

Syllabus...

Course Objective

1. To introduce basics of auditing, principles of auditing, types of audits and types of errors and frauds.
2. To enable learners to plan the audit, know the procedures required to conduct an audit and maintenance of required documentation as per SA for audit evidence.

Course Outcome

1. Learners will be able understand the meaning, need and importance of auditing and distinguish between errors and frauds, different types of Audits.
2. Learners will be understand how an auditor should plan an audit, Different types of audit procedures and documentation required as per SA 230.

Modules at a Glance

Sr. No.	Modules	No. of Lectures
1.	Introduction to Auditing	15
2.	Audit Planning, Procedures and Documentation	15
Total		30

Sr. No.	Modules / Units
1.	Introduction to Auditing 15
	● Basics Financial Statements, Users of Financial Information, Definition of Auditing, Objectives of Auditing – Primary and Secondary, Expression of opinion, Detection of Frauds and Errors, Inherent limitations of Audit. ● Errors & Frauds – Concepts, Reasons and Circumstances, Types of Errors – Commission, Omission, Principle and Compensating, Types of Frauds, Risk of Fraud and Error in Audit, Auditor's Duties and Responsibilities in Respect of Fraud. ● Principles of Audit Integrity, Objectivity, Independence, Confidentiality, Skills and Competence, Materiality and Work Performed by Others, Documentation, Planning, Audit Evidence, Accounting System and Internal Control, Audit Conclusions and Reporting. ● Types of Audit Meaning, Advantages, Disadvantages of Balance sheet Audit, Interim Audit, Continuous Audit, Concurrent Audit and Annual Audit, Cost Audit, Green Audit, Gender Audit, Statutory Audit, etc.
2.	Audit Planning, Procedures and Documentation 15
	● Audit Planning Meaning, Objectives, Factors to be considered, Sources of obtaining information, Discussion with Client, Overall Audit Plan. ● Audit Programme Meaning, Factors to be considered, Advantages and Disadvantages, Overcoming Disadvantages, Methods of Work, Instruction before commencing Work of Audit, Overall Audit Approach. ● Audit Working Papers Meaning, Importance, Factors determining Form and Contents, Main Functions / Importance, Features, Contents of Permanent Audit File, Temporary Audit File, Ownership, Custody, Access of Other Parties to Audit Working Papers, Auditors Lien on Working Papers, Auditors Lien on Client's Books. ● Audit Notebook Meaning, Structure, Contents, General Information, Current Information, Importance.

1

INTRODUCTION TO AUDITING

SYNOPSIS

1. Financial Statement
 - 1.1 Users of Financial Statement
2. Definition of Auditing
 - 2.1 Features of Auditing
3. Difference between Book-Keeping, Accountancy and Auditing
 - 3.1 Book-Keeping
 - 3.2 Accountancy
 - 3.3 Auditing
 - 3.4 Investigation
 - 3.5 Distinction between Book-Keeping and Auditing
 - 3.6 Distinction between Accounting and Auditing
 - 3.7 Distinction between Auditing and Investigation
4. Objects of Auditing
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 - 4.2 Secondary Objects
 - 4.3 Specific Object
5. Detection and Prevention of Fraud
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 - 5.2 Fraud Through Defalcation
 - 5.3 Fraud Through Manipulation of Accounts, i.e. Window Dressing
 - 5.4 Fraud Through Creation of Secret Reserve
6. Circumstances Causing Suspicion
7. Procedure to Detect Errors
8. Duties Regarding Fraud
9. Circumstances Indicating Errors and Frauds
10. Responsibilities of Auditors for Errors and Frauds
11. Advantages of Audit
12. Inherent Limitations of Audit
13. Auditing Principles
14. Auditing Concept
 - 14.1 Materiality Concept
 - 14.2 Going Concern Concept
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15. Objective Questions

1. FINANCIAL STATEMENTS

Financial statements also called as 'financial reports' are balances of different accounts arranged in an effective meaningful order called the Balance Sheet and the Profit and Loss Account (Income statement) so that the information contained therein can be easily understood, readily interpreted, and used as bases for business decisions by the users of accounting information.

The term 'financial statements, as used in modern accounting refers to two statements. These statements are the position statements reflecting the assets Liabilities and

Capital of a business entity on a particular date called the Balance Sheet and the other called the Profit and Loss A/c showing the results of business operations during a given period. Some times Profit and Loss A/c may also include a separate section to show appropriations of profit.

Financial statements often referred to as the package of financial statements which are supported by various schedules annexures and footnotes. These supporting schedules and annexures, are considered very much a part of the financial statements. They are prepared for the purpose of presenting a periodic review on the progress by the management.

Nature and purpose of Financial Statements

1. **Balance sheet** : It shows financial position of the organization on a particular date.
2. **Statement of Profit & Loss** : It shows profit earned or loss incurred.
3. **Cash Flow** : It shows movement of cash during the year.
4. **Notes to Accounts** : Notes are in the nature of explanatory information contained in the financial statements.
5. **Accounting Standards** : Accounting standards are applicable to all financial statements.

Q. 1 What is the nature and purpose of financial statements?

1.1 Users of Financial Statement

Financial statements satisfy the information requirements of a wide cross-section of the society representing corporate managers, executives, bankers, creditors, shareholders, investors, labourers, consumers and government institutions.

1. Executive

Financial statements provide sufficient accounting information to the executives and managers to enable them to decide on important issues facing them. The common issues facing corporate managers to-day, like efficient capital utilisation, maintaining the profitability through cost control, dividend paying capacity of the company and observing credit standards, can be tackled effectively, if the executives have a proper understanding of analysis of the financial statements.

2. Bankers

Bankers take precautions before advancing loans to their constituents. Every banker, before sanctioning credit, wishes to be assured on the borrower's ability to repay the loans when they become due; to ascertain the company's ability to pay interest charges on loan on their respective due dates. Therefore, they scrutinise and study the financial statements in depth and analyse them to ascertain the borrower's liquidity, solvency, profitability (present and future) of his business and his financial strength.

3. Trade Creditors

Credit facilitates mass distribution of goods produced but a manufacturer or a wholesaler would not provide credit facilities indiscreetly to every one. Before opening an account of the trader concerned, the manufacturer or the wholesaler studies the financial statements of the trader, supplemented by various trade and bank references, to ascertain his creditworthiness. These information could be obtained from the financial statements.

4. Shareholders and Prospective Investors

Shareholders, who have permanent interest in the life and operations of the company, are ever desirous of knowing about their company's year to year financial strength, profitability, solvency and liquidity trends. These shareholders are particularly interested in the future of the company. The financial statements provide the share-holders all the information they require. What is said for the shareholders holds equally good for the prospective investors.

5. Labourers

Labourers contribute to the earnings of the company and they are the people who work on raw materials with the aid of capital goods to produce wealth. They are also interested i.e. the working of the company as they are primarily interested in their wages and salaries, bonus and working conditions. As far as bonus, working conditions and other incentives are concerned, they largely depend on the company's profitability and liquidity. The labourers are also interested in the continuity of the business as a 'going concern' as it only ensures their permanent employment.

6. Consumers and Society

Consumers attempt to find out whether they are being exploited by the producers. Society is interested in an enterprise's performance since it is the cumulative effect of the performance of all enterprises that result in the increase of employment opportunities, wealth and standard of living of the people. They are also concerned about the enterprise's contribution to social welfare, environment and national wealth and prestige. Study of financial statements enables the consumers and the society to gain knowledge on these matters.

Q. 2 Who are the users of financial statements?

2. DEFINITION OF AUDITING

The term 'Auditing' has been defined by different authorities as follows :

1. **The Spicer and Pegler** have defined an audit as "such an examination of the books, accounts and vouchers of a business, as shall enable the auditor to satisfy himself or not whether the balance sheet is properly drawn up, so as to give a true and correct view of the state of affairs of the business, according to the best of his information and explanation given to him and as shown by the books; and if not, in what respect it is untrue or incorrect".
2. **L. R. Dicksee** defines an audit as "an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they purport to relate". But this is not the end of the matter, in addition the auditor also expresses his opinion on the character of the statements of accounts prepared from the accounting records so examined whether they portray a true and fair picture".
3. **According to Montgomery**, "Auditing is a systematic examination of the books and records of a business or other organisation, in order to ascertain or verify, and to report upon the facts regarding the financial operations and results thereof".
4. **A.W. Hanson** defined auditing as, "an audit is an examination of such records to establish their reliability and the reliability of statements drawn from them".
5. The book "An Introduction to Indian Government Accounts and Audit" issued by the Controller and Auditor General of India, defines audit, "an instrument of financial control. It acts as a safeguard on behalf of the proprietor (whether an individual or a group of persons) against extravagance, carelessness or fraud on the part of the proprietor's agents or servants in the realisation and utilisation of his money or other assets and it ensures on the proprietor's behalf that the accounts maintained truly represent facts and that expenditure has been incurred with due regularity and propriety. The agency employed for this purpose is called an auditor.
6. International Auditing Guidelines "Auditing is an independent examination of financial information of any entity with a view to expressing an opinion thereon."
7. **Auditing Standard SA 200 by ICAI**

Auditing is the independent examination of financial information of any entity whether profit oriented or not / and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

Auditing is a Systematic and Independent examination of data, statements, records, operations and performance (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognises the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgement which is communicated through his report..., ICAI.

