checking, investment checking etc.

Significance of surprise check

1. Audit effectiveness
2. Review of internal control
3. Detection of errors and frauds
4. Moral check
5. Suitability
6. Areas for checks
7. Up to date records

Depth-Auditing

Examination in depth means examination of a few selected transaction from the beginning to the end through the entire flow of the transaction

It involves studying the recording of transaction at the various stages through which they have passed.

Test-checking

Test checking is an accepted auditing procedure where in only a part of it is checked to form an opinion instead of checking all transaction.

How should test checking be made scientific and effective?

1. effective test checking

   a good test check system will provide sufficient satisfaction to the auditor if,

   it is one based on the appropriate size of the same,
   it is selected on random basis,
   it reduced the chance of bias in selection of the sample

it is capable of giving results with a calculated degree of risk

2. precautions

Test checking technique is an accepted auditing procedure and is generally used in case of large business organization having many homogeneous transactions.

The precautions to be taken are.

   a. Classification – under appropriate heads
   b. System study
   c. Efficacy of internal control
   d. Clarity of plan
   e. Scientific sample selection
   f. Prohibited areas
   g. Sample size
   h. Materiality

Judgment sampling

The auditor determines the size of the sample and qualifies the same, based on his previous experience
Example:- in a certain year the auditor may select transaction of June, Sep, Nov. month for cash book verification and other month for verification in the following year.

Statistical sampling

It is a method of drawing a sample based on mathematical and statistical techniques
Example:- the theory of probability and theory of roman numbers are considered in determine the sample size and composition.

Audit materiality

The concept of materiality is fundamental to the process of accounting

It is therefore, an important and relevant consideration for an auditor to judge whether a particular item or transaction is material or not.

Internal control

- Internal control may be defined as the organization plans and all the methods and procedures adopted by the management for achieving,
- Orderly efficient conduct of its business, including adherence to management policies,
- Safeguarding of assets,
- Prevention and detection of fraud and error,
- Timely preparation of reliable financial information.

Duties of an auditor with regard to internal control

- The auditor should study and evaluate the operations of the internal controls upon which he wishes to rely in determining the nature, timing and extent to other audit procedure.
- If auditor reviews the internal control system of the client he will be in a position to bring to the notice of the management the weakness of the system and to suggest measure for improvement
- During the course of his audit, he may also ascertain how far the weakness have been removed.
- Proper understanding of the internal control system enables the auditor to decide upon the appropriate audit procedure. To be applied in different areas in which internal control is considered weak, he might extend certain tests to cover a large number of transaction

Internal control questionnaire (ICQ)

1. Meaning
    a. ICQ is a detailed series of questions designed to provide a complete view of the state of internal control in an organization
    b. The questionnaire is usually provided to the client and the client is requested to get it filled by the concerned executive and employees for the purpose of evaluation of internal control system
2. Objective

    Questions are generally designed in sections of areas like,

    a. Purchase and creditors for goods
    b. Sales and debtors
    c. Stocks
    d. Cash and bank receipts and payments
    e. Fixed assets
3. Use of ICQ
    a. To identify weakness in the internal control system
    b. To decide extent and depth of checking in account areas required during audit
    c. To select proper samples in a rational manner
    d. The audit program is planned and also be modified if considered necessary.

Internal Check

Checks on day to day transactions which operate continuously as part of he routine system whereby the work of one person is provided independently or s complementary to the work of another the object being the prevention or early detection of error or fraud.

Internal Auditing

Internal auditing is a review of the operation and records, sometimes continuously undertaken, within business by specially assigned staff.

Limitations of internal control

1. Management's consideration that control be cost-effective
2. The fact that cost controls do not tend to be directed at transactions of unusual nature
3. The potential for human error
4. The possibility if circumstances of control through collusion with parties outside the entity or with employees of entity
5. The possibility that a person responsible for extracting control and abuse that authority
6. The possibility that a procedures may become inadequate due to change in conditions and compliance with procedures may deteriorate
7. Manipulation by management with respect to transaction or estimates and judgments required in the preparation of financial systems.

State general consideration in framing a system of internal check

1. No single person has an independent control over any important aspects of the business. Every aspects must come under the review of another
2. The duties of member of the staff should be changed from time to time without any previous notice so the same officer does not perform the same function for considerable time.
3. Every member of staff should be encouraged to go on leave at least one in year, because frauds successfully concealed by employee are often found when that are on leave
4. Persons having physically custody of fixed assets must not be permitted to access to book of accounts
5. To prevent loss or misappropriation of cash, mechanical device such as the automatic cash register should be employed
6. For stock-taking at the close of the year, trading activities should, if possible be suspended
7. The financial and administrative powers should be distributed very judiciously among different officers should be reviewed periodically.
8. Procedures should be laid down for periodical verification and testing of different sections or accounting records to ensure that they are accurate.

Relationship between statutory auditor and Internal Auditor

Statutory Auditor (SA)	Internal Auditor (IA)
The extent of the work undertaken by SA arises from the responsibility place him by the statutes	The extent of the work undertaken by the IA is determined by the management
The approach of this auditor is governed by the his statutory duty to satisfy himself that the accounts to be presented to the shareholder show a true and fair view of the financial position	The approach to this auditor is with a view to satisfy that the accounting system is efficient, so that the accounting information presented to the management is accurate and discloses material facts
This auditor is responsible directly to the shareholder	This auditor is responsible to management
External auditor is not the employee of the company so he has independent status	Internal auditor is an employee of the company. So he can not enjoy independence that Statautory auditor has.

Can statutory auditor is rely upon the work of an internal auditor.

1. <u>Reliance on internal auditor</u>

   Relying upon the work of an internal auditor states that the external auditor should as part of his audit, evaluate the internal audit function to the extent he considers that if will be relevant in determining the nature and extent of his compliance and substantive procedure.
2. <u>Common audit approach</u>

   There is considerable similarity in the function and areas of operation of internal and statutory auditor like common interest in ensuring accounting system is adequate, examination of same accounting documents.

3. Effect of internal Audit
   After seeing the work of an internal auditor, he may reduce his areas of routine checking whenever he fells that the internal audit is adequate and effective
4. Responsibility of external auditor
   Any reliance he place upon work performed by the internal auditor is part of audit approach. It does not reduce his duty to exercise sufficient professional care and skills before he pronounce an audit opinion.

