Chapter 10

Company Audit – II

10.1 LOCATION OF BOOKS OF ACCOUNT [Sec. 209(1) and (2)]

Location		Conditions
1. **Registered office**		All the books of account shall be kept at the registered office.
2. **Any other place**	***Place in India***	All or any of the books may be kept at any other place in India.
	Board resolution	The Board must pass a resolution according approval to keep the books at such other place.
	Requirements of Board resolution	The Board resolution must specify – (i) the nature of books to be kept at such other place; *and* (ii) the full address of such other place.
	Notice to registrar	▪ The company shall give a notice to the registrar. ▪ The notice shall be given *within 7 days* of passing the Board resolution.
3. **Branch office**	***Nature of books***	All the books of account in respect of branch office may be kept at such branch office.
	Duties of the company	(a) The branch office shall prepare up-to-date summarised returns. (b) The interval between preparation of any two summarized returns *shall not exceed 3 months*. (c) The summarised returns shall be sent to the company (at the registered office or at such other place where the books are kept) within a reasonable time of compilation of the returns.

10.2 CONTENTS OF BOOKS OF ACCOUNT [Sec. 209(1)]

Nature of books to be kept	Every company shall keep books of account with respect to – (a) receipts and expenditures; (b) sale and purchase of goods; (c) assets and liabilities; (d) prescribed particulars relating to cost incurred on materials, labour and other items if– (i) the company is engaged in production or processing or manufacturing or mining; *and* (ii) an order for maintenance of cost records is made by CG.

10.3 'PROPER BOOKS OF ACCOUNT' [Sec. 209(3)]

[illegible] u/s 209(3)	*True and fair view*	▪ The books must not suppress any transaction. ▪ The books must not contain any fictitious transaction.
	Accrual basis of accounting	Cash basis and Hybrid system of maintenance of books is prohibited.
	Double entry system	Single entry system of maintenance of books is prohibited.

10.4 PRESERVATION OF BOOKS OF ACCOUNT [Sec. 209(4A)]

- Books of account for 8 years immediately preceding the current year shall be maintained.
- The relevant vouchers shall also be preserved.

10.5 ANNUAL ACCOUNTS – LEGAL REQUIREMENTS (Sec. 210 and 211)

Laying of annual accounts at an AGM	***Duty of laying of annual accounts***	It is the duty of the Board of directors to lay the annual accounts at every AGM.
	Meaning of annual accounts	(i) B/S (ii) P&L A/c
Requirements of B/S and P&L A/c	***B/S***	(i) The B/S shall be in the same form as set out in Part I of Schedule VI. (ii) The B/S must comply with the 'Notes' given at the end of Part I of Schedule VI.
	P&L A/c	(i) No form has been prescribed for P&L A/c. (ii) P&L A/c must comply with the requirements of Part II of Schedule VI.
	B/S and P&L A/c	B/S and P&L A/c must give a true and fair view.
'Financial year'	***Meaning of FY***	▪ The period for which P&L A/c is prepared is called as FY. ▪ It may be more or less than a calendar year.
	Maximum period of FY	▪ FY shall not exceed a period of 15 months. ▪ But, it may exceed upto 18 months with the special permission of registrar.
	Change of FY from year to year	▪ The Board is empowered to decide the period covered in a FY. ▪ The period covered in a FY may be different from the period covered in the preceding FY(s).
Responsibility	Same persons are responsible for preparation of B/S and P&L A/c as are responsible for maintenance of books of account.	

10.6 ACCOUNTING STANDARDS (Sec. 211 and 227)

Meaning of accounting standards	▪ AS means the standards of accounting recommended by ICAI, as may be prescribed by CG after consultation with National Advisory Committee on Accounting Standards. ▪ Until AS are prescribed by CG, the standards of accounting specified by the ICAI shall be AS.	
Duties of the company regarding AS (Sec. 211)	*Compliance with AS*	Every company shall comply with AS.
	Disclosure in case of non-compliance	▪ Deviation from AS; ▪ Reasons for deviation; ▪ Financial effect due to deviation.
Duties of the auditor regarding AS (Sec. 227)	▪ The auditor shall state as to whether the P&L A/c and B/S comply with AS. ▪ If the P&L A/c or B/S does not comply with AS, the auditor shall qualify the audit report.	

10.7 CONTENTS OF BOARD'S REPORT (Sec. 217)

Contents specified u/s 217(1)	(a) The state of the company's affairs (b) Profits proposed to be transferred to reserves (c) Dividend recommended by the Board (d) Material changes subsequent to close of FY.	
Disclosures relating to conservation of energy etc.	***Conservation of energy***	
	Technology absorption	
	Foreign exchange earnings anu outgo	
Changes during the financial year	***Nature of disclosure required***	Change in – (a) nature of the company's business; (b) company's subsidiaries; (c) nature of business carried on by subsidiaries of the company; (d) generally, in the classes of business in which company has an interest.
Disclosure of particulars of certain employees	***Nature of disclosure required***	Designation, Remuneration, Nature of duties, Qualifications and experience, Age, Last employment, Nature of employment, Other terms and conditions, Percentage of equity shares held, Whether the employee is a relative of any director or manager. This is required for those employees getting salary more than specific amount as described in The companies act.

Disclosures in Directors' Responsibility Statement [Sec. 217(2AA)]	***Accounting standards***	▪ The directors shall state as to whether they have complied with AS. ▪ In case of material departures, the directors shall give proper explanation for the same.
	Accounting policies	The directors shall state as to whether the accounting policies – ▪ have been consistently applied; *and* ▪ used by them are reasonable.
	Judgments and estimates	The directors shall state as to whether the judgments and estimates made by them are – ▪ reasonable and prudent; *and* ▪ give a true and fair view.
	Proper and sufficient care	The directors shall state as to whether they had taken proper care for – ▪ the maintenance of adequate accounting records in accordance with the provisions of this Act; ▪ safeguarding the assets of the company; *and* ▪ preventing and detecting fraud and other irregularities.
	Going concern Assumption	The directors shall state as to whether they have adopted the assumption of going concern while preparing annual accounts.
Reasons for non-completion of buyback	▪ Every buy-back should be completed *within 12 months* from the date of passing the resolution for buy-back. ▪ If a buy-back could not be completed within the specified period of 12 months, the Board shall disclose the reasons for the same.	
Comments on auditor's report	The Board shall give fullest information and explanations in respect of every reservation, qualification or adverse remark contained in the auditors' report.	

10.8 CIRCULATION OF ANNUAL ACCOUNTS, ETC. (Sec. 219)

Nature of documents requiring circulation	(a) Balance sheet (b) Profit and loss account (c) Auditor's report (d) Every other document required to be annexed or attached to B/S The above documents have been referred to as 'annual accounts etc.' u/s 219 and 220.	
Persons entitled to receive annual accounts, etc.	(a) Every member (b) Every debenture trustee (c) All persons who are entitled to receive the notice of GM, *e.g.*, the auditors.	
Supplying of annual accounts, etc. on demand	***Who can demand the annual accounts, etc.***	(a) A member (b) A debenture holder (c) Any depositor.
	Duties of the company	The company shall supply the annual accounts, etc. – free of cost – *within 7 days* of demand.
	Consequences of default	CLB may direct the company to furnish the annual accounts, etc.

10.9 CONSIDERATIONS FOR AUDITORS WHILE EXAMINING CERTAIN DOCUMENTS

(1) Memorandum of Association

(i) It contains the objects for which the company is formed. It defines the powers of the company.

(ii) It shall contain following clauses:

- N Name clause
- S Situation clause
- O Object clause
- Liability clause
- C Capital clause
- A Association (Subscription) clause

(iii) It shall be

- Printed,
- Divided into numbered paragraph &
- Signed by subscribers.

(iv) Auditor should check whether MOA contains all the required information

(v) He should carefully study various powers of company enlisted in MOA.

(vi) While checking transactions/ contracts entered into by the company, he should ensure himself that these are intra-virus. (*i.e.*, authorised by MOA)

(2) Articles of Association (AOA)

(i) AOA contains rules & regulations framed by the company for its own governance.

(ii) AOA must be signed by the person who have signed the MOA .

(iii) *For example* it contains the following:

- Voting rights of members;
- Powers of Directors;
- Qualifications of Directors;
- Conditions for making the call;
- Provisions regarding maintenance of accounts.

(iv) Auditor should carefully study the AOA & note its important contents in his working papers.

(v) He should pay special attention to its contents which directly / indirectly relate to books of accounts and financial statements.

(3) Prospectus

(i) It means an invitation to the public for subscription to company's shares or debentures.

(ii) A public company is required to issue prospectus/ statements in lieu of prospectus before making allotment of shares.

(iii) It contains terms & conditions w.r.t. issue of capital.

(iv) It usually contains:

- Details of authorised, issued, subscribed & paid up capital.
- Whether issue is at par / Discount/ Premium.
- Particulars regarding underwriting commission etc.
- Up coming projects of the company.