Q. 3. Define Auditing.

2.1 Features of Auditing

Analysis of the above definitions brings out the following features of auditing:

1. **Systematic** : The audit should be systematically planned. It is a scientific examination of records of an organization.
2. **Independent** : The auditor while forming his opinion should not be susceptible to any influence from the clients or pressure from the clients.
3. **Data statements, records operations & performance** : Audit extends from examination of records to review of operations and performance connected with nonfinancial area also.
4. **Purpose** : The audit process should be designed as per the stated purpose.
5. **Clear idea about propositions** : The auditor should have a clear idea about the proposition he is examining. He must know what he has to prove stated purpose may be broader than propositions.
6. **Collects evidence** : The auditor has to collect evidence and evaluate it on the basis of his professional knowledge. Evidence consists of books of accounts, tax returns, direct confirmations records etc.
7. **Formulates Judgements** : After examination of records, the auditor has to formulate his judgement and communicate it to the shareholders through audit report, Format of audit report depends on the statutory requirements.

Q. 4. What are the features of Auditing?

3. DIFFERENCE BETWEEN BOOK-KEEPING, ACCOUNTANCY AND AUDITING

3.1 Book-Keeping

Book-keeping means recording the transactions in the books of original entry and ledgers. This is an elementary work, generally performed by the junior staff who may be known as the accounts clerks or 'book-keepers'. It is a mechanical work and may be performed by persons not having specialised knowledge of accountancy. "Accountancy begins where Book Keeping ends."

3.2 Accountancy

It is the job of an "accountant". It involves preparation of final statements of accounts, viz. balance sheet and profit and loss account to show the state of affairs of the business and the profit or loss for an accounting period. The work of an accountant is to prepare the final accounts, and then analyse, review and draw conclusions there from. It is a work of specialised knowledge of the principles of accountancy. An accountant also has to supervise the work done by the book-keepers.

"Where accountancy ends, auditing begins".

3.3 Auditing

As discussed in the earlier paragraphs, auditing is the examination of accounts, to find out their accuracy. It is undertaken to verify whether or not the final accounts prepared by an accountant give a true and fair view of the state of affairs of the business and also of the profit or loss for the accounting period.

3.4 Investigation

Investigation implies systematic, critical and special examination of the records of a business for a specific purpose.

The Central Government can order investigation

- On receipt of report of the registrar or inspector U/S 208 of the companies Act 2013;
- On intimation of a special resolution passed by a company that the affairs of the company ought to be investigated;
- in public interest;
- where an order is passed by a court or the Tribunal in any proceeding before it that the affairs of a company brought to be investigated

3.5 Distinction between Book-Keeping and Auditing

Point of Difference	Book-Keeping	Auditing
1. Nature	It includes actual recording of transactions.	It is analytical in nature. It is relating to verification of accounting records.
2. Commencement	It starts when business transactions take place.	It starts when accounts writing is over.
3. Object	The object is to record all the facts of business.	The object is to certify correctness of financial statements.
4. Qualifications	No formal qualifications are required for a book-keeper.	Formal qualifications must be possessed by an auditor.
5. Reporting	A Book-keeper is not required to submit a report unless specially called for.	An auditor has to submit a report to the concerned authority.
6. Status	A Book-keeper is an employee of an organisation.	An auditor is not an employee of an organisation.
7. Scope	Recording of all the facts of business are necessary for the purpose.	It is decided by the agreement or by the law.

Q. 5. Distinguish between Book-Keeping and Auditing.

3.6 Distinction between Accounting and Auditing

Point of Difference	Accounting	Auditing
1. Meaning	It is recording of all the day to day transactions in the books of accounts leading to preparation of financial statements.	It is critical examination of the transactions recorded in the books of accounts.
2. Nature	It is concerned with finalisation of final accounts.	It is concerned with establishment of reliability of financial statements.
3. Objects	The object is to ascertain the trading results.	The object is to certify the correctness of financial statements.
4. Commencement	Accounting begins when book-keeping ends.	Auditing begins when accounting ends.
5. Scope	It involves various financial statements. It involves maintenance of books of accounts. It does not go beyond books of accounts.	It depends upon the agreement or upon the provisions of law. It goes beyond books of accounts.
6. Qualifications	An accountant needs no formal qualifications.	An auditor needs prescribed qualifications.
7. Reporting	An accountant does not submit any report.	An auditor has to submit report in the prescribed form.
8. Status	An accountant is an employee of an organisation.	An auditor is not an employee of an organisation.

9. Errors and Frauds	Accountant may commit errors and frauds.	Auditor cannot afford to commit errors and frauds.
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Q. 6. Distinguish between Accounting and Auditing.

3.7 Distinction between Auditing and Investigation

Point of Difference	Auditing	Investigation
1. Object	The object is to find out whether Balance Sheet and Profit and Loss Account exhibit a true and fair view of business.	It is undertaken to know the essential facts about a matter under enquiry. It is done with some special purpose of view.
2. Period	It is carried quarterly or half yearly or yearly.	It is not limited to rigid time frame
3. Conducted	It is conducted for proprietors only.	It is carried out on behalf of any party interested in the matter.
4. Scope	The scope is wide, it is determined by the Act.	It may be governed by the statute.
5. Compulsion	Audit is legally compulsory for companies.	It is voluntary. It is required under certain circumstances.
6. Time	It may be conducted at the end of the year.	It may be conducted at any time in case of suspicion about any transaction.
7. Report	Form of report is prescribed. It is presented to the share-holders.	Form of report is not prescribed. It is presented to the person on whose behalf conducted.
8. Appointment	Owners appoint the auditors.	Even third parties can appoint investigators. Central Govt. can appoint investigator.
9. Qualifications	The statutory auditor must possess proper qualifications.	Even an employee preferably a chartered accountant may be appointed as investigator.
10. Rework	Reaudit is not generally undertaken.	Reinvestigation may be undertaken.
11. Nature	It involves test checking to collect evidence for forming a judgement.	It involves detailed study and examination of facts and figures.
12. Evidence	It is concerned with prima facie evidence.	It seeks conclusive evidence.
13. Limitations	Audit suffers from inherent limitations.	It does not suffer from inherent limitations due to the nature of engagement.
14. Accounting principles	It is to comply with accounting principles audit procedure and disclosure requirements.	It is analytical in nature. It requires thorough mind capable of observing, collecting and evaluating facts.

Q.7. Distinguish between Auditing and Investigation.

