GOVERNMENT ARTS AND SCIENCE COLLEGE
(Affiliated to Manonmaniam Sundaranar University, Tirunelveli.)
PALKULAM, KANYAKUMARI-629 401.

STUDY MATERIAL FOR B.COM

AUDITING

VI - SEMESTER

ACADEMIC YEAR 2022-23

PREPARED

BY,

DEPARTMENT OF COMMERCE

III B. COM

PART III - MAJOR CORE -40

AUDITING

Objectives

1. To know the importance of audit in commercial and non-commercial organizations.

2. To understand the procedures to be followed while auditing the business organizations.

Unit I: Introduction – meaning- objectives – difference between accountancy and Auditing

– advantages – limitations – audit programme – audit working papers – preliminaries before audit . (10 hours)

Unit II: Internal check – meaning- objectives – difference between internal control and internal audit – advantages and disadvantages of internal check. (15 hours)

Unit III: Vouching – meaning – objects – importance of vouchers – precautions to be taken by the auditors while examining vouchers – vouching of various transactions.

(15 hours) Unit IV: Verification and valuation of assets and liabilities – classification of assets – verification of different types of assets – valuation of investment, stock -in -trade and book debts. (10 hours)

Unit V: Company auditor - appointment – qualification and disqualification – removal of an auditor – status – rights – duties and liabilities – auditor’s report.

Text Books

1. Saxana, Reddy and Appannaiah, Text Book of Auditing, Himalaya Publishing House.

2. Dr.T.R. Sharma, Auditing, Sahitya Publication, Agra.

Reference Books

1. B. N. Tandon, Auditing, S. Chand & Co., New Delhi.

2. Dinkar Pagare, Principles and Practice of Auditing, Sultan Chand & Sons, New Delhi.

Unit – 1 INTRODUCTION

The term audit is derived from the Latin word 'audire', which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. The original objective of auditing was to detect and prevent errors and frauds. In India, the companies Act 1913 made audit of company accounts compulsory with the increase in the size of the companies and the volume of transactions.

Objectives of Auditing

The objective of an audit may be classified as

(1) Primary Objective

(2) Subsidiary Objective

(3) Specific Objective

Primary Objective or Main Objective: - The main objective of auditing is to verify the accounts and record sand to report to the owners of the business whether the profit and loss account and the Balance sheet have been properly drawn up according to the requirements of law, and whether they exhibit a true and fair view of the profit and the financial position of the business.

To ensure that the primary objective of audit is achieved, an auditor must:

(a) Examine the Internal Control and Internal Check.

(b) Verify whether all the books of accounts as required by law are kept.

(c) Verify whether proper accounting principles and procedures are followed.

(d) Check the arithmetical accuracy of the books of accounts.

(e) Verify the authenticity and validity of the transactions.

(f) Confirm the existence and the values of the assets and liabilities by physical verification.

(g) Find out whether the financial statement is properly drawn up.

(h) Report whether the profit and loss gives a true and fair view of the profit or loss for the year

Subsidiary or Ancillary objectives: -

Subsidiary objectives of auditing are

(1) Detection and prevention of errors.

(2) Detection and prevention of frauds

Detection and prevention of Errors: -

Errors refer to unintentional misstatements in the records or books.

Errors are two types namely (1) Clerical or technical errors and

(2) Errors of principle

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Clerical Errors: - Clerical errors refer to all types of errors committed on account of clerical mistakes.

They are (1) Errors of omission (2) Errors of Commission (3) Compensating errors and (4) Errors of duplication.

Errors of Omission: - An error of omission is one which arises when a transaction has been omitted to be recorded in the books of accounts either wholly or partially.

An error of omission may be an error of complete omission or an error of partial omission.

An error of complete omission does not affect the agreement of the trial balance, as both the aspects of the transaction are omitted from the trial balance, they cannot be detected easily.

They can be detected only by an intensive checking of the subsidiary books, and the postings from the subsidiary books to the ledger.

On the other hand, an error of partial omission affects the agreements of the trial balance, as only one of the aspects of the transactions is omitted from the trial balance, it can be detected easily.

Errors of Commission: - Errors of commission refer to errors committed in the process of posting from the subsidiary books to the ledger accounts, casting, carry forward and balancing of ledger accounts. Some of the errors of commission will not affect the agreement of the trial balance.

They cannot be detected easily. Only a thorough checking of the subsidiary books and posting to the ledger can help to detect these errors.

Compensating errors: - When the effect of one error is counter balanced, set off or compensated by another error, the errors are known as compensating errors or offsetting errors. Compensating

errors do not affect the agreement of the trial balance, as they are counter balanced or set off.

Errors of Duplication: - Errors of duplication arise when an entry in a book of original entry has

been made twice and also been posted twice

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2.Errors of Principle: - An error of principle arises when the generally accepted principles of

accountancy are not observed, while recording a transaction in the books of account.

In other words, if a transaction is recorded in the books of account against the generally accepted principles of accountancy, the error is known as an error of principle.

Capital expenditure recorded as revenue expenditure or vice versa, capital receipt recorded as revenue receipt or vice versa is examples of errors of principle.

Errors of principle will not affect the agreement of the trial balance. Only a detailed and intensive checking will reveal these errors

Detection and prevention of frauds: - It is intentional or willful representation or deliberate

concealment of material fact with a view to deceive, cheat or mislead somebody.

Fraud may be broadly classified into three types. They are

(1) Misappropriation of cash

(2) Misappropriation of goods

(3) Manipulation of accounts

Misappropriation, Defalcation or Embezzlement of Cash: - Misappropriation of cash means the fraudulent appropriation of cash belonging to another person by whom it has been entrusted.

Misappropriation of cash may take place in any of the following ways:

(a) Suppression or non disclosure of Cash receipts :

The following are examples of suppression of cash receipts:

(1) By misappropriating the receipt by not recording the same in the Cashbook.

(2) By entering lesser amount on the counterfoil and misappropriating.

The difference between money actually-received and the amount entered on the counterfoil of the

receipt book

(3) By not recording the receipt of sale of a casual nature for example Sale of scrap, sale of old newspapers etc.

(4) By omitting to record cash donations received by non-profit making charitable institutions

(5) By misappropriating the cash received on discounting the bills Receivable and showing them

as bills outstanding on hand.