(v) Auditor should carefully study all relevant conditions listed in the prospectus.

(vi) He should also check requirement of CARO (End use of money raised by public issue).

10.10 AUDIT OF SHARE CAPITAL

(1)	Kind of shares	(i) Preference share having preferential rights as to. • Payment of dividend & • Repayment of capital (ii) Equity share *i.e.*, share others than preference share	
(2)	**Kind of share capital**	***(i) Authorised / Registered share capital***	• Maximum amount of capital, • Set out in MOA, • Which can be issued by the company.
		(ii) Issued & subscribed share capital	• That part of authorised capital, • Which has been actually allotted by the company.
		(iii) Paid up share capital	• That part of subscribed capital, • For which money / other consideration, • Has been received by the company.
(3)	**General considerations while auditing share capital**	(i) Authorised capital should be verified by examining MOA & audited financial statements of the previous year. (ii) Issued & subscribed capital should also be examined by referring to last years audited financial statements. MRL should be obtained regarding non-issuance of capital in year concerned. (iii) In case fresh issue of capital is made in current year, following should be considered: • Conditions w.r.t power of company to make fresh issue & compliance of same. • Conditions w.r.t minimum subscription (90% of shares offered to public). If minimum subscription is not received within 120 days of issue of prospectus, money received has to be refunded to applicants. • Whether application money received by company has been kept in separate bank account. • Whether application money payable on each share is not less than 5% of nominal value of a share. • Payment of brokerage as per rates stated in prospectus. • Special provision for share issued at premium or at discount. • Compliance with guidelines issued by SEBI in this regard.	
(4)	**Audit of shares issued for cash**	***1. Stage-I Application***	(a) Test check a few original applications received w.r.t entries in application & allotment register. (b) Examine money received with corresponding entries in cash book. (c) Examine letter of regret in case sum is refunded to unsuccessful applicants. (d) Check correctness of accounting treatment in share capital account. (e) Examine arithmetical accuracy of totals in application & allotment Register.

	2.	*Stage-II Allotment*	(a) Examine minute book of director's meeting w.r.t allotment of shares. (b) Examine letter of allotment sent to successfull applicants. (c) Check whether money received on allotment has been appropriately credited to share capital account. (d) Trace relevant entries in cash book /bank statements. (e) Ensure appropriateness of accounting treatment on allotment. (f) Ascertain whether share certificates have been delivered within 3 months of allotment. (g) Ensure that return of allotment has been filed with ROC.
	3.	*Stage-III Calls*	(a) Examine minute book of director's meeting to check resolution making a call. (b) Test check some call letters with reference to calls register. (c) Examine amount received on calls with copies of receipt issued to shareholders. (d) Trace relevant entries in cashbook / Bank statements. (e) Examine whether share capital account has been properly credited. (f) In case of calls in arrears, examine appropriateness of disclosure in balance sheet. (g) Examine calculations of interest charged on calls in arrears. (h) Examine schedule of calls received in advance to ensure its accuracy of treatment in books of accounts. (i) Examine calculation of interest paid on calls in advance.
(5) Audit of shares issued for consideration other than cash	(a) Shares may be issued to underwriters towards payment of underwriting commission or to promoters for services rendered by them. (b) Thus, auditor should examine relevant contract entered into with such parties. (c) Examine Board resolution to issue such shares for non- cash consideration. (d) Ensure appropriateness of accounting treatment on allotment of such shares. (e) Examine whether these have been separately disclosed in the balance sheet.		

10.11 AUDIT OF SECURITIES ISSUED AT PREMIUM (Sec. 78)

No condition for issue of securities at premium	▪ No provision is required in the articles to issue the securities at premium. ▪ The Companies Act does not prescribe any restriction or condition regarding issue of securities at premium.
Utilisation of premium	Auditor should ensure that the premium is transferred to the 'Securities Premium Account'. Further he will also ensure that the 'Securities Premium Account' is used only for the following purposes: (a) Issuing fully paid bonus shares. (b) Writing off the preliminary expenses of the company. (c) Writing off the commission paid or discount allowed on issue of shares or debentures of the company. (d) Providing for the premium payable on the redemption of any redeemable preference shares or debentures of the company. (e) For buy back of shares.

AUDIT OF SHARES ISSUED AT A DISCOUNT (Sec. 79)

Nature of shares	The shares to be issued at a discount must belong to a class of shares already issued by the company.
Nature of resolution required	Auditor should ensure that Ordinary Resolution is passed in General Meeting and it specifies the rate of discount at which the shares shall be issued.
Approval of CLB	Auditor should ensure that approval of the CLB has been obtained.
Time limit for issue of shares	Auditor should ensure that the shares have been issued *within 2 months* of obtaining sanction of the CLB. However, the CLB may extend such time.
Rate of discount	Auditor should check that the maximum rate of discount does not exceed 10%. However, CLB may sanction issue of shares at a discount exceeding 10% considering the special circumstances of the case.
Company must have completed 1 year	Auditor should check that at the date of the issue, at least 1 year has elapsed since the date on which the company was entitled to commence business.
Disclosures	It should also be examined that the prospectus contains particulars of the discount allowed on the issue of the shares.

AUDIT OF ISSUE OF SWEAT EQUITY SHARES (Sec. 79A)

Meaning of sweat equity shares	'Sweat equity shares' means equity shares issued by the company to the employees or directors – (a) at a discount; *or* (b) for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.	
Nature of shares	Auditor should verify that the sweat equity shares belong to a class of shares already issued by the company.	
Nature of resolution required	▪ It should be ensured that Special Resolution in this regard is passed in General Meeting. ▪ Further ensure whether Special Resolution passed by the company specifies the following particulars: (a) Number of shares (b) Current market price (c) Consideration (d) The class of directors or employees to whom such equity shares shall be issued.	
Company must have completed 1 year	Auditor will verify that at the date of issue of sweat equity shares, at least 1 year has elapsed since the date on which the company was entitled to commence business.	
Compliance of Rules	***Listed companies***	– Auditor should ensure that the regulations made by SEBI in this behalf have been complied with.
	Unlisted companies	– Auditor should ensure compliance with the rules prescribed by Central Government.

10.14 AUDIT OF BUY-BACK OF SHARES (Sec. 77A)

Sources of Buy back	*Auditor should see that Sources of buy-back should be only those prescribed by The Companies Act i.e.* 1. Free reserves 2. Securities premium account 3. Proceeds of fresh issue of shares However, the buy-back shall not be made out of the proceeds of an earlier issue of the same kind of shares.
Power in articles	Auditor should ensure that the buy-back is authorised by the articles of the company
Special resolution	The Special Resolution authorising the buy back should be verified.
Limits on buy-back by passing Special Resolution	▪ Auditor should verify that the buy-back doesn't exceed 25% of aggregate of paid up capital and free reserves. ▪ Auditor should also ensure that the buy-back of equity shares in any F/Y does not exceed 25% of its total paid up equity capital in that F/Y.
Debt-equity ratio	Auditor should check that the ratio of debt owed by the company must not be more than twice the aggregate of paid up capital and free reserves *after such buy-back*.
Shares must be fully paid	It should be confirmed that the shares for buy-back are fully paid-up.
Time limit for completion of buy-back	▪ Auditor should check that the buy-back is completed *within 12 months* from the date of passing the Resolution. ▪ If buy-back is not completed within the specified period of 12 months, the Board shall disclose the reasons thereof in the Board's Report.
Declaration of solvency	Auditor should ensure that the company files with the Registrar a declaration of solvency stating that it will not be rendered insolvent *within next 1 year*.
Extinction of shares bought back	Auditor should ensure that the company extinguishes and physically destroys the shares bought-back *within 7 days* of completion of buy-back.
Prohibition of further issue of shares	Auditor will also ensure that the company does not make further issue of the *same kind* of shares *within next 6 months*.
Register of shares bought-back	Auditor will ensure that the company maintain a register containing the following particulars: (a) The shares bought back; (b) The consideration paid for the shares bought-back; (c) The date of cancellation of shares; (d) The date of extinguishing and physically destroying of shares.

P → POWER IN ARTICLE
L → Limit (25% max)
S → Sources
↳ Free Reserves
↳ Sec Prem A/c
↳ Proceeds of fresh issue.

S → Solvency
I → Issue prohibited (6mths)
S → S.R
T → Twelve mths of comp
E → Extinction
R → Register

[illegible]

F → Fully Paidup
D → Debt Eq
2:1 max

10.15 AUDIT OF CALLS IN ADVANCE

Power to accept calls in advance	Auditor should check whether power is specified in the articles to accept the uncalled amount on shares.
Interest on advance	▪ A company may pay interest on calls paid in advance. ▪ The interest shall be paid at such rate as may be specified in the articles. ▪ A company can pay interest @ 6% per annum.
Voting rights	A member is not entitled to any voting rights in respect of 'calls in advance'.