4. OBJECTS OF AUDITING

As it has been already pointed out that the main object of audit is to find out whether the financial statements are properly drawn or not and whether they exhibit a true and fair view of the state of affairs of the company. This is possible only when all the accounts are properly verified. He has to detect errors and frauds while performing his duty. Objects of audit are illustrated as given in the following chart :

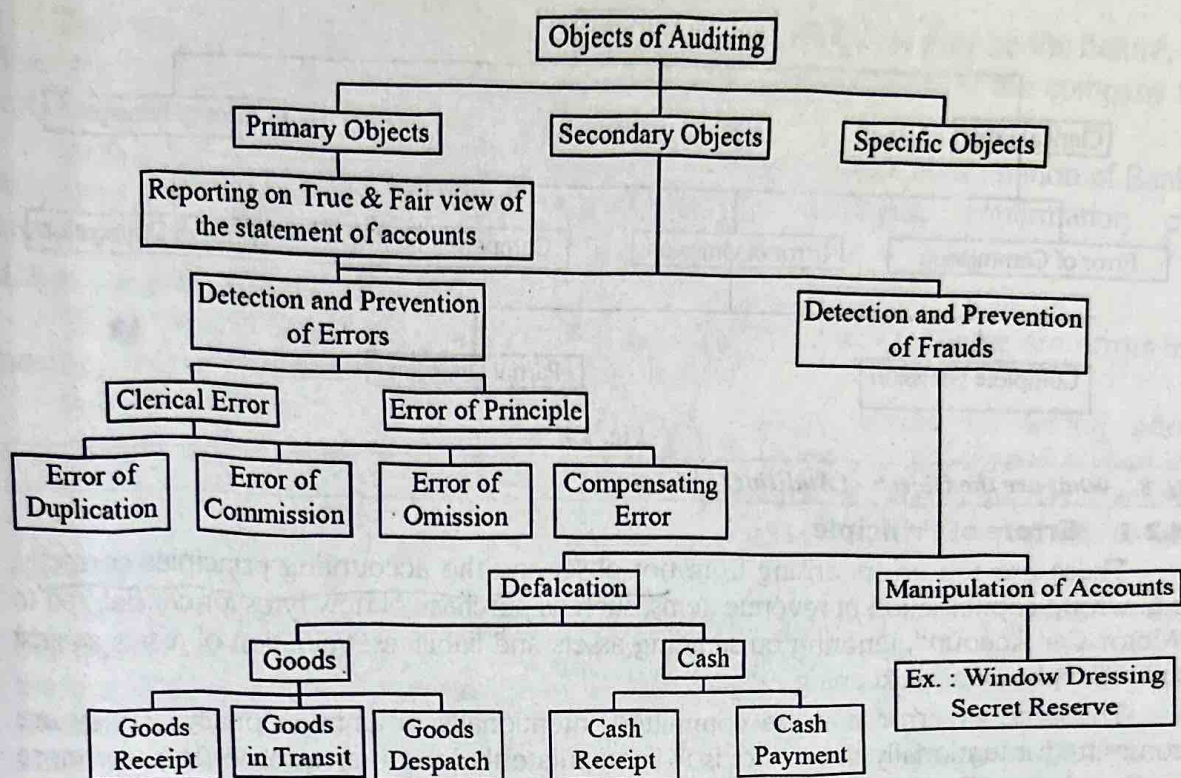


Fig. 1.1

4.1 Primary Objects (Basic Object)

Expression of Opinion

SA 200 states that, "Auditing is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form when such examination is conducted with a view to expressing an opinion thereon." The object is to enable the auditor to **express an opinion on financial statements**.

The main object of an audit is to ascertain that the Balance sheet and Profit and Loss Account of an undertaking do show true and fair view of the financial position and earnings. Auditor's main duty is to report on accounts examined by him. He has to check the books of accounts, documents, vouchers etc., to enable him to express his expert opinion through his audit report as to whether or not he is satisfied with the adequacy and reliability of such accounts.

The auditor has to report whether or not the accounts audited by him give a true and fair view of the state of affairs of the business and also of the profit or loss of the business. If he is not satisfied with the accounts examined by him, he has to report the same in his audit report. Audit cannot be said to be complete unless the auditor gives his report on the accounts examined by him.

4.2 Secondary Objects (Incidental Object)

Detection and prevention of accounting errors and frauds

Another incidental object of an audit is detection of accounting errors. Auditor should carefully check the transactions, so that if there are any accounting errors, they can be detected. There are different types of errors which may be committed at various stages of accounting. The types of errors and their detection is discussed later.

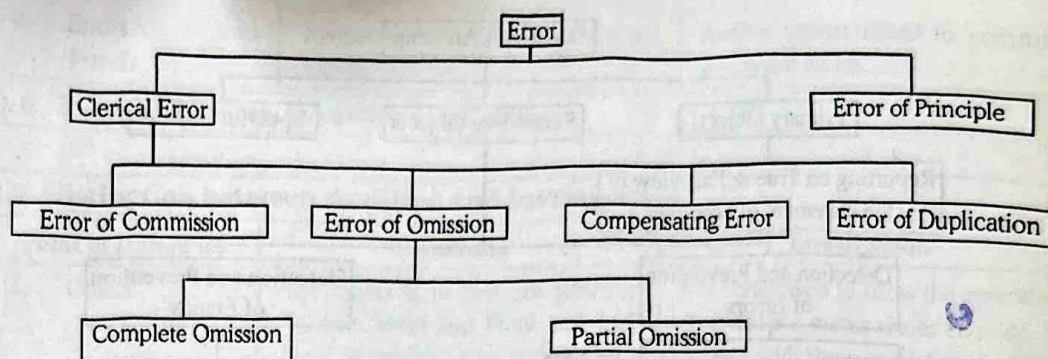


Fig. 1.2

Q. 8. What are the Objects of Auditing?

4.2.1 Errors of Principle

These are the errors arising from not observing the accounting principles correctly, e.g. wrong capitalisation of revenue items, such as purchase of new tyres for car debited to 'Motor Car Account', ignoring outstanding assets and liabilities, valuation of assets against the principles of book keeping.

This type of error may be committed intentionally or unintentionally. If they are committed intentionally the object is to manipulate the accounts in order to show more profit or less profit. Hence the auditor has to be very careful about this type of error.

Examples of such errors are :

1. Over-valuation or under valuation of stock.
2. Inadequate provision for depreciation.
3. Omission of provision for depreciation.
4. Treatment of capital expenditure as revenue expenditure or vice versa.
5. Inadequate provision for bad and doubtful debts.
6. Wrong adjustment about prepaid and outstanding expenses etc.

This type of error does not disturb the trial balance, i.e. the trial balance will tally even after existence of such errors. The auditor has to be very careful while examining the accounts so that such errors may be detected.

4.2.2 Clerical Errors

These are human errors arising in the course of recording the transactions. These types of errors can be further subdivided into four, viz. (1) error of duplication, (2) Errors of omission, (3) Errors of commission and (4) compensating errors.

4.2.2 : 1 Error of Duplication

In the type of error, the transaction is recorded twice. It is duplicated. The transaction may be recorded double or the posting may be done twice. For example purchase of goods ₹ 50,000 recorded twice or posting to supplier's A/c may be done twice.

4.2.2 : 2 Errors of Omission

This is an error of omission of recording a transaction in the books of accounts. An omission may either be complete or partial. There is said to be a complete omission when the transaction is not recorded at all in the books of accounts, e.g. A purchase transaction not recorded at all.

Complete omission does not affect the agreement of a trial balance and only with proper care and caution, can such errors be detected by the auditor. When the transactions are partly omitted, i.e. one aspect is recorded and the other omitted, it is a partial omission which affects the trial balance. Such errors are comparatively easier to detect.

This type of error may be intentional or unintentional. Whatever may be the nature, it does affect profit/loss and assets and liabilities. Thus the state of affairs of the company is not disclosed correctly due to this type of error.

Such errors can be detected only through Bank Reconciliation, confirmation of Bank Accounts, Vouching, Scrutiny of Creditors/debtors Accounts, confirmation of creditors/debtors balances etc.

4.2.3 Errors of Commission

This is an error of recording a transaction wrongly in the books. These are errors in posting, casting, carry forward or taking out balances etc.

Posting errors may be of a wrong account, wrong amount or wrong side. e.g. amount received from X credited to Y's account, Purchase of ₹ 360 from A posted in his account as ₹ 630 or sales returns from M posted as the debit of his account etc. The first type of error will not affect the trial balance, however, the other two will affect the agreement of trial balance.

Casting errors are the errors committed while taking the totals. Such errors affect the trial balance. Errors in carrying forward and errors in taking out the balances also affect the trial balance. While totaling sales Journal one invoice of ₹ 10,000 taken as ₹ 1,00,000 Error of duplication is another type of error of commission which means recording the same transaction twice in the original books of entry and also posting it to the ledgers. Such errors do not affect the agreement of a trial balance.

However, the trial balance cannot be corrected unless the errors are rectified. Examples of this type of errors are as follows :

1. Entering wrong amount in the books of accounts.
2. Entering the transaction in the wrong book such as, recording purchases in Return Book, sales in purchase Book, sales Return in Purchase Return Book etc.

4.2.4 Compensating Errors

Whenever one error exists and another error takes place as a result of which the effect of the previous error is counter balanced, i.e. set off, there is said to be a compensating error. e.g. If the sales account total is undercast by ₹ 1,000 and the purchases account total is also undercast by the same amount, there is a compensating error. Purchase from a creditor Mr. X ₹ 25,000 posted to X A/c ₹ 5,000 and another purchase of ₹ 5,000 is posted to X A/c as ₹ 25,000. It is a compensating error. The existence of compensating errors does not disturb the trial balance and hence the auditor should use all his skill to detect such errors.