Distinguish between internal audit and internal check

Particular	Internal Check	Internal Audit
Definition	Checks on day to day transaction which is operate continuously as part of the routine system whereby the work of one person is proved independently or complimentary to the work of another, the object being the prevention of the earlier detection of fraud	Independent appraisal activity within an organization for the review of operations a s a service to the organization. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls
Objective	Minimizing the detecting error and frauds in day to day function performed	Evaluating the effectiveness of implemented organizational control
Function	It is a routine line function	It is a specified staff function
Need for separate staff	Separate staff is not necessary. It is an integral part of the regular operation	Separate staff of the internal audit department is necessary
Scope	It operates as a built in device as far as staff organization and job allocation aspects of the control system are concerned	It involves review of the adequacy and operations internal control on a regular basis to ensure that all significant controls are operating effectively
Nature	It is merely an arrangement of book keeping and clerical duties	It involves evaluating the quality and operating effectively
Orientation	Procedure oriented	Control oriented

Doing an audit in and CIS (EDP) environments is simpler since trial balance always tallies? Analyze sentence

- In EDP environment the trial balance may tally, but it does not necessarily mean that the job is of an auditor becomes simpler. There is still the possibility of
  a. Error of complete omission
  b. Compensation error
  c. Duplicate of entries
  d. Error of principle and
  e. Deliberately covered fraud
- Audit objective is expression of opinion on true and fair view of the financial statements, not just ensuring arithmetical accuracy
- Besides tallying a trial balance, there are other audit issues like estimation of depreciation, valuation of inventories etc., where the auditor is required to exercise his skill and judgment.
- In view of the above, it may be concluded that a tallied trial balance in EDP environment need not necessarily simplify the audit function

Comment on the overall objective and scope of an audit does not change in EDP environment

- The principal objective of an audit of financial statements is to ensure that the financial statements reflects a true and fair view
- The scope of an audit of financial settlements is determined by the auditor having regard to the terms of the engagement, the requirement of relevant legislation and the pronouncements of the institute

- The overall objective and scope of an audit does not change in an EDP environment but the use of a computer changes the processing, storage and retrieval of information and may affect the organization and procedures employed by the entity to achieve adequate internal control
- The computerization of accounts would also have an impact on the increase in frauds and error, thus when auditing in an EDP environment, the auditor should have sufficient understanding of computer hardware, software and processing system to plan the auditing procedure.
- The auditor should also have sufficient knowledge of EDP environment to complement the auditing procedures, depending upon the particular audit approach adopted.
- Thus, it is clear from the above that overall objective and scope of audit does not change irrespective that whether the account information is generated manually o through EDP.

Describe the internal control in EDP environments.

They can be classified into

1. Overall control affecting the EDP environment – General EDP Control
2. Specific controls over accounting application - EDP application control

General EDP Control

- It seeks to establish a framework of overall control over the absolute that the objective of internal control are achieved

Type of Control	Description
Organization and management control	It includes policies and procedure relating to control function Appropriate segregation of incompatible function
Application system development & Maintenance control	To provide reasonable assurance that systems are developed and maintained in an authorized and efficient manner 1. Testing, conversion documentation of new system 2. Changes to application system
Computer operation control	To control the operation of system and provided reasonable assurance that, 1. The system are used for authorized purpose only 2. Only authorized programs are used 3. Processing error are detected and immediately corrected
System software control	Authorization, approval, testing and documentation of new software and system software modification Use for authorized program only
Data entry and program control	An authorization structure is established over transaction entered into a system Access to data program is restricted to authorized person only
Continuity control	Offsite backup data and computer program Provision for offsite processing in the event of disaster

EDP application control

- It seeks to establish a specific control procedures over the accounting application and provide reasonable assurance that all transactions are authorized, recorded and processed completely, accurate and on a timely basis they are include following

Type of Control	Description
Control over input	Transaction are properly authorized before being processed Transaction are not lost, added, duplicated or improperly changed. Incorrect transaction are rejected, corrected and if necessary resubmitted on timely basis
Control over processing and computer data files	Transaction including system generated transaction are properly processed by the computer
Control over output	Results of processing are accurate

	Access to output is restricted to authorized person only Output is provided, at the proper time to the appropriate personnel.

Different designs and procedural aspects of CIS/EDP environment.

2. Consistency of performance
   - Function exactly as programmed
   - Potentially more reliable than manual system
3. Programmed control
   - Can have inbuilt internal control procedure with limited visibility
4. Single point updating
   - A single input to the accounting system may automatically update all records associated with the transaction
   - Erroneous entry will be reflected in various accounts
5. System generated transaction
   - Some transaction may be initiated by the system itself without the need for an input document (like interest)
6. Date security problems
   - Large volume of data and the computer programs used to process such data may be stored on a portable or fixed storage media

Installation of computer system in entity created both problems and benefits of auditor

Benefits of CAAT's

1. Increase in the effectiveness and efficiency of auditing procedure
2. Saving in time:- the auditor can save time by reviewing the CIS control through CAAT than through other audit procedures
3. Effective test checking:- test checking and examination in depth

Problems of CAAT's

1. Audit trail disappearance
2. Lack of visual observation
3. Internal storage:- difficult to determining procedure followed
4. Change in programs
5. System jargon:- the source code listing provided to the auditor may not agree with the object code used by system

Audit Trail

- It refers to a situation where it is possible to relate "one-to-one" basis. The original input along with the final output
- Thus audit trail can be defined as those documents, records, journals, ledgers, masters file etc., that enables an auditor to trace the transaction from the source document to the summarized total in accounting reports or vice-versa
- E.g. sequentially numbered sales invoice copies would normally be listed register tor daybook and subsequently filed either in numerical or chronological sequence. If It would be possible than be possible, to trace a particular invoice from the daybook to the original n file or vice-versa, by reference to the number or the date of the invoice

The use of computer system facilities by a small enterprise may increase the control risk

1. Law staff strength
   Users of computer may be able to perform two or more function simultaneously
2. Lack of internal check
   The principal that one person should not record a transaction independently is not followed since it is not cost-effective
3. Audit risk
   To overcome such risks in case of small companies using computer facilities, the auditor may perform substance tests in detail and take large samples.

Audit Risk

Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is material misstated.