10.16 AUDIT OF CALLS IN ARREARS

Share register	Verify the amount of calls in arrears from the share register
AOA	Examine AOA to ascertain the company's powers regarding: (a) Interest chargeable on calls in arrears. (b) Forfeiture of shares for non payment of calls.
Interest	Verify compliance with AOA for the interest charged.
Disclosure	▪ Ensure that calls in arrears have been disclosed as a deduction from the total paid up capital on the liabilities side. ▪ Ensure that separate disclosure has been made in regard to calls due from: (a) Directors and (b) Others

10.17 AUDIT OF REDEEMABLE PREFERENCE SHARES (Sec. 80)

Term of preference shares	Auditor should ensure that the term of preference shares shall not exceed 20 years.
Power in articles	Ensure that the articles of a company authorise it to issue the preference shares.
Fully paid shares	Auditor should check whether the preference shares to be redeemed are fully paid up.
Sources of redemption	Auditor should check that these have been redeemed (a) out of the profits; (b) Out of a fresh issue of shares
Premium payable on redemption	Ensure that Company has utilised: (a) Profits of the company (b) Securities premium account
Creation of CRR	(a) Creation of CRR is mandatory, if preference shares are redeemed out of profits. (b) Amount to be transferred to CRR = Nominal amount of preference shares redeemed by the company. Auditor should check adequacy of CRR.
Notice to registrar	Auditor should ensure whether Company has given notice to the registrar *within 30 days* of redemption of preference shares.

→ Fully Paid Shares

→ AOA

→ Term (Max 20yrs)

Premium → P&L, Sec Prem

Source → Profit + Fresh Issue.

Cr Credit

C → CRR = Nominal Amt of Sh.

R → Registrar

DACD Meeting Intigration

10.18 AUDIT OF ALTERATION OF SHARE CAPITAL

AOA	Verify that the alteration is authorised by Articles of Association.
OR	Ensure that the alteration is by an Ordinary resolution at a General Meeting.
Minutes of Meeting	▪ Inspect the minutes of shareholders authorizing alteration. ▪ Inspect the minutes of Board meetings for Director's Resolution on allotment consolidation, conversion or subdivision passed pursuant to the resolution of members.
Certificates	Examine the cancelled certificates, if any, and agree the same with counterfoils of new certificates issued.
Intimation to ROC	Ensure that necessary intimation has been sent to Registrar of Companies.
Disclosure	Verify that the share capital, as altered, is correctly disclosed in the Balance Sheet.

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10.19 AUDIT OF REDUCTION OF SHARE CAPITAL DR के SP को (Sec. 100 – 104)

Power in articles	Specific provision in articles is required for effecting reduction of share capital. Thus Auditor should study AOA.
Special resolution	Check whether SR has been passed by the company.
Sanction of Court	Ensure that Confirmation of Court has been obtained before effecting the reduction of capital.
Power of Court	The Court may direct the company to add the words 'and reduced' at the end of the name of the company. Ensure compliance with the same.
Registration	Examine whether company has delivered to the ROC:- (a) a certified copy of the order of the Court; *and* (b) a certified copy of the minute approved by the Court.
Effective date of reduction	Reduction shall become effective only on registration of the order and minute. Thus examine whether ROC has registered the same.

10.20 AUDIT OF FORFEITURE OF SHARES

1. Authorisation for forfeiture	▪ Auditor should check that specific provision in the articles is given for this purpose. ▪ Also the articles must be studied to check grounds for forfeiture of shares.	
2. Legal requirements for forfeiture	***Grounds for forfeiture***	▪ Generally, forfeiture is made on the ground of non-payment of a call. ▪ However, forfeiture is also possible on any *bonafide* ground contained in the articles.
	Call made	Auditor should check that a valid call have been made by the company. Only if the call remains unpaid, the company proceed for forfeiture of shares.
	Notice of forfeiture	Auditor should ensure that notice of forfeiture to the defaulting shareholder is given before effecting forfeiture.
	Resolution for forfeiture	The shares stand forfeited only when the Board passes a resolution effecting forfeiture. Auditor should examine the same.

10.21 OPTION ON SHARE CAPITAL

Meaning	An option on shares arises when a person has acquired a right under an agreement with the company if he so chooses.
Instances	Option on share capital generally arises under the following circumstances:— (a) Under the promoter's agreements, subsequently ratified by the company; (b) Collaboration agreements; (c) Loan agreements; (d) Debenture deeds; (e) An agreement for convertible preference shares; (f) Employee stock option schemes.
Requirements	▪ If company allows a right of option in respect of loans or debentures, it should obtain:— (a) Approval of CG and (b) Special resolution in a general meeting. ▪ Ensure compliance with the Schedule VI of the Companies Act.

10.22 SHARE TRANSFER AUDIT (Sec. 80)

Notice	Ascertain whether notices were sent to the transferors and, in case of joint —holders, to each of the holders and the objections, if any, raised by them, were taken into consideration before the transfer were registered.
AOA	Inspect the articles of association and note the conditions relating to share transfer e.g form of transfer, time limits by articles or by law, issue of share certificates etc.
Internal controls	Review the internal controls relating to recording of share transfers.
Requirement of Companies Act	Ensure compliance with the provisions of section 108 to section 108F of the Companies Act.
Share Transfer forms	Examine each share transfer form and consider whether: ▪ application for transfer has been made in the prescribed form. ▪ prescribed authority has stamped the date on which it was presented. ▪ each transfer form is dated, signed and properly witnessed. ▪ name and address of the transferee have been given in full. ▪ transfer deed has been accompanied by the related share certificates or letter of allotment. ▪ the amount of consideration is correctly stated in figure and in words. ▪ in case of the transferee being a firm, the transfer is recorded in the individual names of the partners.

Chapter 12
Special Audit

12.1 AUDIT OF EDUCATIONAL INSTITUTION /COLLEGE

Preliminary work		(1) Study the provisions of applicable statute as per the legal status of the institute. (2) Examine the trust deed or regulation. (3) Study the minutes of meetings of governing body / trustee to gain knowledge of any important decision which may affect the accounts for e.g., purchase of computer etc (4) Evaluate the system of internal control. (5) Obtain list of accounting records & accounting policy adopted by them.
Receipts	***Fee from students***	(i) Check the admission fee to confirm whether amount has been credited to a separate account. Refundable money is shown as liabilities. (ii) Check whether demands for fee are raised against all students. (iii) Ascertain whether the amounts demanded from student are as per rates specified according to their course. (iv) Verify the fee received by comparing fee collection register and copy of receipts issued to students, For cheque received, examine passbook and for cash received, check entries in cashbook. (v) Check authorisation for fee concessions. (vi) Ensure that in case of late payment of fee, fine has been properly imposed, collected & accounted for. (vii) Ascertain accounting & authorisation for fee received in advance. (viii) In case hostel facility is also granted to students, check whether hostel dues are properly demanded & collected on timely basis. Also ascertain whether all hostel dues have been properly accounted for.
	Rent	(i) Examine agreement with tenants to know rates of rent & their due dates etc. (ii) Verify rent received by comparing counterfoils of receipts issued with the bank pass book.
	Income on Investment	(i) Verify investment registers to check whether interest w.r.t. same has been duly accounted for. (ii) Interest and dividend received should be checked with reference to entries in bank pass book.
	Donations & grants	(i) Donations may be of two types, for specific use or for general use. Check recording of such amount in separate accounts. (ii) Vouch counterfoils of receipts issued to donors. (iii) Verify grant from government or any local authority with reference to sanction letter.

Exp	***Towards students***	(i) Check the basis for providing scholarships to student verify acknowledgement letter from students. (ii) Examine payment w.r.t. prize distribution ceremonies. (iii) Examine whether expenses on books in library & sports item are properly authorised & accounted for.
	Towards staff	(i) Examine the terms and conditions of salary to each category of staff. (ii) Check the calculation w.r.t. gross remuneration payable & deductions there from. (iii) Vouch payment made to teachers & other personnel with reference to bank pass book .
	Common Expenditure	(i) Vouch payment against electricity & water bill etc. (ii) Examine payments towards maintenance of hostel.
Assets	(i) Examine whether all fixed assets are properly accounted for. (ii) Verify ownership & existence of fixed assets by examining records & conducting physical verification respectively. (iii) Verify whether depreciation has been properly calculated w.r.t each class of fixed assets. (iv) Obtain MRL w.r.t existence, ownership & valuation of assets.	
Liability	(i) Verify corpus / capital fund with special attention to any increase in the same as compared to that of previous year. (ii) Check that any deposit paid by the student on admission, if refundable, is shown as a liability & not transferred to P&L account.	