(6) By misappropriating cash received from debtors and concealing the same by giving artificial credit to the debtors in the form of bad debts, Discount or sales return etc.

(7) By adopting the method of "teeming and lading" or "lapping process". This is one of the

methods of misappropriation of cash. Under this method cash received from the first customer is misappropriated by the cashier. The money received from the second customer is credited to the account of the first customer, the money received from the third customer is credited to the account

of second customer, and the money received from the fourth customer is credited to the account of third customer and so on. This process is carried out throughout the year.

(8) By suppressing the cash sales by not recording them or by treating the cash sales as credit sales.

(9) By misappropriating the sale proceeds of VPP sales or sales of Goods on approval basis by

treating the transaction as goods Received or not approved

(10) By under casting receipt side total of the cashbook.

(b) Inflating the payments or showing false cash payments: - The following are examples of this type of misappropriation:

(1) Recording fictitious or false cash purchases and pocketing the amount.

(2) Inflating the cash purchases and pocketing the difference.

(3) Recording payments to fictitious creditors for purchases and pocketing the money.

(4) Recording the payment to creditors at a figure higher than the actual amount and pocketing the difference.

(5) Recording payments to dummy workers and pocketing the money.

(6) Recording fictitious payments of expenses and pocketing the money.

(7) Recording payments of some accounts at figures higher than the actual payments and pocketing the difference.

(8) By showing credit purchases as cash purchases and misappropriating the amount

(9) Recording personal expenses as business expenses

MANIPULATION OF ACCOUNTS

Manipulation of accounts means falsification of accounts without any misappropriation of cash or goods. It implies presentation of accounts more favorably than what they actually are. Manipulation of accounts may be done in any of the following ways:

(1) Non provision of depreciation on fixed assets.

(2) Provision of less depreciation on fixed assets

(3) Provision of more depreciation on fixed assets

(4) Over valuation of assets

(5) Showing short term liabilities as long term liabilities.

(6) Recording sales of the next year in the current year's revenue account.

Specific objectives

There will be specific objective in respect of each type of specific audits. For example, in

operational audit, the aim of audit is to evaluate the existing operations of the entity in order to give expert advice to improve their efficiency. The cost audit is to check the cost records of the

entity in order to make a report on the proper ascertainment of cost of production of goods or

services. Depending upon the

nature of specific audit, there may be different objective in respect of each specific audit

PROCEDURE TO BE FOLLOWED TO DETECT ERRORS

Following procedures may be adopted by the auditor to detect the errors.

1. Check the opening balances from the balance sheet of the last year.

2. Check the posting into respective ledger accounts

3. Check the total of the subsidiary books.

4. Verify all the castings and the carry forwards.

5. Ensure that the list of debtors and creditors tally with the ledger accounts.

6. Make sure that all accounts from the ledger are taken into accounts.

7. Verify the total of the trial balance.

8. Compare the various items from the trial balance with that of the previous year.

9. Find out the amount of difference and see whether an item of half or such amount is entered

wrongly.

10. Check differences involving round figures as Rs. 1,000; Rs. 100 etc.

11. See where there is misplacement or transposition of figures that is 45 for 54; or 81 for 18 etc.

12. Ultimately careful scrutiny is the only remedy for detection of errors.

THE AUDITOR's Position and duty in regard to detection and prevention of errors and

frauds

1. Examine all aspects of the finance.

2. Vouch all the receipts from the counterfoils or carbon copies or cash Memos, sales mart

reports etc.

3. Check thoroughly the salary and wages register.

4. Verify the methods of valuation of stocks.

5. Check up stock register, goods inwards notes, goods out wardsbooks and delivery challans etc

6. Calculate various ratios in order to detect fraudulent manipulation of accounts

7. Go through the details of unusual items

8. Probe into the details of the problems when there is a suspicion.

9. Exercise reasonable skill and care while performing the duty.

10. Make surprise visit to check the accounts.

Difference between Accountancy and Auditing

1. Meaning

Accountancy: It is the process of recording, classifying, summarising and interpreting all the financial transactions.

Auditing: It is the process of examining books of accounts and reporting on the financial statements.

2. Objectives

Accountancy: Its main objective is to find out profit earned or loss suffered by a company and to show the financial position of the company for a particular period.

Auditing: Its main objective is to examine the correctness of the accounts and financial statements and certify that whether the company exhibits a true and fair view of state of affairs of the concern.

3. Nature of Employment

Accountancy: An accountant is a permanent employee of the organisation.

Auditing: An auditor is an independent person and is not an employee of the organisation.

4. Qualification

Accountancy: An accountant does not require any formal qualification.

Auditing: An auditor should be a qualified chartered accountant certified by the Institute of Chartered Accountants of India.

5. Reports

Accountancy: Accountant is not required to submit the report on the financial statements prepared by him.

Auditing: Auditor should submit the report certifying the truth and fairness of the financial statements.

6. Remuneration

Accountancy: An accountant is remunerated in the form of salary.

Auditing: An auditor is remunerated in the form of professional fees.

7. Commencement of work

Accountancy: Accountancy starts where Book-keeping ends.

Auditing: Auditing starts where Accountancy ends.

ADVANTAGES OF AUDIT: -Audit offers several advantages. They are:

1. Advantages of Audit to the business enterprise and Management :

(1) Audit ensures the accuracy or correctness of the books of accounts

(2) Audit ensures the authenticity and reliability of the financial statements.

(3) Audit helps in the detection and rectification of errors and frauds.

(4) Audit helps the enterprise and management to ascertain whether the legal requirements are complied with.

(5) Audit point out the weakness of the existing system of internal check and internal control.

(6) Audit examination makes the employees in charge of accounts and records vigilant, regular

and up- to –date in their work.

(7) Loans and credit facilities can be easily obtained by a concern on the basis of audited accounts.

(8) Liability of an enterprise as to income tax, wealth tax, and value added tax etc can be easily determined on the basis of audited accounts.

(9) A business can enjoy better reputation, if its accounts are audited by an independent

professional auditor.

(10) Audited accounts are more reliable as evidence in courts of law.

(11) Facilitates calculation of purchase consideration.

(12) The insurance claim can be easily determined on the basis of audited accounts.