Such risk may exist at overall level, while verifying various transaction and balance sheet items.

Components of Audit Risk

1. Inherent Risk :- Risk that material error will occur
2. Control Risk:- is the risk that the clients' system internal control will not prevent or correct such errors, to assess risk
3. Detection risk:- risk is that an auditors procedure will not detect a misstatements that exists in an account balance or class of transaction that could be material on other balance or class
   - Inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design to substantive procedure on acceptable level of detection risk, thereby reducing audit risk to an acceptable law level.

Vouching

Vouching is defined as the examination of all documental evidence which is available to support the geniuses of transaction entered in client's books.

For Answer the Vouching question use this pattern...

1. While examining a voucher
    a. The date of the voucher falls within the accounting period
    b. That the voucher is made out in the client's name
    c. That the voucher is duly authorized
    d. That the voucher comprised all the relevant documents which could be expected to have been received on brought into existence on the transaction having been entered into
    e. That the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments passed thereto on its inclusion in final account

Audit of Cash Transaction

1. General consideration
    a. Internal control system
    b. Correctness of book keeping records
    c. Observation of accounting principles
    d. Evidence of transaction
    e. Validity of transaction
    f. Disclosure in the final accounts
2. Casting or totaling of account s matched or not
3. Bank reconciliation statements duly signed by the accountant

Audit of Trading Transaction

1. <u>General consideration</u>
    a. Correctness of book keeping records
    b. Observance of accounting principles
    c. Checking of stock and record
2. <u>Internal control in respect of trading transaction</u>
    a. Trading is a chain of business process buying, taking delivery of goods bought, making proper arrangements for their storage and issuing them on sale
    b. The function of audit in this background, is to ensure that there is no leakage of goods or cash
    c. Also ensure that goods purchased have been received and are of the type dealt in by the firm, the parties are normal and the goods have been duly accounted
3. <u>Internal control in respect of service</u>
    a. The internal control check should provided for the regulation of the charges for the service rendered, either according to an agreement entered into with the parties, to whom the service have been proved, or on the basis of costs incurred in providing the service.
    b. It is the duty of the auditor to verify that an appropriate internal check exist in respect of different types of transaction entered into by the client ensure that all the income receivable has been properly accounted for and adequate precaution have been taken to control expenses.
4. <u>Cut-off arrangement</u>
    a. If agreement is for long time than verify that necessary working of each period correctly ascertained

5. Balance sheet audit
    a. A balance sheet audit consists of the verification of all includible balance sheet item, together with the examination of expense and income accounts which are so closely related to these items that it cannot be properly verified without such analysis and test
6. External confirmation
    a. External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertion made by management in the financial statements

How will you vouch/Verify the following?

1. Recovery of bad debts

- Total amount of bad debts
- All recoveries of bad debts have been properly recorded
- Examine notification from court, letter from collecting agencies for amount recovered
- Check credit manager's file and amount has been deposited in bank matched with each other or not.

2. Borrowing from banks /term loans/overdrafts

- Reconcile the balances in the overdraft or loan account with that shown in the pass book and confirm the last mentioned balances by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
- Obtain a certificate from the bank showing a particular of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern and confirm that the same has been correctly disclosed and duly registered with register of companies
- Verify the authority under which the loan or draft has been raised
- According to companies act.,1956 assure that maximum amount of loan that the company can rasie has not been contravened
- Ascertain the purpose for which loan has been raised and the manner in which t has been utilized.

3. Receipt of capital subsidy

- Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available
- Examine documents for the grant of subsidy and note the condition attached with the same relating to its use,
- See that conditions to ne fulfilled and other terms especially whether the same s for a specific assets or is for setting up a factory at a specific location
- Check relevant entries for receipt of subsidy
- Check compliance with requirements of AS 12 on "accounting for government grants" i.e whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

4. Provision for income tax

- Obtain the computation of income prepared by the auditee and verify whether it is as per the income tax act., 1961 and rules made hereunder
- Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment
- Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands
- Compute tax payable as per the latest applicable rates in the finance act.
- Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.

5. **Goodwill**

- Ensure that goodwill has been recorded in the books only when some consideration in money or money's worth has been paid for. Goodwill arises form business connection, trade name or reputation of an enterprise of from other intangible benefits enjoyed by an enterprise
- Check the vendor's agreement on the basis of which assets of the running business have been acquired by the company at a price existing in the book value of the assets or where a specific sum has been paid for the goodwill
- See that only the amount paid to the vendors not represented by tangible assets has been debited to the goodwill account. Therefore, it is not prudent that goodwill should be shown in the company's account by way of writing up the value of assets on revaluation or writing back the amount of goodwill earlier written off by the company
- See whether goodwill has been written off as a matter of financial prudence

6. **Building**

- Verify the cost by reference to the architect's certificate as well as the contractor's receipts for amounts paid in case of building is completed during the year. If the building has been constructed by the client's own organization, it will be necessary for the auditor to verify that the basis upon which cost of materials, wages and the supervision charges have been allocated to the account and same are reasonable
- Check whether depreciation has been provided on a constant basis\
- Confirm the existence of building either through physical observation or other documentary evidence
- Check the title deeds and verify that building is owned by the entity
- Examine lease deed, if the building is leasehold, to ascertain the cost, amortization etc. and also ensure that all convents in the lease deed have been fulfilled by the client
- If revaluation has taken place see the basis of revaluation and ensure that the disclosure of the same has been made.
- In case of a company, check that presentation and disclosure has been as per the part of companies act, 1956

7. **Sale of investments**

- See that sale of investment has been made on the proper authorization of board or other competent authority
- Ascertain the method of selling investment. It may be either through broker, directly or through a bank. See the broker's sold note
- See that the difference between the carrying amount and the sales proceeds, net of expenses, is recognized in the P & L account. Ensure that when only a part of the holding of an individual investment is sold, the carrying amount s allocated on the basis of average carrying amount of the total holding of the investment.
- See that proper disclosure as required by AS 13 re made as follows
    a. Interest, dividends, rentals on investmanets is to be shown in P & L account at gross value and TDS as advance tax paid.
    b. Showing separately profit and loss on disposal and charges in carrying amount of current and long term investments.