12. ...DIT OF HOSPITALS

Preliminary	(i) Hospitals can be run as sole proprietorship or partnership or trust and even as a company etc. Auditor should ascertain the legal status & study applicable statute, if any. (ii) Examine the trust or partnership deed or MEMORANDUM, ARTICLES as per the status of hospital. (other points ,same as in previous topic)	
Receipts	***From Patients***	(i) Check copies of bills issued to the patients with reference to register of patients to ensure that all patients have been billed properly. (ii) Check calculation of few bills. (iii) Examine whether bills are raised properly bifurcating into rent charges, services charges & payments regarding medicine. (iv) Check internal control & authorisation for bills raised at concessional rates. (v) Check cash collected shown in cash book with duplicate copies of receipts issued to them.
	From grants	(i) Check copies of correspondence with the government or local bodies to ensure the purpose of grant. (ii) Ensure whether grant or donations received for specific purpose have been properly applied. (iii) Obtain MRL regarding use of grants. (iv) Examine accounting for grants with special attention to classification into capital & revenue.
	Income from Investment	(i) Examine investment register. (ii) Vouch interest, dividend etc. to ensure whether same has been properly accounted for. (iii) Check collection of various incomes received on investment with reference to entry in cash book.

Payments	*With respect to purchases & various expenses*	(i) Ensure authorisation of various payments specially capital expenditure (ii) Compare various items of expenditure with those of previous year (ARP). (iii) Check few calculations w.r.t staff salary to check whether these are in accordance with the pay rules. (iv) Special attention should be given to purchase of high value medicines & injections. Also check whether there is strict control over their purchases and issues. (v) Obtain MRL regarding abnormal item of expenses if any.
	Taxation	(i) Examine calculation & accounting of provision for taxation. (ii) Check whether hospital is eligible for income tax exemption.
Assets & liabilities	(i) Examine whether all fixed assets are properly accounted for. (ii) Check ownership & existence of fixed assets by verifying records & conducting physical verification respectively. (iii) Verify whether depreciation has been properly calculated on each class of fixed assets. (iv) Obtain MRL for existence, ownership & valuation of assets. (v) Verify corpus/ capital fund with special attention to any increase in the same as compared to that of previous year. (vi) Examine adequacy of internal controls over purchase and issue of stock. (vii) Examine whether any claim against the hospital has been properly accounted for.	

12.3 AUDIT OF CINEMA HALL

Preliminary	(1) Study the provision of applicable statute as per the legal status of the cinema hall. (2) Examine the trust deed or regulations. (3) Study the minutes of meetings of governing body / trustee to gain knowledge of any important decision which may affect the accounts, for e.g., purchase of projector etc. (4) Evaluate the system of internal control. (5) Obtain list of accounting records & accounting policy adopted by them.	
Receipts	***From shows***	(i) Check that tickets issued are serially numbered & kept in proper custody. (ii) Perform compliance procedures to check whether there is strict internal control on entry to cinema hall which should be only against show of the ticket. (iii) Check internal control w.r.t. issuance of free passes. (iv) Check collection shown in cash book with number of tickets sold for each show. (v) Check internally generated daily report with number of tickets sold for each category (balcony , first class etc.). (vi) For advance booking, ensure that different series of tickets are issued. (vii) Reconcile total entertainment tax collected with total number of tickets sold for each category.

	From Advertisement	(i) Study agreement entered into for advertisement. (ii) Ascertain whether income w.r.t slides shorts exhibited has been properly recognised & collected. (iii) Check calculations of it with reference to agreement.
	Restaurant Income	(i) Study the agreement entered into by cinema hall with restaurant run in the premises. (ii) Check collection of share in restaurant income. (iii) Stall may be run by cinema hall. In this case, ensure about recognition & accounting of stall incomes, also consider control over stock of foodstuff , cold drinks, ice creams etc.
	(I) Towards Expenditure	(I) Examine whether expenditure incurred has been properly classified into Capital & Revenue. (ii) Vouch the payment made for repairs and maintenance of infrastructure. (iii) Examine expenditure incurred on advertisements or any promotional campaign. (iv) Vouch payments towards film hire with the copies of bills given by distributors. (v) Check agreement entered into with distributors.
	(ii) Advance paid to Distributor	(i) Check whether all advance paid relating to films already run has been properly adjusted. (iii) Obtain MRL & confirmation from distributors.
Assets & liabilities		(i) Examine whether all fixed assets are properly accounted for. (ii) Ensure about ownership & existence of fixed assets by verifying records & conducting physical verification respectively. (iii) Verify whether depreciation has been properly calculated on each class of fixed assets. (iv) Obtain MRL w.r.t existence, ownership & valuation of assets. (v) Verify corpus/ capital fund with special attention to any increase in the same as compared to that of previous year.

12.4 AUDIT OF CHARITABLE INSTITUTIONS

Preliminary work	(1) Study the provision of applicable statute as per the legal status of the institution. (2) Examine the trust deed or regulation. (3) Study the minutes of meetings of governing body / trustee to gain knowledge of any important decision which may affect the accounts. (4) Evaluate the system of internal control. (5) Obtain list of accounting records & accounting policy adopted by them. (i) List the activities run by charitable institute.

Receipts	*Donations & grants*	(i)	Examine donations received as shown in cash book with reference to copies of receipts issued.
		(ii)	Ensure that all donations received has been taken into account.
		(iii)	Check periodic internal report w.r.t. donations received during that period (monthly or quarterly).
		(iv)	Donation may also be received in kind, ensure their proper recognition in books of account.
		(v)	If any grant has been received for some particular purpose, examine whether the same has been utilised for designated use only.
	Incomes	(i)	Vouch income from investment *i.e.*, dividend, interest to ensure that these are properly accounted for.
		(ii)	Check calculation of interest income.
		(iii)	There may be income on account of rent. Examine agreement with tenants to check terms & conditions thereof.
		(iv)	Check subscription details to ensure their proper recognition.
Payment	*Expenses*	(i)	Vouch all expenses, specially to check whether expenses have been made towards object of the trust.
		(ii)	Check payment to staff towards salary etc.
		(iii)	Verify that all payment are made after proper sanction by proper authority.
		(iv)	Compare other expenses like stationery telephone etc. with those of previous year (ARP).
	Taxation	(i)	Examine whether the trust enjoys income tax exemption under the Income Tax Act 1961.
		(ii)	Check whether payment of tax has been made, if circumstances require so.
Assets and Liabilities	*Investment*	(i)	Check authorisation of purchase & sale of Investment
		(ii)	Physically check the investment certificate.
	Other Assets & Liabilities	(Same as in topic 12.3)	

12.5 AUDIT OF CLUBS

Preliminary	(1) Study the provision of applicable statute as per the legal status of the club. (2) Examine internal rules & regulations of club. (3) Study the minutes of meetings of governing body to gain knowledge of any important decision, which may affect the accounts. For e.g., purchase of sports equipment etc. (4) Evaluate the system of internal controls. (5) Obtain list of accounting records & accounting policy adopted by them.

Receipts	*Admission fee*	(i)	Vouch admission fee with members list & copies of cash receipts issued to them.
		(ii)	Check the accounting policy of club regarding recognition of admission fee, as it is normally treated as a capital receipt.
	Subscription	(i)	Examine subscription register with members list & copies of receipts issued to them.
		(ii)	Reconcile total subscription due with collections and arrears w.r.t same.
		(iii)	Check subscription in arrears to ensure whether amount irrecoverable has been written off.
		(iv)	Check adjustment w.r.t. subscription received in advance.
	From Services provided to members	(i)	Examine the rate criteria enlisted in rules for different services like sports, swimming pool and restaurant etc.
		(ii)	Examine whether charges has been recovered form members w.r.t. special services provided to them.
		(iii)	Vouch revenue form sale of cigars, wines etc.
Payments	*Purchases*	(i)	Examine whether payment w.r.t. different sports items & furniture etc. has been made after proper sanction.
		(ii)	Ensure that bulk purchases of food items, sports material etc. have been made from approved vendor.
		(iii)	Check entries in cash book regarding payments on account of purchases.
	Administrative expenses	(i)	Ensure whether salary to staff has been properly calculated & accounted for.
		(ii)	Check payments towards phone & electricity etc. with copies of bills received by club.
		(iii)	Compare various expenses with that of previous year.
Assets Liabilities	*Stock*	(i)	Attend physical verification of stock conducted by the management.
		(ii)	Examine stock register.
		(iii)	Check valuation of closing stock also.
	Other assets & liabilities		(Same as in topic 12.3)

12.6 AUDIT OF HOTELS

Preliminary	(1) Study the provision of applicable statute as per the legal status of the hotel.
	(2) Examine the internal rules & regulation of hotel.
	(3) Study the minutes of meetings of governing body to gain knowledge of any important decision, which may affect the accounts. For e.g. purchase of cars etc.
	(4) Evaluate the system of internal controls.
	(5) Obtain list of accounting records & accounting policy adopted by them.