(13) Audited accounts serve as a basis for solving the disputes as to higher wages.

(14) Comparison of accounts from year to year becomes easier since the accounts are uniformly prepared.

2. Advantages of audit to the owners of the business:

(1) In the case of a sole trader, auditing assures him that all business transactions have been duly accounted for and there are no errors or frauds. It also helps him to know the true facts about the business.

(2) In the case of partnership firm, audited accounts serve as an evidence of proper management of the affairs of the business. Audited accounts are help in the valuation of goodwill and settlement of accounts on the admission, retirement or death of a partner. Again audited accounts minimize the chances of disputes among the partners.

(3) In the case of a joint stock company, audit of accounts assures the shareholders that the affairs of their company are smoothly and their investment is safe. The shareholders of a company can value their shares on the basis of audited accounts.

(4) In the case of a co – op society or a trust, audit assures the members or the beneficiaries that the affairs of the society or trust are conducted properly and their investment are looked after

properly.

3. Advantages of Auditing to others:

(1) Lenders can depend on audited financial statements while taking a decision to grant credit to the business concern

(2) Tax authorities can depend on audited statements in assessing sales tax, income tax and wealth tax of the business.

(3) Audit of accounts safeguards the interests of the workers and is helpful in the settlement of

claim for higher wages and bonus.

(5) Insurance company can rely on audited accounts to settle claims in respect of damage or loss of any business asset by fire, theft etc.

(6) The purchaser of a business can easily calculate the amount of purchase consideration on the

basis of audited accounts.

(7) Audited accounts create confidence in the minds of investors in a joint stock company.

Limitations of Auditing: - Generally following are the Limitations of auditing

1. Non-detection of errors or frauds: - Auditor may not be able to detect certain frauds which

are committed by the clients.

2. Dependence on explanation by others: - Auditor has to depend on the explanation and

information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.

3. Dependence on opinions of others:- Auditor has to rely on the views or opinions given by

different experts viz Lawyers, Solicitors, Engineers, Architects etc, he cannot be an expert in all

the fields

4. Conflict with others: - Auditor may have differences of opinion withthe accountants,management, engineers etc. In such a case personal judgement plays an important role. It differs

from person to person.

5. Effect of inflation : - Financial statements may not disclose true picture even after audit due to

inflationary trends.

6. Corrupt practices to influence the auditors: - The management may use corrupt practices to

influence the auditors and get a favourable report about the state of affairs of the organisation.

7. No assurance: - Auditor cannot give any assurance about future profitability and prospects of the company.

8. Inherent limitations of the financial statements: - Financial statements do not reflect current

values of the assets and liabilities. Many items are based on personal judgement of the owners .Certain non-monetary facts cannot be measured. Audited statements due to these limitations cannot exhibit true position.

9. Detailed checking not possible: - Auditor cannot check each and every transaction. He may be required to do test checking.

10. Auditing is a post mortem examination of accounts.

Audit Programme:

An audit programme is a detailed, written statement designed by the auditor indicating the work to be performed by the audit assistants, specifying the time limit for completion of work, instructions and guidance to the audit staff. In short, it is a tool for planning, directing and controlling the audit work.

An audit programme is a detailed plan of the auditing work to be performed. It specifies the procedures to be followed in the conduct of audit more efficiently. The auditor outlines the whole procedure of audit from beginning till the finalization of audit report. Audit programme is generally contained in the audit notebook.

Features (or) Characteristics of an Audit Programme:

The features of an audit programme may be of the following:

1. It is a set of procedures to be adopted to conduct the audit more efficiently

2.It is a written scheme designed by the auditor.

3.It is a blue print of the audit work.

4 It facilitates delegation of work, based on the capabilities of audit staff.

5 It acts as evidence in future for the audit work being performed

.6 It specifies the work to be done by the audit staff, the manner and time limit for completion of the work.

Objectives of Audit Programme:

The following are the objectives of audit programme:

1.To provide clear instructions to the audit assistants specifying the nature of work to be performed and fixing the time span for completion of each work.

2. To facilitate coordination among various parts of audit work.

3 To ensure uniformity in the performance of audit work and to avoid duplication and repetition of work.

4. To attain a fair allocation of work among audit team.

5 To fix responsibility and accountability of each audit assistant.

6. To serve as a guide for planning the audit work in future.

7. To serve as evidence in future showing the date of completion of audit work, methods or procedures undertaken, persons involved in completion of audit work etc.

Contents of an Audit Programme:

The following are the details of an audit programme:

1. Name of the client.

2. Nature of operations and business of client.

3. Review of system of internal check.

4. Date of commencement of audit work.

5.Duration of audit work.

6.Accounting system followed in client organization.

7.Review the report of the previous auditor.

8. Review the remarks, instructions or objections raised in the previous audit report.

9. Examine the various ledger accounts and subsidiary books.

10.Examine the statutory books and registers, profit and loss account, and balance sheet.

Advantages of an Audit Programme

An audit programme can give the following advantages:

1.Helps in Estimation and Division of Work: Audit Programme helps in estimating the quantum of audit work in advance and also helps in dividing the work among the audit assistants based on their capabilities.

2. Helps in Fixation of Responsibility: It enables to fix responsibility on the audit assistants by clearly defining the scope of work.

3. Helps in Future Planning: Audit programme serves as a basis for planning the audit work for subsequent year.

Audit Working Papers

Audit working papers are the outcome of the documentation process. Working papers are the record of various audit procedures performed, audit evidence obtained, allocation of work between audit team members etc. Audit working papers are the documents and evidence that an auditor collects and retains with himself during the audit.

In general audit working papers consists of the following:

1. Schedule of Debtors, Creditors and bank statement.

2. Correspondences and balance confirmations from Debtors, Creditors and bankers.

3. Correspondences from legal advisors and statutory authorities.

4. Certificates of officials with regard to bad debts.

5. Certificate from valuers for valuing stock-in-trade and investments.

6. Certificate confirming cash balance.

7. Certificate from authorized person with regard to outstanding assets and liabilities, contingent assets and liabilities etc.

8. Bank Reconciliation statement.

9. Adjusting entries.

10. Copies of the minutes of the meeting of directors and shareholders.

Objectives of Audit Working Papers

1. Planning and Organizing Audit Work: Working papers provide a means of planning, organizing and reviewing the audit work. They are the evidence for conducting the audit work against the generally accepted auditing standards and practices.