R. K. Mautz has classified the errors as follows :

1. Self revealing errors
2. Non self revealing errors
3. Unintentional errors
4. Intentional errors
5. Unconcealed errors
6. Concealed errors
7. Procedural errors

Q. 9. What are the different types of errors?

Distinction between Error and Fraud

Point of distinction	Error	Fraud
1. Meaning	It is an unintentional mistake in presentation of financial information	It is an intentional mistake in presentation of financial information

2. Intention	It is unintentional. An error is committed though ignorance	It is committed with an intention to derive some personal gain. It is deliberate.
3. Effect on audit work	The auditor should adjust financial statements for errors detected	The auditor should consider its effect on financial statements and decide whether to withdraw from engagement.
4. Detection	There is a more possibility of detection	There is a less possibility of detection as it is deliberately concealed. It can be detected by diligence and due care by the auditor.
5. Example	Error of Principle, Error of omission, Error of commission, error of duplication.	Defalcation of goods and cash

Q. 10. Distinguish between Errors and Fraud.

4.3 Specific Object

Audit does not imply financial audit alone. It may include such areas like review of operations, performance, cost record, and so on. Accordingly, there will be specific objective in respect of each type of such specific audit. For example, in cost audit an attempt is made to control cost. In operational audit, an attempt is made to evaluate the existing operations of the organisation.

5. DETECTION AND PREVENTION OF FRAUD

5.1 Fraud

Fraud means the willful misrepresentation made with an intention of deceiving others. It is a deliberate mistake committed in the accounts with a view to get personal gain. Management charged with governance, employees or third parties may get involved in committing frauds to obtain an illegal advantage or personal gain. Fraud may be either misappropriation of assets that may be called employee fraud or manipulation of accounts that is referred to as management fraud.

5.2 Types of frauds

Frauds may be of the following types :

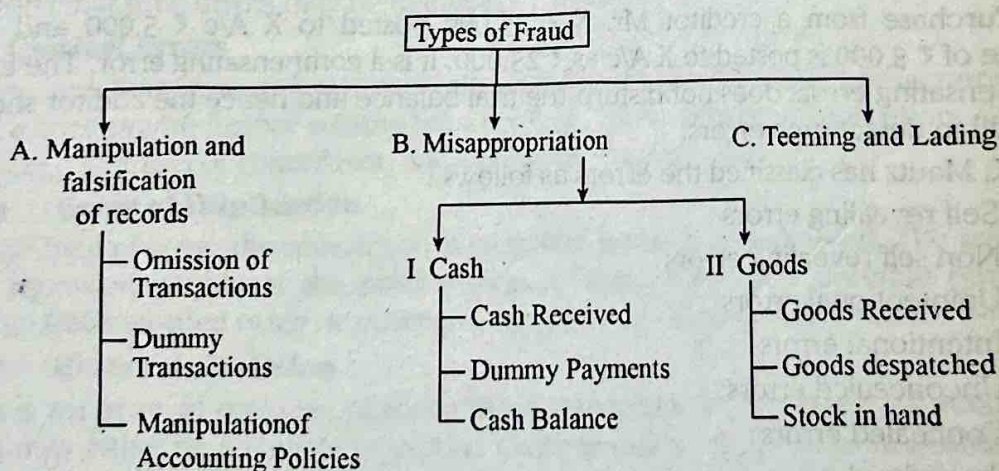


Fig.1.3

A. Manipulation, falsification of records

Records may be manipulated or falsified in the following manner

a) Omission of transactions

The accountant may omit some transactions and commit frauds. For example, sale of goods to Mr X ₹ 25,000 is not recorded in the books of accounts.

b) Recording Dummy Transactions

Records may be manipulated by recording Dummy transactions. For example consignment sale may be recorded as actual sales and recorded in the sales Journal.

c) Manipulation of Accounting Policies

The accounting policies may be manipulated. For example income due but not received may be shown as advance recorded intentionally. In this case error of principle is intentionally committed.

B. Misappropriation**I. Misappropriation of Cash received**

Cash received may be misappropriated in the following manner :

a) Not recording Cash received

Such type of fraud may be committed in case of cash sales, sale of scrap, sale of assets etc. Cash received on these accounts may not be recorded in the books of accounts and such cash received but not recorded may be pocketed.

b) Recording dummy payments or fake expenses

In this case expenses though not actually incurred may be recorded and the cash may be pocketed. For example dummy workers may be shown on the muster and their wages and salaries may be shown and pocketed

c) Cash Balance

The cash balance may be stolen or embezzled out of the cash lying in the cash box.

II. Misappropriation of Goods

Goods may be misappropriated in the following manner :

a) Goods Received

The goods received may not be recorded in the books of accounts and such goods may be misappropriated. The fraud takes place because of weak control over purchases and stock.

b) Goods Despatched

Goods may be misappropriated out of the goods despatched and such goods may be misappropriated

c) Stock in hand

Goods may be stolen from actual stock lying in the stores.

C. Teeming and Lading

This technique is used to use business cash for personal use for some time. For example Cash received from Mr X is not recorded in the books. It is not credited to Mr X A/c. when cash is received from Mr Y it is not credited to Mr y's A/c but credited to Mr. X A/c. when cash is received from Mr Z it is not credited to Mr Z's A/c but it is credited to Mr Y's A/c. Due to such mechanism, the accountant can use cash for personal purpose for some time till the fraud is detected. This is also called as delayed accounting of cash received intentionally. For detection of such fraud the auditor has to find out internal check system about cash receipt. If internal check is weak the fraud can be easily committed. The auditor should check the Bank Reconciliation statement properly to detect this fraud. The auditor should see that the days cash receipts and cheques are deposited into Bank on the same day or the next day. The internal check system should be designed in such a manner that the cashier has no access to the ledger.

Q. 11. What are the types of frauds?

5.3 Fraud through manipulation of accounts, i.e. Window Dressing

It implies presentation of accounts more favourably than what they actually are. Window dressing means 'showing wrong picture. The fraud through manipulation of

accounts is also known as window dressing because accounts are manipulated to show a wrong picture of the profit or loss of the business and its financial state of affairs. Generally, this type of a fraud is committed by the people at the top management level. It does not involve any misappropriation of cash or goods but it is either overstatement of profit or under-statement of the same. Such fraud is committed with certain objective, and is relatively difficult to detect.

Q. 12. What do you mean by Window Dressing?

Objects of Window Dressing

Window dressing is done with a view to achieve the following objectives :

1. To show more profit to facilitate payment of more remuneration to managerial personnel.
2. To attract more loans, credit etc. from banks and financial institutions.
3. To attract more response from public for issue of shares.
4. To attract favourable terms from creditors, lenders and financial institutions.
5. To have overvaluation of goodwill at the time of admission of a new partner.
6. To avoid incidence of tax.
7. To declare dividend when there are insufficient profits.
8. To attract potential investors for subscribing to public issue.

Q. 13. What are the objects of Window Dressing?

Arguments against window dressing

1. No true and fair view

Financial Statements do not disclose true and fair view of the state of affairs of a company due to window dressing.

2. Loss to shareholders

Shareholders do not get a correct picture about the value of investments. Dividend may be paid out of capital.

3. Paper prosperity

Window dressing shows paper prosperity. Inefficiency of the management is hidden by window dressing.

4. Withdrawal of profits

The management may withdraw the profits from business for personal use.

5. Against the law

Window dressing is against the provisions of schedule VI of the Companies Act; 1956. This, may attract legal action against the officers who are responsible.