Receipts	*Room rents/ sales*	(i)	Study daily occupancy report prepared by the management.
		(ii)	Ensure properness of billing. Also verify whether appropriate rates have been charged according to category of rooms.
		(iii)	Check whether bills have been raised to all parties listed in guest register. In case it is not so, obtain Reconciliation.
		(iv)	If receipts are in foreign currency, ensure compliance with FEMA.
		(v)	Vouch receipts from room rents. Also ensure their correct posting in relevant accounts.
		(vi)	Special attention is given to receipts accepted through credit cards.
	Restaurant Income	(i)	Examine a few bills issued to customers to ensure their correctness.
		(ii)	Perform compliance procedures to check internal controls in restaurant.
		(iii)	Check a few bills with order books to ensure their correctness.
	Other Incomes	(i)	In case, hotel provides banquet hall for various functions, study tariff structure.
		(ii)	Ensure correctness of billing for letting out banquet hall.
		(iii)	In case spaces have been let out to shopkeepers or travel agencies etc., check agreement entered into with them.
		(iv)	Vouch collections from above and ensure their correct postings.
Payment	*1. Purchase of Various items*	(i)	Check authorisation for purchase of stock such as food, beverages, linens, crockery etc.
		(ii)	Vouch payment w.r.t. same with copies of bills issued by vendors.
	2. To Staff	(i)	Test Check few salary payments made to permanent staff with entries in cashbook.
		(ii)	Regarding casual labour, check attendance records & wage payment registers. Also ensure adequacy of internal controls over this area to rule out possibility of dummy labour.
		(iii)	Compare payment to staff with that made in previous period (ARP).
	3. Taxes	(i)	Hotels charge various taxes from customers such as luxury tax, service tax etc.
		(ii)	Ensure that same has been deposited to authorities on timely basis.
	4. Commission	(i)	Normally hotels pay commission to various travel agents for bookings received through them.
		(ii)	Inspect the agreement entered into with them.
		(iii)	Check whether payments have been made as per agreement.
		(iv)	Ensure appropriateness of accounting of commission in correct account and period.
	5. Expansion Expenses	(i)	Ensure whether room addition expenses / major additions to hotel buildings (construction of new health club etc.) have been properly capitalised.
		(ii)	However, redecoration & daily maintenance expenses should be charged to revenue.
		(iii)	Vouch payments with respect to it. Trace entries in relevant accounts.

Assets	*Fixed Assets*	As usual
	Stock	(i) Check whether valuation methods are consistently applied. (ii) Attend physical stock taking. (iii) Ensure that stocks are kept under appropriate authority.
	Cash and foreign currency	(i) Physically check the cash. (ii) Ensure application of proper conversion rate in case of foreign currency. (iii) Obtain Bank reconciliation statement.
Liabilities	*1. Loans*	(i) In case hotel has taken any long term loan from bank, inspect the loan agreement. (ii) Check regularity of payment of interest charges.
	2. Other liabilities	(i) Check whether all liabilities have been taken into account. (ii) Ensure whether outstanding expenditures has been properly shown as liabilities.

12.7 AUDIT OF PUBLISHERS

Preliminary	As usual	
Receipts	***Income from sale***	(i) Vouch the receipts w.r.t. number of book sold. (ii) Ensure that books sold on approval are properly adjusted & not shown as sales. (iii) In case books have been distributed free of cost (Sample copies), check authorisation. (iv) Similarly check authorisation for discount on sold copies.
	Income from advertisement	(i) In case of publication of magazines & newspapers, a major source of income is through advertisement. (ii) Examine bills raised with subsequent receipts.
Payments	***To Authors***	(i) Inspect agreement entered into w.r.t. mode of computations & payment of royalties. (ii) Vouch payments made to author's w.r.t. royalties. (iii) Trace corresponding entries in cashbook. (iv) Auditor may seek confirmation from authors as well. (v) If any advance has been made to the authors, examine whether these are properly adjusted in accounts.
Assets & liabilities	***Stock***	(i) Attend physical stock taking conducted by management w.r.t. stock of books. (ii) check whether these are shown in financial statements at a proper value. (iii) Special attention should be given to internal controls w.r.t. movement of books.
	Others	In usual way.
	Liabilities	(i) If any case has been filed against client for breach of copyright as at B/s date, check adequacy of disclosure in financial statements. (ii) In this case, he may seek expert's opinion as well.

12.8 AUDIT OF HIRE PURCHASE COMPANY

Preliminary	(i) Obtain knowledge of business in usual way. (ii) Special attention is given to the provisions stated in MOA and AOA. (iii) Understand the nature of Hire purchase transaction as well as the accounting treatment adopted by client for the same. (iv) Note: - Hire purchase transaction is one where - Possession of goods is transferred to purchaser, - On payment of just a part of total price. - But title is passed to him, - Only on full payment of balance instalments.
Examine hire purchase agreement	(i) Whether these are properly dated & signed by concerned parties. (ii) Ensure the terms & conditions specified therein specifically w.r.t. - the asset in question - hire purchase price - no. of instalments - amount of instalments
Purchase of Asset	(i) Check whether purchase of assets is properly authorised. (ii) Vouch payment made for the same. (iii) Trace entries in relevant ledger. (iv) Ensure that client has valid title over the said asset.
Examine Hire purchase transaction	(i) Check whether payments are regularly received from the hire purchaser. (ii) Examine whether instalments have been properly apportioned between – (a) Principal & (b) Interest (iii) Examine accounting policy adopted by the client to ensure whether these are in accordance with generally accepted accounting principles. (iv) Check adequacy of provision for doubtful debts.
Repossession of goods	(i) Sometimes, due to non-payment of instalments by hire purchaser, the client may repossess the goods as per agreement. (ii) Check valuation of goods repossessed, if any. (iii) Verify second sale of the goods, so repossessed.

12.9 AUDIT OF LOCAL BODIES

Background	1. A municipality can be defined as a unit of local self-government in an urban area. 2. 'local self-government' ordinarily means the administration of a locality – a village, a town, a city or any other area smaller than a state. 3. It raises its revenue through local taxation and spends its income on local services. 4. These bodies generally follow the cash basis of accounting.

→ Accountability of govt
→ Ensure that public fund has been properly accounted.

Fin	***Budgetary Procedure***	Budget preparation is determining the levels of taxation, rates and the ceilings on expenditure. The objectives of local bodies budgetary procedure are: ▪ Financial Accountability, ▪ Control of expenditure, and ▪ To ensure that funds are raised and money is spent in accordance with the rules and regulations.
	Expenditure Control	Matters of regular revenues and expenditures are generally delegated to the executives for example, commissioners. Thus, it should be seen whether expenditure is within limits.
	Accounting System	Municipal accounting system is usually kept as per the cash system.
udit	The important objectives of audit are: (a) reporting on the fairness of the content and presentation of financial statements; (b) reporting upon the strengths and weaknesses of systems of financial control; (c) reporting on the adherence to legal and/or administrative requirements; (d) reporting upon whether value is being fully received on money spent; and (e) detection of error, fraud and misuse of resources.	
cedure	***Preliminary***	Auditor should obtain basic information about the constitution, functions and financial status of the urban local body.
	Understand financial administration	▪ Obtain sufficient knowledge about their budget and accounting system. ▪ The auditor should obtain complete knowledge about the budget as it is an important tool of financial planning and control for urban local bodies.
Vouching	***Vouch income and expenditure***	▪ The revenue items may include property tax, collection from public places, grants, etc. ▪ The expenditure may include salary and wages, allowances to employees, rent, printing and stationery, repairs and maintenance, etc. ▪ He should vouch income and expenditure account in the usual manner.
Verification	***Verification of assets and liabilities***	▪ Assets may consist of land, buildings, plant and machinery, vehicles, office equipment, furniture and fittings, etc. ▪ Reserves, long-term and short-term loans and unutilised grants are included in the liabilities side. ▪ Verification of assets and liabilities should also be carried out in usual manner.
Audit report	Finally, he expresses opinion on financial statements. He should also communicate the comparisons of budgeted and actual figures.	

12.10 AUDIT OF LEASING COMPANIES

Meaning

Lease is a contract between the 'Lessor' who is legal owner of the asset and the 'Lessee', who acquires the right to use the specific asset on payment of fixed rentals.

Types

(a) ***Operating lease:*** It is a lease arrangement where, in return of rent, the lessor allows the lessee to use the asset for a certain period.

(b) ***Financial lease:*** Here, the ownership of asset is retained with the lessor but in substance, all the risks and rewards of ownership of the asset are transferred to the lessee.

Audit procedure

- Ensure that provisions of 'Companies Act, 1956' and 'Reserve Bank of India Act' have been compiled with.
- Examine compliance with Accounting Standard 19.
- Study the MOA & AOA of leasing companies to know the kind of assets it can lease-out.
- Study lease agreements to confirm details such as amount of lease-rentals, tenure of lease, dates of payment etc.
- Examine the lease proposal form submitted by the lessee.
- Check the board resolution authorizing the lease agreement.
- Copies of the insurance policies should also be examined.
- Examine the invoices for the purchases of assets given on lease and check whether the leasing company has proper title over asset.
- Examine whether the lease-rentals received from lessees have been properly accounted for.
- Ensure that transaction in regard to 'Sale and Lease back' have been properly identified and disclosed in Accounts.
- Examine the accounts of lessees to identify those from whom lease rentals are overdue. Review the action taken by the company to recover the dues.
- Ascertain the adequacy of provisions for doubtful debts against lessees.
- Examine the cases where the items given on financial lease have been re-possessed. Verify the second lease or outright sale of these items.