2. Support for Auditor’s Opinion: Working papers provide support for the report of the auditor. When the auditor’s opinion on financial statement or recommendations given by the auditor is questioned working papers support the opinion or recommendations given by the auditor.

3. Division of Labour: Working papers help in dividing the audit work among the audit staff so that each staff is responsible for his work to the auditor.

4. Use as a Permanent Record: Working papers are the permanent record of the auditing procedure employed and the financial records examined during the conduct of audit.

5. Basis for Evaluation and Training of Audit Staff: Working papers provide a means to test whether the auditor and his staff have done their job as per the standards. Training to the staff can be provided by reviewing the working papers of past years.

Importance (or) Advantages Of Audit Working Papers

1. Planning the Audit Work: It acts as the process of planning for the auditor so that he can estimate the time that is required for conducting the audit work.

2. Helps in Fixing Responsibility: It helps in fixing responsibility and to measure the work being performed by the audit assistants.

3. Helps in Drawing Conclusions: Working papers are necessary to draw conclusion from the evidence obtained.

4. Helps in Preparing Audit Report: The auditor prepares and finalises the audit report taking into account the informations or extracts contained in the working papers.

5. Documentary Evidence: It is a valuable documentary evidence in the Court or Tribunal of law when a charge of negligence is brought against the auditor.

6. Permanent Record: Working papers are the permanent record of the work done by the auditor during a particular period of time.

Preliminaries before audit

An auditor must prepare well before he actually commences a new audit. He has to take

Certain steps or bear in mind certain considerations before commencing a new audit. These steps are known as preliminary steps or general steps.

The following are the important preliminary or general steps to be taken by an auditor in All types of concerns before the commencement of a new audit:

I. Obtaining letter of appointment.

Auditor should satisfy himself that he has properly appointed.

II. Knowing the scope of his studies.

III. Ascertaining the nature of the business undertaken by the client enterprise.

IV. Knowledge of the organizational structure of the client business.Pattern of authority and responsibility are revealed through the organizational structure.

V. Obtaining the list of principal officers of the client business.

VI. Knowledge of internal check, internal control and internal audit

VII. Knowledge of system of accounting of the client business.

VIII. List of books maintained in the organization.

IX. Detailed study of important documents of the organization.

X. Study of prospectus, preliminary contracts etc of the organization.

XI. Study of the previous year financial statements.

XII. Enquiry about the reason for the change of the auditor.

XIII. Giving instructions to the client.

a) The books should be closed before the audit.

b) Voucher should arranged date vise.

c) Schedules should be kept for ready reference such as schedules of debtors and creditors, list of

bad and doubtful debts, schedule of investment, schedule of depreciation etc..

XIV. Division of audit work among the auditors.

XV. Preparation of audit programme

UNIT-II INTERNAL CHECK

Internal check

It is an arrangement of accounting work under which the work of one person comes under

the security of another person. So, that it is not possible to commit fraud without collusion between two or more persons. In other words, it is an arrangement of accounting system under which no one person is allowed to carry out one work completely Specialization & division of work is important one. The work of one staff is automatically checked by another person in order to locateerrors and frauds.

Objectives.

1) Proper division of work.

2) Minimization of errors and frauds.

3) Easily detection of errors and frauds.

4) Ensures the reliability of accounts.

5) Easily preparation of final accounts.

6) Simplification of the external auditors work

Differences Between Internal Control and Internal Audit

1.The methods and procedures implemented by the management to control the operations, so as to help the organization in achieving the desired ends, is called as an internal control. The auditing program adopted by the firm, to review its financial and operating activities by the expert, is called internal audit.

While internal control is a system designed, implemented and maintained in an organization. Internal Audit is an audit function designed by those charged with governance, to keep a check on the activities of the firm.

2.In internal control, work of one person is verified by another, whereas in the case of an internal audit, every single component of work is verified.

3.In the internal control system, checking is performed simultaneously, while carrying out work. On the contrary, in internal audit system work is checked after it is performed.

4.The basic objective of the internal control system is to ensure compliance with management policies. In contrast, internal audit aims at detection of fraud.

Advantages of internal check

A. Advantages to business

1. Proper division of work
2. Fixation of responsibility
3. Greater efficiency of the staff.
4. Increased carrying capacity.
5. Early detection of errors and frauds.
6. Easy preparation of final account.
7. Truth and accuracy of accounting can be available.

B. Advantages to Owners.

1. Genuineness and accuracy of the account.
2. Overall efficiency, economy in operations, increased profit etc..

C. Advantages to Auditor

1. There is no need for detailed examination of book of accounts.
2. It reduces burden.

Disadvantages of internal check

1) Suitable only for big concerns.

2) Sacrifice of quality for quickness.

3) Certain type of disorder, confusions etc... in the working of the organization.

4) Useful only when there is no collusion between employees.

5) Risky for the auditor.

Principles and essential of good internal check system.

1) Simple, easy workable and effective.

2) Not be too expensive.

3) Carefully devised and properly regulated.

4) Authority should be clearly defined.

5) Proper division of responsibility.

6) Division of work among the staff.

7) Work of similar nature should be entrusted with one person to ensure specialization.

8) No individual should be allowed to perform one work completely.

9) Work should be distributed in such a way that the work of one staff is automatically check

another.

10) No employee should be allowed to remain a particular job for a long period.

11) No employee of the concern should be rely upon too much.

12) Proper reporting to the management.

13) Proper system of filing vouchers.

14) Safeguards should be prescribed for the safe custody of unused cheque book, securities etc…

15) There should be a self balancing ledger system.

16) All incoming letter should be opened by responsible officers.

17) The receipt of cash and disbursement should be entrusted to different personnel.

18) Cashier should have no access to ledger.

19) All remittance received should be deposited in a bank immediately.

20) All cash payments should be made by a cheque.

21) Cash and bank balance should be verified frequently.

22) Petty cash payment should be on imprest system.

23) There should be effective control of receipts and issue of goods.

24) There should be a perpetual inventory system.

UNIT-III VOUCHING

Vouching:- Vouching is the act of checking or examining the entries made in the books of account with the supporting the documentary evidences or vouchers. In the words of L.R DICKSEE," Vouching is an act of comparing entries in the books of account with the documentary evidence in support thereof'.