Auditor's duties as regards window dressing :

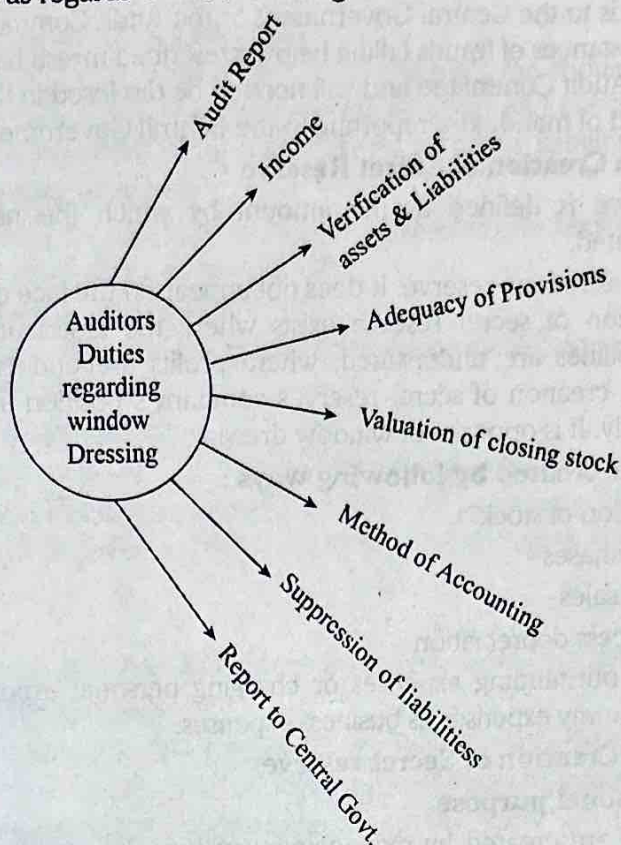


Fig.1.4

1. Audit Report

It is the duty of the auditor U/s 143 (2) of the Companies Act 2013 to report whether there is any window dressing. It is the duty of the auditor to prevent window dressing.

2. Income

The auditor should verify whether income has been properly recorded and reported.

3. Verification of assets and liabilities

The auditor should verify the valuation of assets and liabilities disclosed in the Balance Sheet. He should ensure that actual liability is not shown as a contingent liability.

4. Adequacy of Provisions

The auditor should see that adequate provision is made for any liability.

5. Valuation of Closing Stock

The auditor should see that there is no change in the basis of valuation of closing stock. If there is any change, its effect on profit should be disclosed separately. The auditor should ensure that stocks are valued only as per approved methods of valuation as per Accounting Standard.

6. Method of accounting

The auditor should see that there is no change in the method of accounting. Information about any change should be disclosed.

7. Suppression of liabilities

The auditor should see that no liabilities are suppressed from the books of accounts.

8. Report to central Government

Vide section 143 (12) of the companies Act, 2013, the auditor has to report to the Central Govt. if he has reason to believe that a fraud has been committed against the company by any officer or employee of the company.

"The companies Amendment Act 2015 has provided that thresholds will be prescribed for reporting of frauds to the Central Government or the Audit Committee or the Board of directors. All such instances of frauds falling below prescribed thresholds will be reported to the Board or the Audit Committee and will need to be disclosed in the Annual Report of the company, instead of mandatory reporting to the Central Government."

5.4 Fraud through Creation of Secret Reserve

A Secret reserve is defined as the amount by which the net worth has been deliberately understated.

- Eric Kohler

It is also known as hidden reserve. It does not appear on the face of the balance sheet. Conditions of creation of secret reserve exists where the assets are not recorded or undervalued or liabilities are understated, where profits are understated or losses are overstated. Through creation of secret reserves company's position appears to be worse than what it is actually. It is opposite of window dressing.

Secret Reserves are created by following ways :

1. Undervaluation of stock
2. Inflating Purchases
3. Suppressing sales
4. Charging excess depreciation
5. Overstating outstanding expenses or charging personal expenses to business or including dummy expenses as business expenses.

Objectives behind Creation of Secret reserve

1. To use for personal purpose

Secret Reserves are created by management with an intention to use the funds for their personal use.

2. To misguide competitors

Any company may be interested in hiding its actual earning to misguide its competitors.

3. To hide abnormal profits

Companies may sometime earn high (abnormal) profits. Companies may intend not to disclose it because it is possible that such profit may not be earned in future. Thus, such profits are transferred to Secret Reserve to set off losses.

Objections against Secret Reserve

1. No true and fair view of financial statements

Creation of Secret reserves does not allow statement of profit and loss to state true profit nor it allows Balance Sheet to represent actual position. Thus, true and fair view is not revealed in front of shareholders.

2. Shareholders are at a loss because they do not receive their returns on investment i.e. dividend in time.

3. Management may take undue advantage of secret reserve by taking away excess funds.

4. By Creating Secret reserve management hides its inefficiency. It can use past secret reserves to cover losses of current year.

5. No insurance claim

In case of loss of hidden assets, the company would not get full compensation from the insurance company.

6. Against Law

Creation of secret reserve is against the provisions of the Companies Act; 2013.

Duty of Auditor regarding Secret Reserve

1. Check assets and liabilities properly

The auditor should check asset register and vouchers. He should check valuation of all assets. He should also undertake verification of liabilities and check their valuation. He should make sure that no contingent liability is shown as actual liability.

2. Check income and expenses

The auditor should see to it that all incomes are properly booked and expenses are properly charged to statement of profit and loss.

3. Check closing stock valuation

The auditor should check valuation of closing stock. He should ensure that there is no change in valuation method.

4. Disclosure in audit report

The auditor has to issue audit report on his findings. He has to report to the shareholders as to whether the accounts give true and fair view of the financial position of the company. Thus, if the auditor comes across any secret reserve it is his duty to report it in his Audit Report.

5. Check A/A

The auditor should study the A/A and verify the provisions regarding reserves.

6. Verification of provisions

The Auditor should examine whether the provision for any liability is in excess of the reasonable amount. The excess provision should be disclosed as a reserve.

7. Change in the method of Accounting

Any change in the method of accounting and its impact on profit should be disclosed.

8. No omission of assets

The Auditor should see that none of the assets fixed as well as current has been omitted from the books of accounts.

9. Disclosure of Bad Debts

The Auditor should see that bad debts written off during the year is disclosed in the annual accounts of the organisation.

10. Report to Central Government

Vide section 143(12) of the Companies Act 2013, the Auditor should report to the central Government any fraud committed by the employees of the company.

Q. 14. What are the duties of Auditor regarding Secret Reserve?

6. CIRCUMSTANCES CAUSING SUSPICION

The auditor can suspect fraud under the following circumstances :

1. When vouchers, invoices, cheques, contracts etc. are missing.
2. When control accounts do not agree with subsidiary books.
3. When the difference in trial balance is difficult to locate.
4. When there are greater fluctuations in G.P. and N.P. ratios.
5. When there is a difference between the book balance and the confirmation of the balance by the parties.
6. When there is a difference between the stock as per records and the stock physically counted.
7. When the explanation given by the client is not satisfactory.
8. When there is over-writing of some figures.
9. When there is a contradiction in the explanation given by different parties.

Q. 15. Under what circumstances a suspicion is created about fraud?

7. PROCEDURE TO DETECT ERRORS

The auditor should locate the errors though it is not his duty to do so. The auditor may be required to detect the errors on failure of the officials of a business. Following procedure 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 totals of 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 it sure that all the accounts from the ledger are taken into account.
7. Verify totals 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 of such amount is entered wrongly.
10. Check differences involving round figures as ₹ 1,000; ₹ 100.
11. See where there is misplacement or transposition of figures i.e. 45 for 54 or 81 for 18 etc.
12. Ultimately careful scrutiny is the only remedy for detection of errors.
13. See that no entry of the original book has remained unposted.

In spite of this some errors may remain for which a detailed inspection and examination of the books should be done.

The auditor should be more careful and particularly watchful in respect of errors of principle and frauds. He should not be unduly suspicious nor should always adopt an attitude of mistrust. He should constantly keep in mind the possibilities of errors and frauds and proceed with his eyes open and be alert. It was rightly remarked by the learned judge in the Kingston Cotton Mills Co. case that an auditor was a watch dog and not a blood hound. He should keep a careful watch on the transactions, that does not mean that he should adopt an attitude of distrust.

Q. 16. What steps should be taken by the auditor to detect errors?

8. DUTIES REGARDING FRAUD

The auditor should perform the following duties in detection of frauds :

1. Verify receipts

The auditor should verify the receipts with the help of counterfoil or carbon copies.

2. Examine salary and wage Register

Examine thoroughly salary and wage Register and find out whether there is any ghost worker.

3. Compute Ratios

Compute certain ratios and find out whether there is any fraudulent manipulation of accounts.

4. Unusual items

The auditor should examine any unusual items. In case of any suspicion it should be investigated in detail.

5. Disclosure in Audit Report

The auditor has to report whether accounts exhibit true and fair view of the state of affairs and profitability. Fraud, if any should be reported.