12.11 AUDIT OF NON-GOVERNMENTAL ORGANISATIONS (NGO'S)

Background

1. NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors.
2. They also receive donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities etc.
3. NGO would include religious organisations, voluntary health and welfare agencies, hospitals, old age homes, research foundations etc.
4. Some examples of NGOs operating in India include Child Relief and You (CRY), UNICEF, Vidya, etc.

Legal form

- Non-Governmental Organisations are generally incorporated as societies or as a trust.
- NGOs can also be incorporated as a company under section 25 of the Companies Act, 1956.

NGO are the organisation which are formed not to earn profit but to promote the purpose of its formation such as art, religion, medical facility.

Sources of funds

↳ Donations rec'd in cash
↳ Grant recd.
↳ Subscription
↳

- The main sources of funds include grants and donations, **fund raising programmes**, advertisements, subscriptions, gifts, sale of product or **publications, etc.**
- Donations and grants received in the nature of capital receipts are shown as liabilities in the Balance Sheet of NGO.
- These may either be in the form of corpus contribution or a contribution towards revolving fund.
- A contribution made towards the capital or the corpus of an NGO is known as corpus contribution.
- The grant towards a Revolving Fund is used to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects.
- Donations and grants are also received for acquisition of specific fixed assets or for running some specific project. For example, it may be received for running flood relief camp in certain area.

Capital fund PY CY

Audit program	***Balance sheet items***	▪ **Corpus Fund:** The contributions/ grants received towards corpus should be examined with reference to the letters from the donor. The interest income should be checked with Investment Register. ▪ **Reserves**: Examine board resolutions of NGO. ▪ **Ear-marked Funds**: Check requirements of donors, board resolution of NGO and rules and regulations of the schemes of the ear-marked funds. ▪ **Loans:** Examine loans with loan agreements. ▪ **Fixed Assets:** Vouch all acquisitions / sale or disposal of assets including depreciation in usual way. ▪ **Investments:** Check Investment Register and the investments physically. Also examine that investments are in the name of the NGO. ▪ **Cash in Hand:** Physically verify the cash in hand. ▪ **Bank Balance:** Check the bank reconciliation statements. ▪ **Stock in Hand:** Attend physical verification of stock in hand and obtain adequate MRL for the quantities and valuation of the same.
	Expenses ↳ Actual with budgeted & that of PY.	▪ ***Programme and Project Expenses***: Verify agreement with donor/contributor supporting the particular programme or project. Vouch various disbursements w.r.t. same. ▪ **Other Expenses:** Verify that provident fund, life insurance premium, employee's state insurance and other administrative charges are properly accounted for.

Receipts	(i) ***Contributions and Grants for projects and programmes:*** Check agreements with donors and grants letters to ensure that funds received have been accounted for. Examine relevant entry in pass book. (ii) ***Receipts from fund raising programmes***: Verify in detail the internal control system and obtain confirmations from the persons who are responsible for collection of funds and mode of receipt. (iii) ***Membership Fees***: Check fees received with Membership Register. Reconcile fees received with fees to be received during the year. (iv) ***Subscriptions***: Examine them with subscription register and receipts issued. (v) ***Interest and Dividends***: Check the interest and dividends received and receivable with investments held during the year.

12.12 AUDIT OF A PARTNERSHIP FIRM

Basics ↳ Appointed by partners ↳ Remm fixed by partners ↳ No legal requirem	(i) The auditor is usually appointed by the partners either on the basis of a decision taken by them or to comply with a condition in the partnership agreement. (ii) His remuneration is also fixed by the partners. (iii) The letter of appointment should clearly state the nature and scope of audit. (iv) The Indian Partnership Act, 1932 does not prescribe audit of a partnership firm. (v) Before starting the audit, auditor should examine the partnership agreement and note the provisions therein.
Advantages → Adm → Retirement → Death → Insurance claim → Incom Tax dept. → Bank for providing loan	(i) Audited accounts provide a reliable means of settling accounts between the partners and thus, the possibility of occurrence of a dispute among them is mitigated. (ii) On the retirement or death of a partner, audited accounts constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill. (iii) The audited accounts are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners. (iv) Audited statements of accounts are relied upon by the banks when advancing loans. (v) Audited statements of account can be helpful in the negotiations to admit a person as a partner. (vi) An audit is an effective safeguard against any undue advantage being taken by a working partner.
Considerations	(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit. (ii) Studying the minute book. (iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement. (iv) Examining whether books of account appear to be reasonable. (v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged partner. (vi) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts at proper value. (vii) Verifying that the profits and losses have been divided among the partners in their agreed profit sharing ratio.

12.13 AUDIT OF SMALL COMPANIES

1. **Letter of Engagement** → Scope as per engagement	▪ It is advisable for the auditor to submit to their client and to receive an acknowledgement of the scope of their responsibilities both in respect of the audit and any additional work to be undertaken. ▪ This should subsequently be confirmed in writing, possibly in the engagement letter.
2. **Internal control**	▪ Auditors should take care to bring to the directors' attention their findings on the system of internal control. ▪ Shortcomings in internal control arise because of small number of employees. ▪ This will require them to increase the amount of testing of transactions and to extend the procedures for the verification of liabilities and assets.
3. **Letter of representations**	▪ Letter of representation on the company's letter head addressed to the auditors should be obtained. ▪ The purpose of such letter is to place on record representation of management on significant matters affecting the account ▪ For example, it can be obtained for ownership of asset and basis of valuation and disclosure of assets, liabilities and contingent liabilities.

12.14 AUDIT OF INCOMPLETE RECORDS

1. **Incomplete records-Meaning**	Those accounting records which do not satisfy the requirements of being proper books of account.	
2. **Incomplete records-instances**	▪ accounting records kept by the entity on single entry system, or ▪ accounting records may have been destroyed by fire, flood, etc. or seized by Government authorities.	
3. **Audit procedures if records are incomplete at client's site.**	1. ***Request the management to convert it to double entry basis***	▪ If books of account have been maintained on single entry system, the auditor should request the client to convert them to double entry basis. ▪ In case, books of account are not available for audit, he should make sure that management reconstructs the records from available documents in hand. ▪ For example, trading transactions can be accounted on the basis of third party confirmations and bank statements.
	2. ***Check opening state of affairs***	Ensure that statement of affairs at the beginning of the year is prepared and all the accounts are opened in the ledger.
	3. ***Vouch transactions***	▪ External evidence should be obtained to check authenticity of various transactions. ▪ Examine the relevant documents and perform analytical procedures ▪ Confirmation from debtors and lenders should also be obtained. ▪ To vouch expenses, bank statements can be used. ▪ Same ways, income can be traced from bank statements.

	4. *Verification of assets and liabilities*	▪ Verification of assets and liabilities can be done by performing appropriate procedures. ▪ For example, to verify inventory, the auditor can observe the physical verification carried out by the management, obtain stock register and management representation letter Analytical procedures can also be used to verify inventory. ▪ CP Capital can be examined on the basis of previous year's audited balance sheet, if available. ▪ Bank loan can be examined by obtaining confirmation from Bank.
4. Audit opinion	▪ On the basis of evidence collected and conclusions drawn there from, the auditor should formulate his opinion. ▪ If he can not get sufficient and appropriate evidences even after performing procedures as above, he may provide a qualified audit report or issue a disclaimer of opinion. ↳ DISCLAIMER	

THEORETICAL QUESTIONS

96 May Mention the important items to be examined by the auditor in the audit of a Hospital.

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

97 May Mention the important matters requiring the attention of the auditor in the audit of a charitable institution.

97 Nov Briefly state the special steps involved in audit of a club.

98 May Mention the important items to be examined by the auditor in the audit of a Hospital.

98 Nov State the special points that you as an auditor will consider while conducting the audit of a cinema hall.

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

99 Nov Mention briefly eight special points you as an auditor would consider in conducting the audit of a club.

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

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

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

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

05 May What special steps will you take into consideration in auditing the accounts of a Hotel?

05 Nov What special steps will you take into consideration in auditing the receipts from entry fees of an amusement park? Mention any four points specific to the issue.