(these some accounts and details which are important is mentioned but other accounts and assets vouching for detail study please refer the practice module of ICAI, best book for vouching and verification of assets)

While conducting the audit of the accounts of a manufacturing company, you discover that the rate of gross profit on sales has sharply risen in comparison to the previous year. State the steps you would take to satisfy yourself

There is several possible cause of the sharp increase in the rate of gross profit on sales as compared with that of the previous year; the most likely causes are as under,

1. <u>Increase in sales price</u>
   - The selling price of the finished products may have been increased. Enquiries should be made by auditor as to whether there have been general or specific price increase and the reasons for the same. The auditor should obtain copies of the company price lists prevailing at different point of time and make the relevant comparison
2. <u>Reduction in cost of manufacturing</u>
   - The cost of manufacturing may have reduced substantially. The auditor sould examine the stock and purchases records in respect of large purchases of raw materials, comparing current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.
3. <u>Alteration in sales-mix</u>
   - The mix of sales may have been altered, resulting in the sales or more profitable items. Detailed sales analysis should be made for the period in order to ascertain whether the more profitable lines constituted a large proportion of he total sales
4. <u>impact of automation</u>
   - The mechanism or automation of certain manufacturing processes may have resulted in considerable saving in labour cost and this possibility could be easily verified by comparisons of wages records.
5. <u>Advance to cut-off procedure</u>
   - The company cut-off procedure as regards closing stock and work-in-progress should be investigates, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio.
6. <u>Manipulating sales</u>
   - The possibility of items which have been sent to customers on ‘sale or return’ basis being included in sales should be investigated, as this would give effect for increase n the rate of gross profit.

General consideration for valuation and verification of assets

Auditor should follow

1. Existence

   To confirm that the assets were existence on the date of balance sheet by
   - Physical confirmation
   - Comparison of assets register with genral ledger balances
   - Obtaining confirmation from custodians of assets.
2. Assets must be held for business
3. Ownership
4. Charge
   - Ascertain that no un authorized charges have been created all the charges are duly registered and disclosed
5. Cost
   - To ascertain that the assets are shown at the historical costs
6. Carrying amount
   - To ensure that assets have been correctly valued regarding physical condition
     1. Computation cost as per generally accepted accounting principles
     2. Charging of depreciation on a scientific basis
7. Disclosure
   - Properly disclosed in balance sheet
8. Sale of assets
   - When assets are sold, its sale proceeds should be vouched by reference to the agreement, terms and condition of sale.

Comments on fixed assets have been revelued and the resulting surplus has been adjusted against the brough forward losses

- The revaluation of fixed assets is a normally accepted practice which involves writing up the book value of fixed assets
- AS 10 on 'accounting for fixed assets' requires that "an increase in net book value arising on revaluation of fixed assets in normally credited directly to owner's interest under the heading of revaluation reserve and is regarded as not available for distribution"
- Thus, creation of revaluation reserves does not result into any cash inflows and represents unrealized gains.
- As a matter of prudence, revenue losses can be adjusted against revenue reserves only and not the capital reserves
- Therefore, the accounting treatment followed by the entity is not correct and auditor should qualify the audit report by mentioning the above fact.

Subsequent events and consideration of SE by the auditor

SA 560 on "subsequent events", defines the term as events occurring between the date of financial statements and the date of auditor's report, and facts that become known o the auditor after the date of auditor's report.\

Subsequent events also refer to significant events which occurred up to the date of report of the auditor that component

Thus, subsequent events which occur after the date of balance sheet till the audit report s signed by the auditor

SA 560 requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report

However the exact manner of treatment would be depend upon whether the event falls in the category of 'adjusting event' or 'non-adjusting event'.

Therefore, an disclosure is required to consider all subsequent events while discharging his duties and determine whether those shall have to be adjusted or imply required to be disclosed.

Comments on assets purchased under hire-purchase system were reflected at their full-value and the outstanding installments payable have been included under sundry creditors

- Assets acquired under the HP system should be recorded at the full cash value with corresponding liability of the same amount.
- In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.
- Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.
- Thus, the treatment followed by the company is correct

Outstanding assets

- It is well accepted accounting principal that all expenditure pertaining to the year alone should be charged against year's revenue and all income whether received or not should be accrued for the year.
- Following this principles one has to make certain adjustments in the books of account and outstanding assets are bought to book in that process.
- If expenditure made on certain revenue heads, the benefit of which is to be derived even after the year is over and adjustment is made to the year an outstanding assets is created.
- Generally, outstanding assets are those items for which amounts are yet to be received through service etc., have been rendered, or items for which benefit of service will be received later.
- Example: insurance amount is paid in advance then proportion thereof is applicable o the period subsequent to the date of the balance sheet should be calculated and shown as an outstanding assets.

Verify the stock lying with third parties

- Obtain confirmation from the third party including the time period and reasons thereof
- Evaluate condition of goods and see whether adequate provision has been made
- Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period
- Ensure that the goods have been included in the closing stock through lying with third party.

Persons qualified to be appointed as auditor of company

1. Chartered Accountant holding a certificate of practice
2. All the partners of a CA firm in India are qualified for appointment than its firm name to be the auditor.

Disqualified for being Auditor

1. A body corporate
2. A officer or employee of the company
3. A partner or employee of an officer or employee of the company
4. A person who indebted to company amount exceeding Rs. 1000, or who given such guarantee or provided any security in connection with the third person to company
5. A person holding any security of the company after 1 year from the commencement of business. Security means which carrying voting rights.

Other

1. A person who disqualified from the body corporate which is either
    a. Holding
    b. Subsidiary
    c. Co-subsidiary company
2. A person who become disqualified regarding any above disqualification after his appointment.
3. A person who shall not be qualified for appointment if he is otherwise disqualified.

Appointment of Auditor by Shareholders

<u>The shareholder of the company appoint auditor at each annual general meeting. procedure as follows</u>

- Certificate from auditor :- before appointment of re-appointment, the company shall obtain a certificate which sate that the appointment, if made will be within the ceiling limits
- The auditor shall hold appointment from on annual general meeting to till the conclusion of next AGM.
- The company shall give intimation of appointment to concerned auditor within 7 days of appointment
- The appointed auditor shall communicate to the previous auditor and enquire whether there is any professional reason why the appointment should not ne accepted.
- The auditor on receipt of the intimation from the company about his appointment is required to send a written communication to the ROC in form 23B within 30 days of the receipt of intimation.