Objectives of vouching:-

1) The principal objective of vouching is to ensure that the transactions, as recorded in the books of accounts, are acceptable, genuine, properly authorised and correctly recorded.

2) Another objective of vouching is to ensure that all the entries made in the books are supported by necessary documentary evidence.

3) To see that all the transactions connected with the business have been recorded in the appropriate books of account.

4) To ensure that no transactions, which is not connected with the business, has been recorded in the books of accounts.

5) Detection of errors and frauds.

Importance of vouching:- Vouching constitutes the foundation upon which the super structure of auditing is erected.

It is the back born of auditing. In the words vouching is the essence of audit. Vouching can be regarded as the essence or back bone of auditing for the following reasons.

a) The success of an audit largely depends upon the care and attention with which vouching is accomplished.

b) Vouching is the most potent tool in the hands of an auditor to ascertain the accuracy of the

Transactions recorded in the books of account.

c) To see that all the transactions connected with the business have been recorded in the appropriate books of account.

d) To ensure that there are no transactions, which are not connected with the business, has been recorded in the books of accounts.

e) Detection of errors and frauds

f) Vouching ensures the arithmetical accuracy of the books of account.

g) If vouching is done with care and caution, the auditor can smoothly proceed further in his work.

Precautions to be taken by the auditors while examing vouchers or Essentials of vouchers or points to be noted by the auditor while vouching the vouchers:-

1) Vouchers are consecutively numbered, arranged serially in the order of the entries and are properly filed.

2) Vouchers are in the name of the client.

3) See the teach voucher is genuine on its face.

4) Voucher is certified as correct by a responsible official.

5) The amount of each voucher is written in words and figures.

6) Every voucher, which is a receipt for cash payment over Rs 5000 bears a revenue stamp of Rs1

7) Alteration made in a voucher is properly signed by the maker and approved by a responsible official.

8) Any explanation is desired with to any voucher, the same should be noted in the audit note book.

9) Missing vouchers produced, the auditor should do,

a) Prepare a list of all such missing vouchers

b) Call for explanation from the concerned official from the loss of original vouchers

10) If any voucher requires a special scrutiny, the auditor should proceed cautiously and use special ticks for checking.

11) As far as possible the auditor should complete the vouching work relating to a particular period in continuous sitting.

12) The auditor should not take the help of any staff while vouching the vouchers.

13) Test checking may be resorted only in exceptional circumstances.

Vouching of cash book or cash transactions.

Cash transactions take place almost every day in business. An auditor should give care and attention to the vouching of cash transactions.

The main objectives of vouching of cash transactions are,

1) To ensure that all receipts of cash are duly accounted for.

2) To ensure that no improper payments are made.

3) To see that all receipts and payments of cash are actually and properly recorded.

4) To see that all payments have been made to proper persons and the payments are true payments.

5) To see that cash and bank balance correct and really exist.

Vouching of cash book or cash transaction covers the vouching of receipt side and vouching of payment side.

Vouching of receipt side or debit side of cashbook or cash receipt transactions:-

Vouching of cash receipt transactions is more difficult than that of cash payment transactions, since there is greater chance of manipulation in regard to cash receipt. The auditor should bear in mind the following points, while vouching the cash receipt transactions.

1) The auditor should carefully examine the system of internal check in operation with regard to

cash receipt transactions.

2) An auditor can resort to test checking only if he has satisfied himself that there is an efficient

system of internal check.

3) He should ascertain whether a diary of cash receipt or rough cash book has been in use. If a

rough cash book has been in use, he should examine the entries in the rough cash book and compare with the entries in the ash book.

4) He should examine the methods of depositing daily receipts into the bank.

5) He should check the bank pass book with the entries in the cash book.

6) He should vouch cash receipts by reference to documentary evidences.

7) He should enquire into the system of allowing documents, the rate of discount allowed etc.

8) He should enquire into the bad debts written off. He should satisfy himself the bad debt written off are authorized by a responsible person. He should ensure whether there is a proper control over use of the receipt book.

In this context, he should keep in mind the following points:

a) All receipts are on printed forms.

b) See that receipt book should be consecutively numbered.

c) The receipts have to be signed by a responsible officer.

d) The unused receipt book should be kept in safe custody.

e) All spoilt receipts should remain attached to the counter foils.

Vouching of the important items on the debit side of the cashbook or cash receipt transactions.

1) Opening balance:- The opening balance of the cash book should be vouched by comparing it with the closing balance of cash book as shown in the audited copy of the balance sheet of the previous year,

2) Cash sales:- The vouching procedure in regard to cash sales should be on the following lines:

1. He should examine the system of internal check in operation in regard to cash sales.

2. After ascertaining the efficiency of the internal check system as regards cash sales, auditor should vouch the cash sales as follows:

a) Cash memos written by the salesman should be checked with the summery sales prepared at the end of the day.

b) He should examine the rough cash book, if any.

c) He should check up the rough cash book with the main cash book.

d) The summaries of daily sales should be checked with the entries in the stock register.

e) He should verify the daily deposit of cash received into the bank, pay-in slip also should be vouched.

3) Receipts from debtors:- While vouching the receipts from debtors, an auditor should bear in mind the following

points:

1. He should enquire into the system of internal check in operation in regard to the receipt from debtors.

2. After satisfying himself about the efficiency of internal check in operation in regard to the receipt from the debtors, the auditor should conduct the vouching of receipts on the debtors on the following lines:

a) He should check the total cash received from the debtors by verifying the rough cash book with the counter foils of the receipts issued to customers.

b) He should check the cash book with the rough cash book.

c) He should check the details of cash and cheques paid into the bank.

d) He should enquire into whether bad debts are written off by a competent authority.

e) He should verify the balances due as per the schedule of debtors with letters of confirmation received.

f) He should be alert to the possibility of teeming and lading.

4). Receipts from bills receivable:- Bills receivable include bills of exchange, promissory notes, and I.O.U's received from debtors.