Chapter 13

Government Audit

13.1 INTRODUCTION

Government Audit Meaning	1. Government audit means ▪ the systematic and independent examination, ▪ of financial, administrative and other operations of a public entity, ▪ for evaluating and verifying them. 2. Its objective is to ensure the accountability of the government entity in respect of public revenue and expenditure. 3. Auditor presents a report containing audit findings along with recommendations for future actions. 4. In India, the function of government audit is performed by Comptroller and Auditor General. CAG

13.2 COMPTROLLER & AUDITOR GENERAL – Certain Provisions

Appointment	The President of India shall appoint CAG.	
Removal or resignation each house of parl – 2/3 votes	▪ He can be removed from the office only on the ground of proven mis-behaviour or incapacity. ▪ Moreover, he can be removed from office only when each house of parliament decides to do so by a majority of at least two third of members present and voting. ▪ He can resign any time through a resignation letter addressed to the President of India.	
Remuneration	▪ He shall be paid a salary equivalent to that of a Judge of the Supreme Court. ▪ The parliament is competent to make laws to determine salary and other conditions of service.	
Terms	He shall hold office for six years or up to age of 65 years, whichever is earlier.	
Duties of Comptroller & Auditor General	***Compile and submit accounts***	He shall compile the accounts of the Union/State/Union Territory and submit those accounts to the President/Governor/Administrator respectively.
	To audit receipts and expenditure	He shall audit all receipts and expenditure of any body, which has been substantially financed from the Consolidated Fund of India/State/Union Territory. Note: A body or authority shall be treated as substantially financed if the amount of a grant or loan in one year is greater than; (i) Rs. 25 lakhs, and (ii) 75% of the total expenditure of that body or authority.

	To audit grants and loans	He shall audit specific purpose loan or grant given to any body other than a foreign state or international organization, out of the Consolidated Fund of India/ State/Union Territory.
	To audit receipts of union or states	He shall audit all receipts payable in to the Consolidated Fund of India/ State/Union Territory.
	To audit accounts of stores and stock	He shall audit the accounts of stores and stock kept in any office or department of the union or state.
	To audit accounts of Government Companies and Corporations	CAG shall exercise such powers and observe such duties as per the provisions of the Companies Act, 1956 in relation to the Government Companies or Corporations.
	To audit and report	CAG shall audit and report: (1) All expenditure from Consolidated Fund of India/ State/Union Territory. (2) All transactions of Union State relating to the 'Contingency Funds and Public accounts.' (3) All Trading, Manufacturing, Profit and Loss account and Balance Sheet and other subsidiary accounts kept in any department of the Union/ State.
Powers of Comptroller & Auditor General Sec. 619(3) and (4)	(a) He can inspect any office of accounts under the control of the Union or State Government. (b) He may require that any accounts, books, papers and other documents, which are relevant to the transactions under audit, be sent to specified places. (c) He can put such questions, as he may consider necessary, to the person in charge. (d) He can call for such information as he may require for the preparation of any account or report. (e) **Supplementary Audit** ▪ CAG may comment upon or supplement the report submitted by the professional auditor. ▪ CAG may issue directives to the auditors in regard to the performance of their function. ▪ Person so authorized may well be the auditor of the company. ▪ The form and content of supplementary audit report may be specified by CAG. ▪ Supplementary Auditor may concentrate more on efficiency aspects. ▪ The person so authorized is having same powers as auditor. ▪ However, the directors are not required to comment on any adverse remark contained in the supplementary audit report.	
Submission of Accounts	He shall submit his report relating to the accounts of the Union or States to the President/ Governor who will subsequently lay them before the Parliament/State Legislature.	

AUDIT OF VARIOUS ITEMS

The auditor examines the fulfilment of conditions for incurring government expenditure. It involves examination of following: –

(a) Audit of rules and orders
(b) Audit of sanctions
(c) Audit against provision of funds
(d) Propriety audit
(e) Performance audit

Audit of Rules and Orders/Audit of Regularity and Legality	1. Its objective is to ensure whether the expenditure is in accordance with: (a) relevant provisions of the Constitution and of the laws and rules. (b) the rules, regulations issued by CAG. (c) the orders of, or rules made by, any higher authority. 2. In this connection, auditor should have sound knowledge of rules and orders w.r.t. following: (a) The powers to incur and sanction expenditure from the Consolidated Fund/ contingency fund of India / State; (b) The mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and the financial rules prescribing the procedure to be followed by government; and (c) Regulating the conditions of service, pay and allowances, and pensions of government servants.
Audit of Sanctions	1. Its objective is to ensure whether the expenditure is: (a) Properly covered by a sanction, either general or special. (b) Sanctioned by authority, which is authorized to do so. 2. Thus auditor should consider following: (a) He should have knowledge of the sanctioning powers of various authorities. (b) He should examine whether all sanctions are adequately noted in the prescribed register. (c) For petty expenditure, the signature of the competent authority on a bill can be regarded as a sanction.
Audit against provision of funds	Its objective is to ensure whether the expenditure: (a) Is made for the purpose to which the grant and appropriation has been provided. (b) Does not exceed the appropriation made.
Propriety Audit	1. According to propriety audit, the auditor examines the cases of improper or wasteful expenditure even though the expenditure has been incurred as per the existing rules and regulations. 2. A transaction may satisfy all the requirements of regular audit, but may still be highly wasteful. 3. For e.g. a building may be constructed for running a school but may not be used for the same purpose, resulting in wasteful expenditure.

		4. Auditor should try to examine public financial morality by looking in to the wisdom, faithfulness and economy of transactions. 5. No hard and fast rules can be laid down regarding the standards of financial propriety. 6. Here, the auditor should examine that:— (a) The authorities have made the expenditure with same degree of vigilance, as a person of ordinary prudence would exercise in respect of his own money. (b) The expenditure is not prima facie more than the occasion demands. (c) No authority exercises its power of sanctioning expenditure to pass an order, which will directly or indirectly accrue to its own advantage (d) Public money is not utilised for the benefit of a particular person /section of the community.
	Performance Audit/Full Scope Audit	1. Here, auditor tries to ensure that government programmes have achieved the desired objectives at the lowest cost and given the intended benefits. 2. Performance audit includes efficiency, economy and effectiveness audit. 3. Performance audit is an objective examination of the financial and operational performance. It seeks to identify opportunities for greater economy and effectiveness. 4. **Efficiency audit** It examines whether: ▪ The various schemes/projects are executed, and ▪ Their operations are carried out in efficient manner, and ▪ They are yielding the expected results. 5. **Economy audit** It examines whether: ▪ The government has acquired the financial, human and physical resources in an economical manner, and ▪ The sanctioning and spending authority have observed economy. 6. **Effectiveness audit** It examines whether: ▪ Programmes and projects are performing well. ▪ Overall targeted objectives are being achieved.
Audit of Stores And Stocks		1. Auditor should ascertain whether the internal controls over purchase, receipt, and issue of stores are well designed and properly carried out during the year. 2. He should bring to the notice of the government any deficiencies in the system of control. 3. The audit of purchase of stores is conducted in the same manner as audit of expenditure. 4. The auditor has to ensure that the prices paid are reasonable. 5. Cases of uneconomical purchase of stores and losses due to defective or inferior quality of stores are specifically examined. 6. The certificates of quality and quantity given by expert should be examined. 7. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in stocks. 8. Any excess or idle stocks should be specifically mentioned in the report. 9. Auditor should ensure their existence by attending physical verification of stock. 10. The valuation of the stocks is also examined properly.

Chapter 14
Miscellaneous

14.1 COMPILATION ENGAGEMENT

Objective of Compilation Engagement	▪ To collect, classify and summaries financial information, ▪ By using ***accounting*** expertise.	
Principles of a Compilation Engagement	*Compulsory*	▪ Integrity; ▪ Objectivity; ▪ Professional competence and due care; ▪ Confidentiality; ▪ Professional conduct; and ▪ Technical standards.
	Optional	▪ Independence. But if he's not independent, he should refer it in Accountant's Report.
Management's Responsibility	▪ Ensuring correctness, completeness and reliability of **financial information** generated in the entity. ▪ Maintaining **Accounting Records** and **Internal Controls.** ▪ Selecting and applying appropriate **accounting policies**. ▪ Establishing controls for safeguarding the assets and detecting **frauds**. ▪ Ensuring compliance with **laws** and regulation. ▪ Complete **disclosure** of all material and relevant information to the accountant.	
Defining terms of engagement	Accountant should send an engagement letter listing the key terms of appointments to avoid misunderstanding.	
Procedures and evidences	*General Procedures*	The accountant should - ▪ Obtain the general knowledge of business and operations of the entity. ▪ Be familiar with Accounting principles and practices of industry in which entity operates. ▪ Understand form and content of financial statements. ▪ Request management representation letter on significant matters.

Procedures in exceptional circumstances

If information provided by management appears to be –
(i) incorrect ,
(ii) incomplete, or
(iii) unsatisfactory.

↓

then accountant should –
(i) obtain MRL,
(ii) perform compliance procedures,
(iii) verify any matters and explanations

↓

Request management to provide additional information

↓

If management refuse to provide additional information

↓

Accountant should withdraw from engagement informing entity of the reasons for the withdrawal.

Reporting Layout

(a) Title: "Accountant's Report on Compilation of Un-audited Financial Statements"

(b) Addressee: addressed to the appointing authority.

(c) Identification of the financial information stating that it is based on the information provided by the management.

(d) When relevant, a statement that the accountant is not independent of the entity.