Appointment of First Auditor

- Section 224(5) specified that Board of director shall appoint the first auditor of a company. Appointments shall be made within one from the date of incorporation.
- The company need not send any intimation to the first auditor.
- If the board fails to appoint first auditor, the company in general meeting is empowered to make the appointment.
- The company may remove the first auditor by passing a Ordinary resolution at a general meeting. No specific notice is required for such removal.

Re-appointment of Retiring Auditor

A retiring auditor can be reappointed except under the following circumstances

- If the retiring auditor is disqualified for re-appointment
- If the retiring auditor has given the company a notice in writing of his unwillingness to reappointed.
- If a resolution has been passed at that AGM appointing another auditor instead of retiring auditor.

Filing of casual vacancy

- In case of a casual vacancy arising on account of resignation only the company in AGM can fill the Vacancy.
- Vacancy may arise due to a variety of reasons which include death, resignation, disqualification & dissolution of the auditor firm etc.
- Except resignation if other cause is responsible for vacancy then board of director can fill the vacancy.

Refusal of acceptance of appointment

- When the existing auditor which has been re-appointed at AGM refuses to accept the appointment, it does not amount to casual vacancy or vacancy by resignation.
- Since, the auditor are appointed at AGM, subsequent refusal to appointment does not empower the BOD to appoint a Auditor
- In these circumstances, appointment shall be made by central government.

Appointment of Auditor by central Government.

Appointment mad by CG in case the Auditor not appointed in AGM.

- Section 224(3) provides that where at the AGM, no auditor is appointed or re-appointed the central government may appoint a person to fill the vacancy
- For this company shall give notice of the fact within 7 days to the central government for such fact.
- If company fails to give such notice, The Company and every officer which is in default shall be punishable with fine.

Appointment of auditor by a Special Resolution (SR)

- The auditor in the case of a company in which not less than 25% of the subscribed share capital is held, whether, singly or in combination by a public financial institution or a government or CG, SG
- Any financial institution established by a provision or state act in which a state government holds not less than 51% of the subscribed capital
- A nationalized bank or an insurance company carrying on general insurance business.

Other Points

- If company not appoint auditor by SR in its AGM, the CG shall have the power to fill the vacancy
- For determining 25% holding, the material date shall be the date of AGM in which the SR is required to passed.
- In cases where the holding is less than 25% as on the date of notice but exceeds 25% as on the date of AGM, it is advisable for the company to adjourn the meeting, issue another notice to the member and appointment of auditor by SR in the adjourned meeting.

Ceiling Limits of Company Audit

No company shall appoint a person or firm as its auditor if

- Such person is in full time employment elsewhere or,
- Such person or firm holds the office of auditor of the specified number of companies or more than specified number.
- Ceiling Limit
    1. 20 company audits/person, of this 20, not more the 10 shall be in respect of companies having paid up capital of 25 lakh or more.
    2. For partnership firms, the ceiling limit shall be 20 company audit per partner, who is not n full time employment elsewhere.
    3. When a CA is partner in a number of firm, all the firms in which he is partner or proprietor will be together entitled to 20 company audit on his account.

- **Computation of ceiling limit**

Included Audit	Excluded Audit
Part audit as a Unit	Branch of company
Joint auditor personally one unit	Co-operative societies, trust which are not company
Non-profit companies	Foreign company
	Company limited by guarantee, not having share capital
	Private limited company
	Tax audits, internal audit, special audit for investigation

Remuneration to auditor

- The expression "remuneration" shall include any sums paid by the company in respect of auditor's expenses
- The company auditor's remuneration is fixed by……
  1. By the director when appointment is made by them
  2. By the CG when appointment is made by them
  3. By the Company in GM when appointment is made in GM.
- The P & L account must disclose the remuneration paid to the auditor in the following manner
  1. As auditor
  2. As advisor, in respect of
     - Taxation matter
     - Company law matters
     - Management service
  3. In any other manner

Removal of Auditor

<u>Procedure in the removal on the expiry of term or office</u>

1. Special notice is requiring for a resolution at an AGM for…
   a. Appointment as auditor, a person other than retiring auditor
   b. Providing expressly that the retiring auditor shall not be re-appointed
2. Time of Notice :- 14 days before AGM
3. Circulation of Notice

   Send to all the member of the company and also send to retiring auditor also.
4. Retiring auditor: the retiring auditor has the right to
   a. Making a representation of reasonable length of company
   b. Reducing such representation be circulated among the member
   c. Representation be read out at the AGM and be heard orally at the AGM
5. Company's Duties

   Where the retiring auditor makes a representation in writing to the company, the company shall unless the representation is received by it too late for it.
6. Situation when representation need not be circulated
   a. When representation are received too late by company
   b. If the company law board is satisfied that the right of representation is being misused by the auditor
7. Procedure at AGM

   If company of representation is not sent, the auditor may require that representation shall be read out at the meeting
8. Certificate from appointed auditor,

   Before appointment at AGM, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with limit.

What are the powers of an auditor of a company?

1. Right of access to books and accounts
   - A right of access to books of account at all times to the books and accounts of the company whether kept at the Head office or elsewhere.
   - Auditor can inspect the books, accounts & voucher usually during the normal working Hours.
2. Right to obtain information & Explanations
   - Auditor is entitled to "require from the officers of the company such information explanations as the auditor may think fit for the performance of his duties"
   - If proper information & explanations not given than he has the right to inform the member of the company.
3. Right to Visit Branch office and access to branch accounts
   - Where the accounts of any branch office are audited by any other person, the company auditor is entitled to Visit the branch office and if he deems fit its necessary than he can also suggest that person.
4. Right to receive notice and to attend general meeting.
   - All notices and other communication relating to, any GM of a company which any Member of the company is entitled to receive, are required to be forwarded to the auditor of a company.