The receipts from bills receivable can be in two ways:

1)Receipts from bills discounted The vouching of receipts from bills discounted should be as follows:

a) The amount of cash received from bills discounted should be checked by comparing the bills discounted book with the cash book, pass book, B/R book.

b) See that proper records have been made in the books for discount on bills discounted.

c) He should determine the contingent liability in respect of bills discounted but not matured on the date of the balance sheet.

2). Receipts from bills matured

a) The auditor should check the cash received from bills matured by comparing the bills receivable book with the cash book and the pass book.

b) Special attention should be given to bills which have matured but remain unpaid.

3) Receipts from sale of investment:

Vouching of receipts from the sale of investment should be on the following lines:

a) Investments are usually sold through brokers, as such, broker’s sold notes or contract notes should be examined to vouch the amount from the sale of investments. If the sale of investment has been effected through the bank, then, the bank advice should be examines to vouch the amount received from the sale of investments.

b) The sale proceeds of the investments should also be checked with the related investment account with the stock market quotations.

c) If the investment has been sold cum-dividend, the auditor should see that the sale proceeds are properly apportioned between capital and revenue receipt.

d) If the investment has been sold ex dividend, the auditor should see that the dividend is received and recorded.

e) He should see that the profit or loss on the sale of investment is properly adjusted.

f) If the investments are pertain to some ear marked funds, the auditor should see that the profit or loss on the sale is transferred to the ear marked fund a/c.

4) Receipt from the sale of fixed assets

Vouching of receipts from the sale of fixed assets should be on the following lines:

a) The auditor should see that the sale of fixed asset is properly sanctioned.

b) If the sale of fixed assets is through a broker, the proceeds of the fixed assets sold should be vouched with the help of sold notes. In the case of sale of fixed assets is through an auctioneer,

the sale proceeds should be vouched with the help of the auctioneer’s note. He can verify the cash receipt in the cash book with the counter foil or carbon copy of the receipt issued to the party. He may also vouch the sale proceeds of fixed assets with the correspondence with the parties and the sale contracts and the fixed asset a/c.

c) He should see that proper fixed asset a/c has been credited with the sale proceeds.

d) If there is any profit, the auditor should see that it is credited to capital reserve.

e) In the case of certain prepaid expenses in respect of fixed assets, the auditor should check

Whether suitable adjustments are made in the expenses accounts.

5) Loan received Vouching of loan received should be on the following lines:

a) He should ascertain that whether client is empowered to borrow money.

b) In the case of a joint stock company, he should verify whether the legal provisions have been complied with.

c) He should verify the loan agreement to ascertain the terms and conditions on which the loan has been received.

d) If the loan is secured, he should ascertain what security has been offered and the value of security offered.

e) He should ensure that the loan amount received is recorded in the books of account.

f) If the interest on loan is unpaid, the auditor should see that it is properly adjusted.

6) Dividend on investment

a) The auditor should verify the dividend received is recorded in the cash book with the counter foils of the dividend warrants.

b) To see that dividends have been received in the dates.

c) If the dividend is sold ex-dividend, see that dividends are subsequently received are entered in the cash book and credited to dividend account.

7) Subscription received

8) Insurance claim received

9) Commission received

10) Rent received

11) Royalty received

Vouching of cash payments or credit side of the cash book.

While vouching cash payments, an auditor should pay attention to the following points.

1) All vouchers relating to cash payments should be serially numbered and properly arranged.

2) He should insist that the vouchers are properly dated.

3) He should evaluate the system of internal check in operation with regard to cash payments and satisfy himself as to the efficiency of the internal check.

4) He should see that:

a) The cash payments are for the purpose of the business.

b) Payments are related to the period under audit.

c) The payments is properly sanctioned or authorized.

d) The payments are made to the right person.

e) The payments are supported by proper vouchers.

f) The payments are properly recorded in the cash book.

5). Examine the rough cash book items and compare it with the main cash book.

5) See that the payments made are posted to the concerned accounts.

6) See that the amount appears in the vouchers both in words and figures and it agrees with the amount in the cash book.

7) Ensure that the payments have been passed as correct by a responsible official.

Vouching of different items on the payment side or credit side of the cash book

1)Opening credit balance

The opening credit balance in the bank column can be verified from the previous year's

audited balance sheet.

2)Cash purchases

The vouching of the cash purchases should be on the following lines.

1) The auditor should examine entries in the cash book with the help of cash memos or invoices

issued by the supplier and also goods inward book.

2) Special attention should be paid to trade discount, which should be deducted from purchase.

3) See that the cash paid for the goods have actually received.

4) He should see that the purchases are duly authorised.

5) He should see that the amount paid is debited to the appropriate account.

6) To ascertain whether payment made for cash purchases relates to the business.

3). Payments to creditors

Vouching of payment to creditors should be on the following lines.

1) Payments to creditors may be vouched with the receipts issued by the creditors.

2) He should check the amount due to the creditors with the accounts of the creditors.

3) Examine the goods inward book and see that goods have actually been received.

4) The auditor should verify the periodical statement of accounts.

5) In the case of purchase made before the close of the year, see that goods not actually received are kept out of the closing stock of the year.

4). Payment of bills payable

Payment of bills payable on their maturity should be vouched on the following lines.

1) The payment of bills payable, as recorded in the cash book, should be vouched with the bills

payable book and also with the bills payable returned by the payees.

2) If the bills payable are through the bank, the auditor should examine the bank pass book for the payment.

3) He should see that bills payable paid and returned by the payees are cancelled.

5). Vouching of loans advanced

Loans advanced should be vouched by the auditor on the following lines. 1) He should see that loans advanced are properly authorised.

2) He should examine the loan agreement.

3) He should vouch the loan advanced as recorded in the cash book with the loan agreement also with the receipt given by the borrower.

4) If the loan is advanced against any security, the auditor should examine the security and its title deeds.

5) Examine the mortgage deed, if the loan is advanced against mortgage.

6) See that the provisions of the companies Act as regards the granting of loans to directors and officers of the company are complied with.

6). Purchase of investment

Vouching of purchase of investment should be on the following lines.

1) The auditor should see that the purchase of investment is properly authorised.

2) If the investments are purchased through a broker, he should vouch the investments purchased with the broker's note.

3) If the investments are purchased through the bank, he should examine the bank pass book to check the payment.

4) He should make a physical verification of the investment purchased.

5) If the investments are purchased cum interest, he should see that the payment made is properly allocated between capital and revenue.