6. Reporting to Central Government

If there is any fraud committed by the employees of the company it should be reported to the Central Government as required by sec. 143(12) of the companies

Act 2013. As per CARO 2020, the auditor has to report whether any fraud is noticed during the year. If yes, the nature and amount involved is to be indicated.

7. Reporting whistle blower complaints

Whether any whistle blower complaints are received during the year by the company and whether the auditor has considered it.

8. Verification of A/A

The auditor should examine the A/A and keep in mind the provisions.

9. Change of method of Accounting

Verify whether there is a change in the method of accounting and disclose in the report effect of change on profit.

10. Verification of provisions

The auditor should examine the provision for any liability and see that it is reasonable. In case there is any excess provision, it should be reported.

11. Omission of Assets and Liabilities

The auditor should ensure that no asset or liability is omitted from the records of the company.

12. Disclosure of Bad debts

The auditor should see that any bad debts written off during the year should be disclosed in the annual accounts. It should not be concealed.

13. Verify stock

The auditor should verify the Stock Register and see the basis of valuation. Any change in the method of valuation should be reported.

Q. 17. What are the duties of an auditor in respect of fraud?

(March 2017)

9. CIRCUMSTANCES INDICATING ERRORS AND FRAUDS

The following signals indicate that there may be errors or frauds:

1. Domination by one person or a small group of persons.
2. Absence of internal control and internal check.
3. Higher rate of turnover in respect of employees of accounts department.
4. Under staffing of accounts department.
5. Change in the auditors and lawyers of the company.
6. Inadequacy of working capital.
7. Granting liberal credit to customers inspite of risk of bad debts.
8. Investing in a product which is subject to obsolescence.
9. Heavy dependence on a few products or customers.
10. Transactions near the year and affecting profit.
11. Transactions with associate or relatives.
12. Excessive payment for services
13. Incomplete records
14. Non availability of vouchers or not properly authorised vouchers.
15. Absence of confirmation from parties and reconciliations in quantities.
16. Absence of explanation from management.
17. Cases of large and frequent payments to particular vendors.

Q. 18. What are the circumstances which indicate errors or frauds?

10. RESPONSIBILITIES OF AUDITORS FOR ERRORS AND FRAUDS

SA 240 issued by ICAI spells out the responsibility of an auditor regarding errors and frauds.

Auditor's duty regarding detection and prevention of fraud is laid down by various legal decisions and professional pronouncements.

The perception regarding auditor's duty in detection and prevention of fraud has undergone various changes in the last century. Initially it was based on the decision given in Kingston Cotton Mills Co. Case (1896). The judge summed up that "Auditor is a watch dog, not a blood hound. The auditor should play the role of a watchdog on behalf of the shareholders and protect their interest. His duty is verification and not detection. If he discovers something suspicious during the course of audit, he should probe the matter. He has a duty of "reasonable" care only.

The decision in Westminster Road Construction and Engineering Co. (1932) emphasised adoption of a procedure for confirmation of the facts stated by the management. It has widened the scope of auditor's duty.

In recent years the scope has been further extended to include auditor's duty in such cases where third parties negligence is proved. More recently the decision in Caparo (1990) upheld the principle of auditor's duty towards third parties for detection and prevention of frauds.

Professional perspective

SA 240 expanded guidance an auditor's responsibility for identifying and reporting on fraud and error.

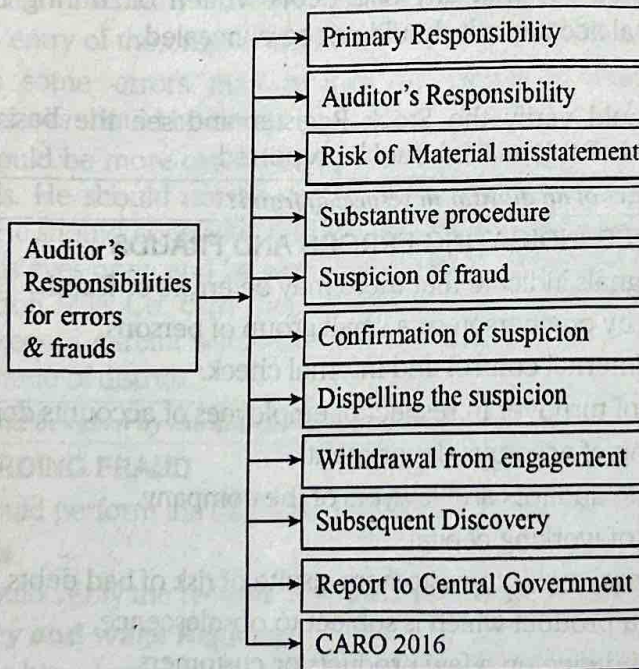


Fig. 1.5

1. Primary responsibility

The primary responsibility about frauds and errors is of those who are charged with governance and the management of the entity.

2. Auditor's responsibility

The auditor should conduct audit to provide reasonable assurance that there is no misstatement in the financial statement which result in fraud or error.

3. Risk of Material misstatement

During the stages of audit the auditor should see the risk of misstatement in financial statements.

4. Substantive procedure

After ascertaining the risk factors, the auditor should modify the procedure to document such factors.

5. Suspicion of fraud

In case of suspicion of fraud the auditor should inform the management and those who are responsible for governance. In such a case the auditor shall investigate further.

6. Confirmation of suspicion

If the suspicion is confirmed, the auditor should consider the implications of misstatement in relation to other aspects of audit. He should verify the reliability of management representation.

7. Dispelling the suspicion

If the auditor is unable to confirm the evidence of fraud, he should assess the impact of such fraud on financial statements and deal with them as per the audit standards.

8. Withdrawal from engagement

If the auditor is unable to complete the engagement he should consider the legal requirements. He should seek legal advice and decide whether he should continue or withdraw.

9. Subsequent Discovery

The auditor cannot be held liable if adequate audit procedure is adopted. The auditor's duty is to consider the risk of material misstatement in financial statements.

10. Report to Central Government

Vide sec. 143(12) of the companies Act 2013 the auditor has to report to the Central Govt. about any fraud committed by the employees.

11. CARO 2020

The auditor has to report whether any fraud by the officer/employee has been noticed or reported during the year.

Q. 19. What is the responsibility of auditor for errors and frauds?

Q. 20. Auditor is a watch dog not a blood hound. Explain.

11. ADVANTAGES OF AUDIT

It is no more controversial that accounting is a necessity while auditing is a luxury. People get their accounts audited in order to ensure smooth functioning of business. It is important in a partnership business in order to ensure healthy relations among the partners and to decide about valuation of goodwill at the time of retirement, death or admission of a partner. In the case of companies audit is made compulsory under the Companies Act 2013. Advantages of audit can be grouped under the following categories :

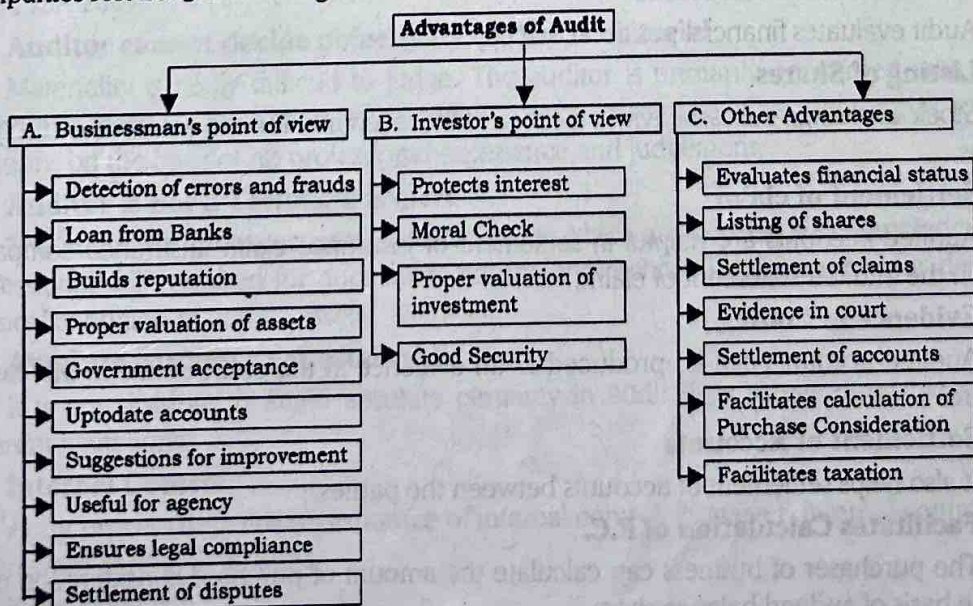


Fig. 1.6

A. Businessman's point of view**1. Detection of errors and frauds**

It helps in detection of errors and frauds.