Statutory Duties of an auditor of a company

1. True and fair view
   - Primarily the auditor is required to state whether the financial statements of the company presents a true and fair view of its state of affair and working results.
2. Disclosure of information
   - The company auditor shall state, whether in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by the act in the manner so required.
3. Obtaining information and explanations
   - The auditor has the power to seek such information and explanations as the consider necessary for the performance of his audit
   - If the auditor has not been able to obtain material information or explanations, he may have to quality his opinion regarding the truth and fairness of the financial statements.
4. Proper Books and Accounts
   - The auditor should state in his report "whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him"
5. Dealing with Branch audit report
   - The auditor report shall state "whether the report on the accounts of any branch office audited under section 228 by a person other than the company auditor has been forwarded to him as required according to law and he has dealt with the same in preparing the auditor report.
6. Reasons for qualifications
   - If any of the matters in the auditor's report is answered in negative or with a qualification, the report shall be also state the reasons for such an answer
   - The qualification is required to answer in **Bold** or *italic* type.
7. Inquiry and reporting
   - Whether loans and advance made by the company on the basis of security have been properly secured and whether the terms in which they have been made are not prejudicial to the intents of the company or its member.
   - Whether transaction of the company, which is represented merely by book entries, are not prejudicial o the interests of the company.

- Where the company is not an investment company within the meaning of section 372 or a banking company whether so much of the assets of the company as consist of shares, debenture and other securities have been sold at a price less than that a which they were purchased by the company
- Whether loans and advances made by the company have been shown ad deposits
- Whether personal expenses have been charge to revenue accounts
- Whether it is stated in the books and paper of the company that any shares have been allotted for cash, whether cash has actually been received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

8. <u>Signing/authentication</u>
   - The auditor shall sign the auditors report or sign authenticate any other document of the company requires by law to be signed or authenticated by the auditor
9. <u>Certification of statutory report</u>
   - Certify the statutory report issued to the members.

Signing of the auditor report

As per the section 229 only the person who appoint as the auditor or the auditor firm is so appointed, only a partner in firm practicing in India may sign the auditor's report.

Responsibility about the auditor's report

- It is the manager's duty and responsibility to send the auditor's report to the individual shareholders of the company who are all entitled to receive notice of the general meeting of company
- It is neither the duty nor the responsibility of the auditor to send his report to the member directly.

Appointment of Branch Auditor

2. <u>Appointment</u>
   a. In case of local Branches
      i. Either the company's auditor appointed
      ii. Or a person qualified for appointed as an auditor
   b. In case of a foreign branches
      i. Either the company's auditor appointed
      ii. Or a person qualified for appointed as an auditor
      iii. An accountant duly qualified to act as an auditor in accordance with the laws of a foreign country.
3. <u>Appointment of person other than company auditor as branch auditor</u>
   - Its decision s taken in general meeting
   - The company may either appoint the branch auditor at the meeting or authorize the BOD to appoint such an auditor in consultation with the company's auditor.

Right of Branch Auditor

- Auditor's power: - to exercise the same powers and duties in respect of branch office audit as enjoyed by company's statutory auditor in respect of company's audit.
- Reporting :- to prepare a report on the accounts of the branches office examined by him and forwarded to the company's auditor
- Remuneration: - to receive such remuneration as the company in general meeting or the board may fit.

Provisions relating to exemption from audit of Branches

1. Exemption based on the quantum of activity

   Branch office shall be exempted from audit if it satisfies following condition

   a. Company should be carrying any manufacturing, processing or a trading activity
   b. Branch office should have a average quantum of activity that not exceed
      i. Rs. 2 Lakh or
      ii. 2% of the average of the total turnover, whichever is higher.

   Here,

   - Average quantum activity means the average of the past there years or the two years or the one years as the case may be, depending upon the availability of financial information.
   - Quantum of activity means
     i. Aggregate value of goods and articles produced, manufactured or processed or sold and od service rendered
     ii. Amount of expenditure, whether of a revenue or capital nature incurred by a branch office of a company during a Financial Year.

2. Exemption Based on Specific application
   a. The company shall make a specific application to the central government in the prescribed form
   b. Contents of application
      i. A certificate to the effect that arrangements have been made for the prescribed audit of the branch office signed by managing director
      ii. A written statement from the auditor that, in his opinion arrangements for audit of branch office accounts are adequate and that the maintenance of branch office accounts enable the branch auditor to certify the truth and fairness of the working branch
   c. If the CG satisfied on the application from the visit of branch than CG may be granted exemption
   d. Communication of order
      i. A copy of the exemption order shall be sent to the company's auditor and shall also read before the next GM

Can a company restrict rights of its statutory auditor?

1. Need for auditor rights: - these specific rights have been conferred on the auditor to enable him to carry out his duties and responsibility prescribed under the Act, which cannot be restricted on any manner.
2. Nature of AGM resolution: - hence, any such resolution even of passed by entire body of shareholder, is ultra virus the companies act, and therefore void.

Under what circumstances can the central government (CG) direct Special Audit?

1. The affairs of the company are not being managed in accordance with sound business principles or practice.
2. The company is being managed in a manner likely to cause serious injury or damage to the interests of trade, industry or business to which it pertains, or
3. The financial position of the company is such as endanger its solvency

Cost Audit and Cost Auditor

Cost audit is the of audit of cost record, it is an audit process for verifying the cost of manufacture or production of any article on the basis of accounts as regards utilization of material or labour or others items of cost maintain by the company.

1. Cost audit – the CG may, if t necessary feels necessary
2. Cost Auditor :- By a Cost accountant with the meaning of ICWA or a CA having prescribed qualification
3. Appointment: - Appointed by the BOD with the previous approval of CG.
4. Disqualification of being Cost auditor
   a. A person covered by disqualification of company auditor

   b. Auditor of the company
   c. A person who acquire any disqualification subsequent to appointment
5. Additional audit
   - Cost audit is not a substitute for annual financial audit
   - The cost audit need not be conducted every year
6. Powers
   - Same powers and duties as the company auditor enjoy
7. Company's duties
   a. Appoint the cost auditor with previous approval of CG
   b. To give up facilities and assistance to the cost auditor
   c. To give full information and explanation on every matter to the CG this contained in cost audit report within 30 days from the date of receipt.

Distinguish between qualified report and adverse report

Qualified report	Adverse report
A qualified report is one where an auditor gives and opinion subject to certain reservations	Is given when the auditor concludes that based on his examination, he does not agree with the affirmations made in financial statements/Report
The Auditor's reservation is generally stated as "subject to the above, we report that the balance sheet shows a true and fair view.	The auditor states that financial statements do not present a true and fair view of the state of affaires and working results of the organizations.
The accounts present a true and fair view subject to certain reservations	The accounts do not present a true and fair view on the whole
A qualification is made in the audit report when the auditor has reservation on specific item(s) of material nature	An adverse report is given when the auditor has his reservations on the true and fair view presented by the Financial statements.