(e) A statement that the management is responsible for:

- Completeness and accuracy of data and complete disclosure of all material and relevant information to the accountant;
- Maintaining adequate accounting records and internal controls and selecting and applying appropriate accounting policies;
- Preparation and presentation of financial statements as per the applicable laws and regulations, if any;
- Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities;
- Establishing controls for ensuring that the activities of the entity are carried out as per the applicable laws and regulations and preventing and detecting any non-compliance.

(f) A statement that the engagement was performed in accordance with standard on compilation engagements.

(g) A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information.

(h) A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework.

(i) Date of report.

(j) Place.

(k) Accountant's signature.

14.2 INVESTIGATION

Investigation implies ***systematic and critical examination*** of accounts and records of a business enterprise for specific ***purpose***. The specific purpose may be evaluation of state of affairs or establishing of a fact (eg: whether to grant loan to an applicant).

Difference between Audit and Investigation

Basis	Audit	Investigation
1. Objective	To judge truthfulness and fairness of financial statement	To establish a specific fact
2. Scope	By law & AAS	By terms of engagement
3. Period	Yearly	It depends on requirement
4. Nature	General examination	Detailed and critical examination
5. Inherent limitations	More	Less (because of detailed checking)
6. Evidences	Persuasive	Conclusive
7. Reporting	General Purpose	Confidential
8. Approach	No doubtful approach	Doubtful approach
9. By whom	Chartered Accountant	Expert Team

14.3 GUIDANCE NOTE ON REVISION OF AUDIT REPORT

Revision-When	Revision of Audit Report after the same has been issued.
Revision-Why	If Auditor becomes aware subsequent to his Audit Report that facts may have existed at that date which might have affected his Report had he been aware of such facts at time of issuance of Audit Report.
Example	Apparent mistake, wrong information about facts or subsequent discovery of facts, etc.
Revision- condition	Auditor may issue the Revised Report referring therein earlier report, if management ensures the auditor that everyone in receipt of previously issued financial statement along with Audit Report is informed to the situation.
If management doesn't ensure Auditor	In this case, auditor may: ▪ Seek legal advice; ▪ Notify the client that Audit report no longer be associated with financial statement; ▪ Notify regulatory authorities; ▪ Make appropriate statement at AGM; ▪ Conclude to withdraw from further engagement.
Time limit for revision	▪ In case of client being company, he can revise report till AGM. ▪ For others, revise within reasonable time, but not later than issuance of Audit Report for immediately next accounting year.

14.4 GUIDANCE NOTE ON AUDITOR'S REPORT ON REVISED ACCOUNTS OF COMPANIES, BEFORE CIRCULATION TO SHAREHOLDERS

When to apply this G.N.	When amended accounts are re-approved by the board of company and statutory Auditors are requested to make a report once again on the amended accounts.
Auditor's duty	▪ Auditor should ensure that all copies of original accounts and report are returned to him and adequate disclosure of fact of revision appears as a specific note in the amended accounts. ▪ However, if notes to amended accounts don't contain any note on revision or if Statutory Auditor does not consider such a note as adequate, it will be his duty to refer to the fact of revision of Accounts, in his report.
As per ICAI	Re-opening or rectification of Accounts after they have been adopted at the AGM, should not be permitted in any circumstances.

14.5 GUIDANCE NOTE ON PROPOSED DIVIDEND

Proposed dividend Meaning	▪ It is dividend recommended by BOD pending approval by shareholders in AGM. ▪ It is a liability, which is not present at balance sheet date.
Statutory ...	As per schedule VI of The Companies act'1956 , it should be shown as current liability in Balance sheet (even if it was not present as liability at B/S date)
As per AS 4	▪ Proposed dividend represents an event occurring after balance sheet date. ▪ However , it must be adjusted in accounts because there are statutory provisions requiring the same.
Auditor's duty	▪ Auditor should ensure that provision for proposed dividend has been made by the company as per requirements. ▪ In case, proposed dividend has not been adjusted in financial statements, he should qualify his audit report.

14.6 TYPES OF AUDIT

1. Independent Audit	Refer to Chapter 1
2. Internal Audit	Refer to Chapter 4
3. Cost Audit	Refer to Chapter 9
4. Government Audit	Refer to Chapter 13
5. Final Audit	Refer to Chapter 3
6. Continuous Audit	Refer to Chapter 3

7. Statutory Audit	1. When Audit is made compulsory by Law, it is termed as statutory audit. 2. For e.g. companies, Banking companies , co-operative societies, general insurance companies, trust etc. where it is required as per governing statute. 3. It can be conducted only by professionally qualified person for e.g. CA. 4. Right, duties of Auditor & scope of Audit is determined as per law. 5. Scope can't be restricted by client.
8. Tax Audit	1. It is conducted under section 44 AB of Income Tax Act. 2. It is conducted to ensure correctness of accounts & compliance with Tax Laws. 3. It can be conducted only by professionally qualified person i.e. Chartered Accountant. 4. It is thus, a special audit governed by statute. 5. Report is given to Tax Authorities. 6. There is specified form of Tax Audit Report.
9. Interim Audit	1. It refers to audit between two annual Audits. 2. It is conducted for Interim purposes. 3. for example for providing for interim dividend. 4. It is not required under any law. 5. Generally, it is conducted by a Chartered Accountant. 6. It results in quick detection of misstatement, thus it acts as good moral check on employees. 7. Therefore, it is early warning signal. 8. However , it is not suitable for small organisation.
10. Balance sheet Audit	1. It means limited audit in which all the balance sheet items are verified. 2. Following are examined: Fixed assets, current assets, balances of reserves and provisions, capital, profit earned or loss suffered by the firm during the year and other liabilities. 3. P&L items directly associated with Assets/Liabilities are also checked. For example, adjustment w.r.t. bad debts. 4. Balance sheet audit is most suitable for small organisations or which have an efficient system of internal control. 5. No statutory requirements. 6. Normally, it is conducted by a Chartered Accountant. 7. However due to limited scope it provides less assurance to Auditor.
11. Concurrent Audit	1. It is a system of audit prevalent in large banks and exceptionally large branches of the banks. 2. It is carried out continuously throughout the year to check effectiveness of working and internal control of banks and branches of banks. 3. Transaction are examined as and when they take place. 4. It is thus conducted on a regular and continuous basis. 5. It is a comprehensive and systematic audit. 6. It helps management of bank to prevent and detect irregularities on an earlier basis. 7. It may be done by independent CA. or internal staff of bank concerned.

12. Operational Audit	1. It is defined as an audit for management to provide it with information & appraisal of activities 2. It covers both financial and operational aspect of the entity concerned. 3. It is carried out in the same manner like internal audit. 4. It helps management to identify weakness in present systems. 5. The auditor provides suggestions also in his audit report. 6. It is usually done by team of experts from various fields.
13. Management Audit	1. It is audit of management performance. 2. It involves examination of all activities from top to bottom, specially to ensure whether general management is functioning smoothly and satisfactorily or not. 3. It is performed for finding weaknesses in management functioning and providing suggestions to improve the situation. 1. It is just another tool to assist management in fulfilling its objectives. 2. Generally, It is conducted by team of management experts. 3. It may be useful in case of ailing entities.
14. Secretarial Audit	1. It is conducted to ensure compliance with Companies Act and other formalities. 2. It is required by SEBI. 3. Listed entities are required to get it done.. 4. It can be conducted either by a Chartered Accountant or Company Secretary.
15. Environmental Audit	1. It involves examination of interaction between business and surroundings. 2. It seeks to ensure how well organisation, management & equipments are functioning to protect environment. 3. It is conducted by team of experts. 4. Measures for environment protection are also suggested. 5. It acts as a good public morality. 6. However, in India it is not mandatory.

14.7 CUT-OFF PROCEDURES

Meaning	▪ It refers to segregation of transaction of one period from the other so that the result of working of each period can be correctly ascertained. ▪ The arrangement that is made to ensure such separation is technically known as 'cut- off Procedure'. ▪ It is part of the internal check of the organization.

Application	▪ This procedure is generally applied to transactions affected by the continuity of business like sales, purchase and stock. ▪ This procedure ensures that goods purchased during a year have been included in ▪ inventory and the liability has been provided in the case of credit purchase. ▪ Similarly goods sold have been excluded from the inventories and credit has been taken for the sales.
Auditor's duty	The auditor satisfies by examination that the cut-off procedures adequately ensure that: (i) goods purchased, property in which has passed to the client, have in fact been included in the inventories and that the liability has been provided for in case of credit purchase; and (ii) goods sold have been excluded from the inventories and credit has been taken for the sales; if the value of sales is to be received, the concerned party has been debited.

THEORETICAL QUESTIONS

98 Nov 'Concurrent audit provides a supplementary management tool'. Comment.

99 May Distinguish between Auditing and Investigation.

00 May An auditor became aware of a matter regarding a company, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion. Comment/state your opinion.

07 Nov Cut off procedures