2. Loan from Banks

It facilitates obtaining loans from Banks as the audited statements are relied upon.

3. Builds reputation

It builds up reputation of the business.

4. Proper valuation of assets

It enables the management to decide correct valuation of assets for the purpose of purchase and sale of business.

5. Government Acceptance

Government authorities accept audited statements as true and fair for the purpose of taxation.

6. Uptodate Accounts

It makes the clerks alert. They keep the accounts uptodate.

7. Suggestions for improvement useful when managed by Agents

Auditor can give concrete suggestions regarding improvement of business.

8. Useful for agency : It is useful when the business is managed by some agents.**B. Investor's point of view****1. Protects interest of investors**

Auditor acts as a representative of shareholders and trustees. This helps to protect the interest of various investors.

2. Moral check

It helps to exercise moral check on directors and managers to act honestly.

3. Proper valuation of investment

Investment held by investors is valued properly.

4. Good Collateral Security

Investment can be a good collateral security for raising loans if the accounts are audited.

C. Other advantages**1. Evaluates financial status**

Audit evaluates financial position correctly.

2. Listing of Shares

Stock Exchange relies heavily on the audited accounts for the purpose of listing of shares.

3. Settlement of claim

Audited accounts are helpful in settlement of Insurance claim. Insurance companies rely on the audited statement of claim.

4. Evidence in Court

Audited accounts can be produced as an evidence in the court of law in the case of dispute.

5. Settlement of Accounts

It also helps settlement of accounts between the parties.

6. Facilitates Calculation of P.C.

The purchaser of business can calculate the amount of purchase consideration easily on the basis of audited balance sheet.

7. Facilitates Taxation

Taxation authorities can rely on the audited accounts. Net profit as per audited statement is the basis of determination of taxable income and tax liability.

Q. 21. What are the advantages of Audit? or What is the importance of Audit?

12. INHERENT LIMITATIONS OF AUDIT

Audit is subject to the following inherent limitations as per SA 200 Revised :

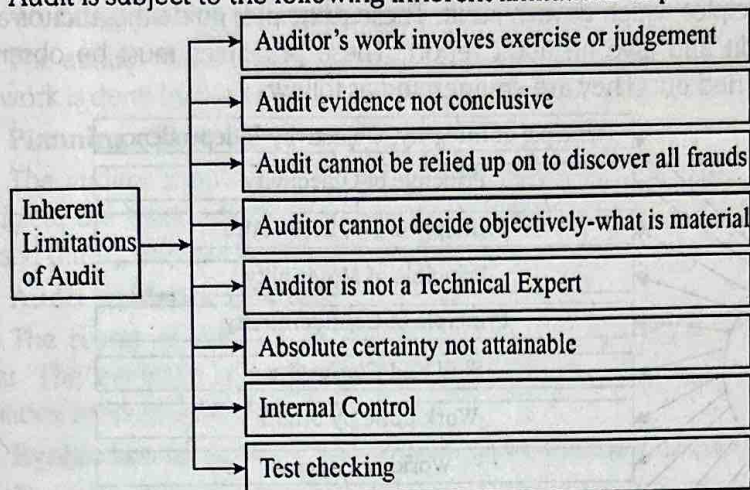


Fig. 1.7

1. Auditor's work involves exercise or judgement

The work of the auditor involves exercise of judgement in deciding the extent of audit procedures and in assessing the reasonableness of judgements and estimates made by management in preparation of financial statements.

2. Audit evidence not conclusive

The audit evidence is only persuasive and not conclusive. The evidence enables the auditor to draw only reasonable conclusions. Much of the evidence enables him to draw only reasonable conclusions.

3. Audit cannot be relied up on to discover all frauds

There is an unavoidable risk of some material misstatement which may remain undiscovered due to inherent limitations of audit. Test check and inherent limitations of the system of control, all frauds cannot be discovered. In this case audit cannot be relied upon. (SA 200)

4. Auditor cannot decide objectively – what is material

Materiality is really difficult to judge. The auditor is primarily concerned with items which are material in relation to the affairs of the enterprise. The auditor has to take decisions on the basis of his professional experience and judgement.

5. Auditor is not a Technical Expert

The auditor is not expected to perform duties which are beyond his competence. The professional skill required for audit does not include technical skill required for deciding physical condition of certain assets.

6. Absolute certainty not attainable

It is not possible to attain absolute certainty in audit. It is rarely attainable due to inherent limitations.

7. Internal Control

Audit process depends on existence of internal control. However, internal control also suffers from certain limitations.

8. Test checking

It is not possible for the auditor to go for detailed checking.

Q. 22. What are the inherent limitations of audit?

13. AUDITING PRINCIPLES

According to the Webster's New International Dictionary, the word 'principle' is defined as a fundamental truth; a primary or basic law or doctrine; a settled rule of action. In auditing, 'principle' is the fundamental truth necessary for the accomplishment of the auditing objectives. These are certain fundamentals developed over the years. SA 200 has laid down the basic principles which govern audit. These principles guide the auditor as to how to conduct an audit and give an audit report. These principles must be observed whenever an audit is carried out. They are enumerated as follows :

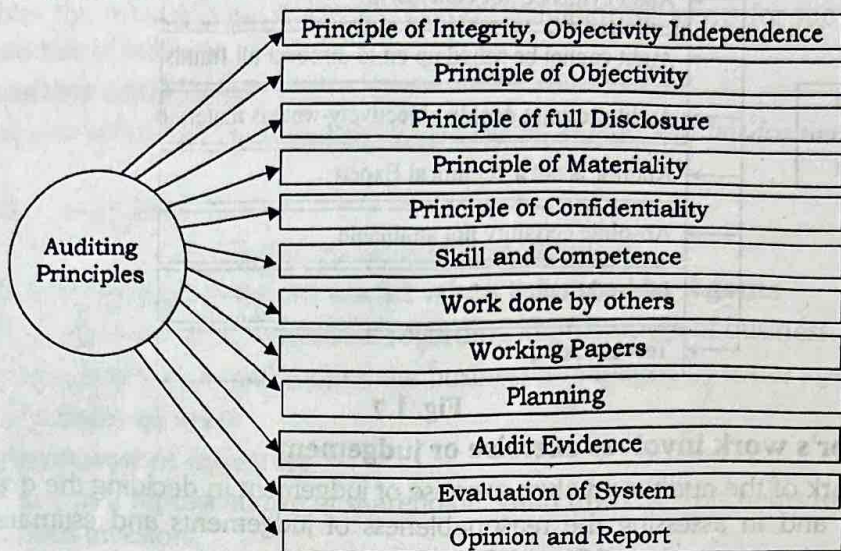


Fig. 1.8

1. Principle of Integrity and independence

It is not only a standard but a basic veracity of auditing. The objectives of auditing cannot be achieved unless the principle of independence is respected. The auditor should be honest and sincere in his audit work. He must be fair and objective. He should be independent.

2. Principle of objectivity

Auditing should be conducted objectively. The auditor should be free from bias and emotions while conducting audit. It demands verification of the transactions and the use of reasonable skill.

3. Principle of full disclosure

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

4. Principle of materiality

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

5. Principle of confidentiality

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

6. Skill and Competence

The auditor should possess prescribed professional qualifications and practical knowledge. He must be aware of the statements issued by the ICAI, amendments in Companies Act and recent judgements given by the court which have bearing on his audit work.

7. Work done by others (SA 220, 299, 600, 610, 620)

The auditor should direct, supervise and review the work done by his assistants. He should see that the work done by others is upto his satisfaction. He should satisfy himself that the work done by Internal Auditor, Branch Auditor, Joint Auditor, and Expert is reliable. The auditor should obtain reasonable assurance that work done by others is adequate.

8. Working papers (Documentation) (SA 230)

The auditor should maintain working papers properly. The working papers prove that the work is done by the auditor according to the basic principles.

9. Planning (SA 300)

The auditor should plan his audit work. He should prepare an audit programme to complete the work efficiently as per the schedule plan should be further developed and revised during the course of audit.

10. Audit Evidence (SA 500)

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

11. Evaluation of Accounting System and Internal Control (SA 315, 330)

The auditor should ensure that the accounting system is adequate. He should evaluate the Internal Controls.