Company provide Xerox copy of accounts & books instead of original books becase its taken by the any authority like Income tax or excise etc.

Solution for above situation

1. Requirements under companies act:- the company auditor should report whether
   a. He has obtained information and explanations required for the purpose of his audit.
   b. Proper books of accounts have been kept by the company
2. Analysis
   a. It is an possible for the auditor to express his opinion on the basis of photocopies of the accounts,
   b. However, if the auditor is able to obtain sufficient appropriate audit evidence on the truth and fairness of financial statements, on the basis of Xerox copies provided to him, he may also furnish a clean report
3. Opinion
   - Where the auditor is able to form an opinion on the basis of the photocopies of books and records produced to him, he shall express his opinion
4. Disclaimer
   - Where the auditor is not able to express any opinion based on the information available to him, he should issue a disclaimer of opinion and any factual knowledge, with due reasons

How do you verify shares issued for consideration other than Cash?

Shares may be issued to

1. Vendors towards payment of purchase consideration
2. Promoters towards preliminary expenses
3. Underwriters towards payment of underwriting commission

Auditor's Duty

Documents	Aspects to be verified
MOA	Company's power to reimburse promoters preliminary expenses, to issues shares other than cash
Minute Book	Contract on the decision to issue shares for consideration other than cash and the actual allotment of shares
ROC Return	Copy of contract entered into with vendor, underwriter is fully filed with the ROC within 30 days from the date of allotment
Disclosure	See that such shares are disclosed as allotted for consideration other than cash under the head shares capital on the liabilities side of the balance sheet.

How do you verify shares issued at premium

About Share Premium

- The company may issue the shares at a premium and company with the requirmrent of Act,
- The values received over and above the nominal value of securities shall be transferred to a separate account called securities premium account.
- Securities premium may be applied in a way which specified in sec 78(2).

Auditor's Duty

Documents	Aspects to be verified
AOA	For any provision on the issue of shares at premium
Minute Book	Ensure that the rate of premium and in accordance with the board's authorization and the rate mentioned in the prospectus
Form 2	Verify the return of allotment with the ROC and note the information submitted in the connection of allotment at premium
Balance sheet	1. Liability side, under reserve and surplus as securities premium account 2. Ensure utilization of securities premium as per the legal provision, the same should be clarify shown under the Balance sheet

How would you verify shares issued at Discount

Company can issue shares at a discount on the following condition only.

1. Authorized by ordinary resolution in GM and sanction by company law board
2. Rate of discount should be specified in the resolution; rate of discount should not exceed 10% unless the CLB may permit higher Rate.
3. The issue should be made within two months of the sanction of CLB, but not earlier than 1 year after the commencement of Business
4. The shares should be a class already issued by the company.

Auditor's Duty

Documents	Aspects to be verified
Minute book	Resolution passed and the rate of discount
Sanction letter	Verify whether letter has been received and issue has been made within the prescribed date within two months

From CLB	Verify whether the regular procedures for receipt of shares application money and allotment have been duly followed.
Allotment register	Verify whether the regular procedures for receipt of share application money and allotment have been duly followed
Balance sheet	Verify whether or not amount of discount has been written off Otherwise shown specify under the head 'Misc. Expenditure'

How would you verify Sweat equity shares by a limited company?

Sweat equity shares means	Equity shares issued by the company, To the employees and directors, At a discount or for consideration other than cash, For knowing know-how or making available right in the nature by whatever name called.
Condition	1. The shares should be of a class already issued, 2. Authorized by a SR passed in a general meeting which specify the number of shares, current market price, consideration other than class or classes of directors and employed to whom such shares issued. 3. Issue take place at least one year after the commencement of business 4. The issue should comply with SEBI.

<u>Auditor's Duty</u>

Documents	Aspects to be verified
Minute Book	Verify the resolution has been duly passed Verify resolution clarify specified condition
Correspondence with allotment	Ensure that issue has been made within the prescribed time period Verify SEBI guidelines have been complied with in listed shares
Allotment Register	Verify whether the regular procedure for receipt of shares application money and allotment has been duly followed.
Balance sheet	Verify whether or not the amount of discount has been written off Verify whether the account entries have been duly recorded in case of issue of shares for consideration other than cash.

How will you verify calls paid in advance?

1. <u>Calls in advance</u>: - if company permitted by articles, may accept from member either the whole or part of the amount remaining unpaid on any shares held by him as calls in advance.
2. <u>No voting rights</u>: - the member shall not be entitled to any voting rights until the same becomes presently pay able and duly appropriated.
3. <u>Dividend</u>: - a company if so authorized by its articles, may pay dividend in proportion to the amount of paid upon each shares.
4. <u>Auditors' Duty</u>

Documents	Aspects to be verified
AOA	Empower the company to, a. Receive call in advance b. Pay dividend, the rate of interest/Dividend payable
Cash book	Examine the cash book and trace the calls received in advance matched with share register
Schedule of interest on Calls in advance	Examine the schedule of interest paid on calls in advance Such interest is chargeable against profits, but can be paid out of capital when profit not available. In winding up calls in advance are repayable along with the interest accrued

Government Auditing

Government auditing means,

- The objective, systematic, professional & independent examination
- Of financial, administrative and other operations of a public entity
- For the purpose of evaluating and verifying them,
- Presenting a report containing comments, conclusions and recommendations and expressing the appropriate professional opinion in respect of financial statement.

Comptroller and Auditor general of India

1. Appointment
    - By the president of India
    - Shall not be removed from office except proven misbehavior
2. Remuneration
    - Equivalent to that of a supreme court judge
3. Removal
    - The C & AG can be removed from the office only when each house of parliament decides to do so by a majority of not less than two thirds of the member of the parliament present & voting
4. Powers and duties
    - C & AG shall perform such duties and express such powers in relation to the accounts of the union states and of any other authority as may be prescribed under the C & AG act, 1971
5. Account maintenance: - in such form as the president may, on the advice of the C & AG.
6. Submission of accounts:- submitted to the president/Governor who shall cause them to be laid before the house of parliament.