6) See that investments purchased are registered in the name of the client.

7) In the case of accompany, the auditor should see that investments have been purchased in accordance with the provisions of the companies Act.

7). Payment of capital expenditure

The payment of capital expenditure refers to the payment made for the acquisition of the fixed assets such as land & building, plant & machinery, patent, copy right, furniture etc. Vouching of payment of capital expenditure should be on the following lines.

1) The auditor should see that the payment of capital expenditure is properly authorised.

2) He should examine the document pertaining to the purchase and ownership of the fixed assets.

3) He should examine the invoices and the receipts obtained from the suppliers to ensure that payments have been made.

4) He should see that all expenses incurred for the acquisition are capitalised.

5) He should see that repairs and maintenance expenses incurred are charged to revenue account.

6) He should physically examine the fixed assets purchased.

7) He should vouch the cash boom entries for the payment of capital expenditure with the concerned ledger account.

8) See that property purchased is registered in the name of the client.

UNIT- IV VERFICATION AND VALUATION OF ASSETS AND LIABILITIES

Verification of assets and liabilities.

Verification means 'proving the truth' or 'confirmation of the truth'. Verification of assets and liabilities means proving the truth about the existence and the correctness of the money value of the assets and liabilities appearing in the balance sheet of the business. In other words, it means establishing the actual existence of the assets and liabilities appearing the balance sheet, ownership and possession of the assets and proper classification and valuation of assets and liabilities. Objects of verification of assets and liabilities.

1) To find out whether assets and liabilities shown in the balance sheet actually exist.

2) To ascertain whether the assets and liabilities appearing in the balance sheet are shown at their correct values.

3) To confirm the possession and ownership of the assets appearing in the balance sheet.

4) To find out whether there is proper classification of assets and liabilities.

5) To check the arithmetical accuracy of the books of accounts.

6) To ascertain whether the balance sheet gives a true and faire view of the financial position of the business.

Valuation of assets.

Valuation of assets means the determination of or the ascertainment of the money value at which the assets are shown in the balance sheet. However in audit it implies critical examination and testing of the determined values of the assets on the basis of generally accepted accounting principles. In short, it is the process of ensuring that the money value of the asset as shown in the balance sheet has been properly determined.

Objectives.

1) To verify whether the assets shown in the balance sheet have been properly valued.

2) To indicate that the balance sheet represents a true and fair view of the financial position of the business.

3) To indicate that there is no manipulation of account to inflate or reduce the profit.

Classification of assets:

1) Fixed assets

They are acquired for permanent use in the business. It is not for resale in the ordinary course of business but for the purpose of enabling the business to earn profit. These assets will be in use for a pretty long period. Examples are land, building, plant, machinery, etc.

Fixed assets are to be valued at original or historical cost less total depreciation written off (Going concern value).

2) Current assets (circulating or floating assets)

Current assets are those assets, which are acquired for resale or produced for the purpose of sale or converting them in to cash. Examples are stock, semi-finished

goods, book debts, cash and bank balance, etc….. Cash and bank balance- no valuation required Book debts and bills receivable- valued at book value

Raw materials- first in first out or last in first out or average cost method Closing stock-at cost price or market price whichever is lower.

3) Intangible assets

Intangible assets are those assets, which cannot be seen or touched. Examples are good will, copy rights, patent etc. these assets are shown at cost price.

4) Wasting assets

Wasting assets are of fixed nature, which are depleted gradually or exhausted in the process of earning income. Examples are mines, quarries, oil wells etc. These assets are valued at original cost less provision for depletion.

5) Fictitious assets

These are neither physically visible nor realizable into cash. They are revenue expenditure that have been temporarily capitalized with the object of generating the amount over a period of years the benefit of which accrues. Examples are preliminary expenses, discount on issue of shares,advertisement suspense account etc.

6) Contingent assets

These are assets the existence, values and ownership of which depends up on the

occurrence of a specified event. Examples are claim for refund of income tax, sales tax.

Various values used for valuation.

UNIT-V COMPANY AUDITOR

Qualifications of an Auditor

Section 226 of the Companies Act prescribes the qualifications and disqualifications of company auditor. Accordingly, only the following persons will be competant to be appointed as an auditor of a company:

(i) If he is a chartered accountant within the meaning of the Chartered Accountants Act of 1949.

(ii) Partnership firm as auditor: In the case of a firm, if all its partners practising in India are qualified for appointment as auditors, it may be appointed by its firm name to be auditor of a company. In such a case, any of its practising partners can act in the name of the firm.

(iii) Certified auditors: Apart from the practising chartered accountants, a person holding a certificate under the Restricted Auditor's Certificate (Part B States) Rules, 1956, is also qualified to be appointed as auditor of a company.

(1) Disqualifications of auditors

The following persons shall not be qualified for appointment as auditors of a company:

(i) A body corporate.

(ii) An officer or employee of the company.

(iii) A person who is a partner or who is in the employment of any officer or employee of the company.

(iv) A person who is indebted to the company for an amount exceeding Rs. 1,000.

(v) any other body corporate which is:

(a) a subsidiary of that company; or

(b) the holding company of that company; or

(c) a subsidiary of that company's holding company

(vi) Further, if the auditor already holds appointment as auditor in the specified number of companies, he will be disqualified for further appointment as auditor of any other company.

Right to access books of Accounts and Vouchers: The auditor has a right of access at all times to the books and vouchers of the company whether kept at the head office or elsewhere. At all times means at any time during the business hours. The auditor may pay a surprise visit when he suspects any irregularity in the accounts or wishes to verify the cash balances, etc.

(2) Right to receive Information and Explanations: A company auditor has a right to receive from the directors and responsible officers of the company any information or explanation as he may think necessary.

(3) Right to receive Particulars: The auditor has a right to get from an officer or other person any particular or information required to be given to the Balance Sheet or Profit and Loss Account of a company or in any document required to be annexed or attached thereon.

(4) Right to receive notice and attend General Meetings: The auditor has a right to receive notices and other communications relating to general meeting in the same way as a member of the company. He can speak in the meeting in which accounts are discussed.

(5) Right to visit Branches: The auditor has a right to visit the branch office of the company, if any, if the accounts of the company branch have not been audited by a duly qualified auditor.