Duties of C & AG under the Act

1. To compile and submit accounts
    - Compile the relating to the annual receipt and disbursement
    - He shall submit those accounts to president/governor
2. To render assistance in accounts maintenance
3. To audit and report

    Shall be audit and report on
    - All expenditure from the consolidated fund of India to ascertain whether moneys disbursed were legally applicable to purpose when they been applied
    - All transaction of union/state relating to contingency funds and public accounts
    - All trading, manufacturing, P & L account, balance sheet and other subsidiary accounts kept in any department of union/state.
4. To audit receipts and expenditure
    - To audit receipts and expenditure of the body or authority shall be treated as substantially financed if the amount of grant or loan in a year is..
        i. Greater than Rs. 25 Lakh
        ii. Such amount is greater than 75% of the total expenditure of that body.
    - This unit must ne audited for its receipts and payments
5. To audit grants or Loans
    - This applies to any specify loan or grant given from consolidated fund of India/state/union territory.
    - The C & AG shall scrutinize the procedure by which the sanctioning authority satisfies itself as to fulfillment of the condition of giving loans

6. To audit receipts of union or States
7. To Audit account of stores and stock
8. To audit account of Government companies and corporations.

In the context of government expenditure audit, write in brief, what do you understand by,

1. Audit against rules and order
    - To ensure that the expenditure incurred conforms to the relevant provision of the law and is in accordance with the financial rules and regulation formed by the competent authority.
2. Audit of sanction
    - To ensure that there is sanction, either special or general accorded by the comptent authority
3. Audit against provision of funds
    - To ensure that there is a provision of funds out of which the expenditure can be incurred and the same has been authorized by the competent authority.
4. Audit of propriety
    - To ensure that the expenditure was incurred with due regard to the broad and general principles of financial propriety.
5. Audit of performance
    - To ensure that the various programmes schemes, projects where large financial expenditure has been incurred are being run economically and yield the expected results.

Audit of Local bodies

1. Statutory auditor:- the local fund audit wing of the state government is generally incharge of the municipal accounts.
2. Objectives
    a. Reporting on fairness of the content and presentation of financial statements
    b. Reporting upon the strength and weakness of system of financial control.
    c. Reporting on the legal and administrative requirements
    d. Reporting upon whether value is being fully received on money spent.
    e. Detection and prevention of fraud, error and misuse of resources.
3. Coverage
    a. Audit against rules and orders
    b. Audit of sanction
    c. Audits against provision of funds
    d. Audit of propriety
    e. Audit of performance

Outline the audit programs of NGO

Subject	Verification matter
Constitution	➢ Ascertain the constitution of the organization and note the legal provision affecting the operations, accounts and audits.
Minute book	➢ Ensure that the decision taken have been duly complied with, ➢ E.g. operation of bank account, sanctioning of expenditure
Income verification	➢ Contribution and grants for projects and program have been accounted. ➢ Verify in detail the internal control system and ascertain who are the person responsible for collection of funds ➢ Ensure that all collections are accounted and deposited in the bank daily. ➢ Check fees received with membership register ➢ Check the interest and dividends received and receivable with investment held during the year
Expenditure verification	➢ Verify agreement with donor/contributors supporting the particular program or project to ascertain for undertaking the program/project ➢ Check office and administrative expenses by reference to vouchers and supporting documents

Loans	➢Ascertain the borrowing powers of the NGO for specific projects. ➢Verify whether interest and installments payments have been properly made along with counter-foils. ➢Obtain confirmation from balances from bankers/lenders of loans taken by NGO
Fixed Assets	➢Vouch all the acquisition/sale or disposal of assets including depreciation and the authorization for the same. ➢Verify whether assets received as contribution have been accounted based on donor's letter
Investments	➢Verify the investment register and conduct physical Inspection of investment ensuring that investments are in the name of NGO. ➢verify whether accrued income on investments have been duly accounted for.
Current Assets	➢cash in Hand:- physical verify the cash with books and accounts ➢Bank Balance:- check the Bank reconciliation statement and ascertain details for old outstanding and unadjusted amount ➢Stock in Hand:- verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.

Mention the special points in the audit of an entity from incomplete records.

Audit from incomplete records may arise in the following situation

1. Maintenance of records under single entry system
2. Accident destruction of records like fire, termites etc.
3. Seizure of Records by authorities like excise, Income-tax etc.

<u>Auditor considers the following points for the audit from incomplete records.</u>

1. Ascertain the exact status of accounting records available including memorandum records
2. Scrutinize the opening balance sheets and account are accurately opened or not
3. Analyze the personal account of debtors to obtain information on credit sales, sales returns, discount allowed, bills received and also obtain direct confirmation from parties in respect of balance due from them.
4. Analyze the personal account of creditors to obtain full information on credit purchase, purchase return, discount received, and bills payable and also obtain directly confirmation from parties in respect of balance due to them.
5. Verify the cash book for various receipts and payments
6. Verify fixed assets physically and obtain suitable evidence explain the title and value of fixed assets.
7. Perform analytical review procedure in depth and notice derivation to investigate. Ratio analysis and comparison shall be of importance to identify significant variation and cause for them.
8. Conduct surprise check to verify cash in hand, inventory etc.
9. Obtain external evidence, physical examination, observation and managerial representation.
10. Formulate an appropriate audit opinion based on above findings. A disclaimer of opinion may be appropriate in case there is any problem in the scope of audit.

Auditing the books of cinema hall

(Only main points are covered under material is as per audit language)

1. Internal control in show collection
2. Advertisement receipts
3. Refreshment/restaurant income
4. Cash book verification
5. Expenditure verification
6. Advances to distributors
7. General
   a. Fixed assets and depreciation
   b. Sundry creditor for goods and analyze whether they are any abnormal movement

   c. Form and manner of presentation of finanacial information conforms to accounting standards and applicable legal rules

Auditing the accounts of a hospital

1. Legal status
2. Internal check
3. Income from service to patients
4. Cash collection
5. Grants and donation
6. Income from investments
7. Purchases of medicine and expenses
8. Stock in trade
9. Property and investment register
10. General
    a. Fixed assets and depreciation
    b. Sundry creditor for goods and analyze whether they are any abnormal movement
    c. Form and manner of presentation of financial information conforms to accounting standards and applicable legal rules.