(6) Right to seek opinion from Experts: The auditor has a right to seek opinions of experts in different fields whenever he feels it necessary as he is not expert in all the areas.

(7) Right to receive remuneration: The auditor is entitled to demand his remuneration from his client after he has completed the work of auditing. Even if he is dismissed in the middle, he has a right to get full remuneration of the year.

Duties of Company Auditor

(1) Duty to Submit Report: It is an important duty of the auditor to make a report to the members of the company on the accounts examined by him. The report should contain the following information:

(i) Whether in his opinion, the Profit and Loss Account referred to in his report shows a true and fair view of the profit or loss.

(ii) Whether in his opinion, the Balance sheet referred to in his report is properly drawn up so as to show a true and fair view of the state of affairs of the business.

(iii) Whether the auditor has obtained all the informations and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.

(iv) Whether in his opinion proper books of accounts as required by law have been kept by the company so far as appear from his examination of those books.

(v) Whether the report on the accounts of any Branch office audited under section 228 by a person other than the Company's auditor has been forwarded to him and how he had dealt with the same in preparing the auditor's report.

(vi) Whether the Company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and return.

(2) Auditors duties to enquire into the affairs of the Company:

Loans and Advances: He has to see whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members.

(ii) Transactions represented merely by book entries: He must see that transactions which are not supported by any facts or evidence, though recorded in the books, are not prejudicial to the interests of the company.

(iii) Sale of investments at less than purchase price: Where the company is not an investment company or a banking company, the auditor is required to see whether it has sold any shares, debentures or other securities at a price which is lower than their price purchase.

(iv) Loans and advances shown as deposits: He has to see whether loans and advances made by the company have not been shown as deposits, so as to avoid scrutiny by the members or others.

(v) Personal expenses: He should enquire whether any personal expenses have been charged to revenue accounts of the company, so as to improperly utilise the funds of the company for the individual benefit of any person directly or indirectly in control of the affairs of the company.

(vi) Allotment of shares for cash: Where it is stated in the books and papers of the company that any shares have been allotted for cash, the auditor must enquire whether cash has actually been received in respect of such allotment, and if no cash has actually been received, whether the position as stated in the account books and the Balance Sheet is correct and regular.

(3) Duty to sign report: It is the duty of the auditor to sign the report prepared by him. In case the auditor is a firm, only a partner of the firm practising in India may sign the report.

(4) Duty as to statutory report: It is the duty of an auditor to certify statutory report as correct to the extent it relates to:

(i) Shares alloted by the company,

(ii) Cash received in respect of such shares and

(iii) Receipts and payments of the company.

(5) Duty as to prospectus: It is the duty of the auditor to certify informations given in the prospectus with regards to certain matters.

(6) Duty as to report under voluntary winding up: If a company goes into voluntary winding up, the directors are required to file a declaration of solvency. Thus, it is the duty of the auditor to give a report about such declaration.

(7) Duty to assist investigation: Where an inspector is appointed to investigate the affairs of the company, it is the duty of the auditor to assist investigator in connection with the investigation.

(8) Duty of care and caution: The auditor holds himself out as an expert and must act honestly and exercise due care and caution in the performance of his engagement. As an expert, he cannot set up ignorance as a defence. He must prove that in the course of his audit he has employed skills that would reasonably be applied by any other auditor.

Appointment of a Company Auditor

Section 224 of the Companies Act deals with the provisions regarding the appointment of auditor(s) of a company as follows:

(1) Appointment of First Auditor by Board of Directors: The first auditors of a company shall be appointed by the Board of Directors within one month of the date of registration of the company. Such auditor(s) shall hold office until the conclusion of the first annual general meeting.

If the first auditors are not appointed by the Board of Directors, they may be appointed by the company in a general meeting.

(2) Appointment by shareholders:

Appointment by shareholders: Every company shall, at each annual general meeting, appoint auditor(s) to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting, and shall, within seven days of the appointment give intimation thereof to every auditor so appointed.

(3) Appointment of Auditors by Central Government: Where an auditor(s) is not appointed or re-appointed at the annual general meeting, the company must notify the fact to the Central Government within seven days thereafter and thereupon the Central Government will appoint a person to fill the vacancy

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

(a) a public financial institution or a Government company, or the Central Government, or any State Government; or

(b) any financial or other institution in which a State Government holds not less than 51% of the subscribed share capital; or

(c) a nationalised bank, or an insurance company carrying on general insurance business.

(4) The appointment or reappointment (at each annual general meeting) of an auditor(s) shall be made by a special resolution.

(5) Appointment of auditors of Government Companies: The auditor of a Government company shall be appointed or reappointed by the comptroller and Auditor General of India only.

Removal of Auditors

(1) **Removal after the Expiry of Term:** After the expiry of term, an auditor can be removed in the annual general meeting by passing an ordinary resolution.

(2) **Removal before Expiry of Term:** An auditor can be removed before expiry of term as follows:

(i) **In Case of First Auditor :** The first auditor who is appointed by the Board of Directors to hold office till the conclusion of the first annual meeting, can be removed before the expiry of term at the general meeting even without the prior approval of the Central Government. However, a special notice of at least 14 days is required for the appointment of another auditor in his place.

(ii) **In case of other Auditors:** Auditor appointed by the members can be removed before the expiry of his term by the company only at a general meeting, after obtaining prior approval of the Central Government and after giving a due notice to the auditor. Remuneration of the Company Auditor

The person or persons who are authorised to appoint an auditor are considered fully competent to fix the auditor's remuneration. It is provided in Section 224 (8) of the Companies Act that:

(i) If an auditor is appointed by the Board of Directors or by the Central Government, his remuneration is to be fixed by the Board or Central Government as the case may be.

(ii) In other cases, the remuneration of the auditor shall be fixed by the company in the annual general meeting or in such a manner as the company in general meeting determine.

(iii) The remuneration is inclusive of all expenses allowed to him and he is not entitled to any other payment.

(iv) In the case of a retiring auditor who is re-appointed as an auditor in the general meeting, the amount fixed for the previous year is considered as the remuneration for the current year unless a resolution is passed, refixing his remuneration.

(v) In case where an auditor renders extra work over and above his audit work, he is entitled to receive extra remuneration in addition to normal fee for the audit.