12. Audit Conclusion and Reporting (SA 700)

The auditor should form his opinion about the accounts on the basis of audit evidence. He should submit his report to the shareholders. The Report should clearly express his opinion. The content and form of report should be as required by law.

Q. 23. What are the principles of Auditing?**14. AUDITING CONCEPT****14.1 Materiality Concept**

SA 320 Audit materiality deals with the concept of materiality and its relationship with audit risk.

While conducting audit the auditor should consider the concept of materiality. Whether a particular item is material or not depends on the professional judgement. The concept recognises that some matters are relatively important for true & fair presentation of financial information. The auditor considers materiality at both the levels i.e. overall financial information level and in relation to individual account balances.

Materiality may be influenced by :

- i) Legal and regularity requirements
- ii) Considerations relating to individual account balances

Materiality should be considered by the auditor when :

- i) deciding the nature, timing & extent of audit procedures
- ii) evaluating the effect of misstatements.

Legal Requirements

Many a time, materiality is influenced by law. The companies Act requires disclosure of all items which are material or non-recurring.

1. Material items

The Companies Act requires disclosure of all material items so as to give a true and fair view of the state of affairs of the company.

2. Non-Recurring items

The P & L A/c should disclose expenses of an exceptional nature.

3. % Cutoffs

Expense exceeding 1% of the revenue from operation of the company or ₹ 1,00,000 whichever is higher shall be shown as a separate item.

4. Previous year's figure

It is compulsory to disclose the corresponding figures for the previous year. Such disclosure helps to judge materiality.

Professional Requirements**1. Extra-ordinary items**

As per AS 5, extra-ordinary item is treated as a material item. Nature and amount of such item should be disclosed separately.

2. Ordinary items

As per AS 5, certain ordinary items are treated as material items for example, valuation of inventory, sale of fixed assets, sale of long term investments, legal settlement, reversal of provisions.

3. Prior period items

AS 5 treats prior period item as a material item. It should be disclosed separately.

4. Change in Accounting Policies

As per AS 5 any change in an accounting policy which has a material effect should be disclosed separately in the financial statements.

14.2 Going Concern Concept (SA 570)

The enterprise is normally treated as going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing the scale of the operations. In other words, there is neither intention of discontinuance of business, nor necessity of liquidation of organisation or discontinuance of major operations of the business.

According to SA 570, Going Concern is one of the fundamental accounting assumptions. Specific disclosure of the same is not required unless the assumption is not followed in the financial statements.

According to SA - 570 the auditor's duties are as given below :

A. Appropriateness

1. When planning and performing audit procedures and in evaluating the results thereof, the Auditors should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements.
2. The Auditor should also consider the risk that the concern assumption may no longer be appropriate. The entity's inability to continue as a going concern may be shown by various factors. Some potential indicators of going concern problem can be listed as under :

i) Negative Trends

- a) Negative working Capital
- b) Adverse key financial ratios
- c) Recurring losses
- d) Short term finance for Long term needs.

ii) Internal Matters

- a) Loss of key personnel
- b) Labour problem
- c) Soaring stock levels
- d) Out-dated products

iii) External Matters

- a) New legislation
- b) Pending litigation

vi) Other Matters

- a) Default on a loan
- b) Inability to pay dividends
- c) Restructuring of a debt
- d) Restrictions placed on trade terms e.g. change from credit to cash and delivery transactions with suppliers.

B. Mitigating factors may include group support, rescheduling of loan repayment, alternative sales market and reducing level of operations.

C. Evidence**Audit Procedures**

The Auditor should seek sufficient appropriate audit evidence through performing routine and specific procedures.

1. Routine Procedures may be the following :

- i) Reading minutes of various meetings
- ii) Reviewing the terms of debenture and loan and whether they have been breached.
- iii) Reviewing status of claims under litigation.

2. Specific Procedures can be classified as under :**i) Assessing client's** plan of recovery for feasibility may include the following :

- a) Analysing forecasts such as cash flows and other relevant variables and examining appropriateness of assumptions underlying.
- b) Examining reliability of entity's system for generating such information.
- c) Discussing with management and obtaining written representations from management.

ii) Reviewing subsequent events such as restrictions of debt on the date of balance sheet or availability of additional borrowings.**iii) Assessing group support** : This may involve examining whether agreements are legally binding, examining financial statements of related companies, obtaining legal advice etc.**D. Auditor's Report**

The auditor, after considering managements plan and other evidence will issue his report. As stated above, he would base his report upon the appropriateness of going concern accounting concept. The following table summarises various aspects related to the kind of report and going concern accounting concept.

Kinds of Audit Report and Going Concern Concept

Appropriateness of going concern concept	Adequacy of disclosure	Kinds of audit opinion
1. Appropriate	–	Unqualified
2. Appropriate due to mitigating factors	Yes No	Unqualified Qualified or adverse Opinion
3. Doubt remains	Yes No	Emphasis of Matter paragraph in an unqualified report or a disclaimer of opinion qualified or adverse report Qualified or adverse report
4. Inappropriate	–	Qualified or adverse report

14.3 Concept of True and Fair View

The phrase, 'True and fair' in the auditors report signifies that the auditor gives an opinion as to whether the financial statements represent fairly the actual financial position as at the end of the accounting period. The auditor should follow the procedure designed to satisfy him that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. As per section 134(5) of the Companies Act, 2013 the auditor has to report whether the accounts give a true and fair view :

1. In the case of the Balance Sheet of the state of affairs at the end of the financial year, and
2. In the case of the Profit and Loss Account of the profit or loss for its financial year.
3. Cash flow of the company

The company's board is responsible for preparation of financial statements in accordance with the accounting principles in India including the accounting standards specified under section 133 of the Act read with Rule 7 of the companies (Accounts) Rules, 2014.

Section 128 (1) of the companies Act, 2013, provides that every company shall prepare and keep at its registered office, books of accounts and other relevant books and papers and financial statements for every year which give a true and fair view of the state of affairs of the company.

Section 129 of the Companies Act 2013, requires financial statements to give true and fair view.

In other words, so long as the financial statements are drawn up in conformity with the provisions of schedule III of the Companies Act, 2013, they would be deemed to be disclosing true and fair view of the state of affairs of the company.

The concept of "True and Fair" implies that the financial statements should be true. They should disclose truth about the organisation. It should not contain any false information. At the same time the statements should be fair. They should disclose all that is required as per the provisions of the law.

1. Adherence to accounting principles

The books of accounts must be kept according to the normally accepted accounting principles.

2. No Window dressing

The accounts must be prepared honestly. There should not be any window dressing i.e. overstatement or understatement of profits. The accounts must disclose true position. There should not be any secret reserve created. The accounts should reflect actual conditions. For this purpose, the accounts must comply with the following norms :

- i) That the financial statements agree with the books of accounts and they are arithmetically accurate.
- ii) That the assets and liabilities are not under-valued or over-valued. They are valued as per the accepted accounting principles.
- iii) That adequate provision is made for depreciation on fixed assets.
- iv) That the stocks are properly valued and there is a consistency in the method of its valuation.
- v) That all contingent liabilities are disclosed in the balance sheet.
- vi) That proper distinction is made between capital and revenue expenditure and profits.
- vii) That the items of income and expenditure of previous year are adjusted and disclosed separately.
- viii) That the events after the balance sheet date are disclosed properly.
- ix) That the items of unusual nature are disclosed separately.

- x) That proper distinction is made between provisions and reserves and the excess provision is shown as reserve.
- xi) That the statements as required U/S 129 of the Companies Act, 2013 has been attached to the statements of holding company.
- xii) That the financial statements disclose information as required by Schedule III of the Companies Act, 2013.
- xiii) That no material assets are omitted.
- xiv) That no material liabilities are omitted.
- xv) That accounting policies have been followed consistently.

3. Disclosure of Material facts

The books of accounts must disclose all the material facts regarding revenues, expenses, assets and liabilities. Material facts means important facts. There should not be suppression of vital facts in the financial statements. There should not be any misstatement in the financial statements.

4. Conforming to financial reporting framework

Financial statements must be prepared according to the provisions of Schedule III of the Companies Act 2013. The final accounts must be prepared in the format prescribed by the Companies Act, 2013 as per Schedule III.

5. Guidelines of ICAI

The accounts must be in accordance with the various guidelines prescribed by the ICAI. These guidelines are given in the statements, standards and guidance notes issued by the ICAI.

6. S.143(2)

As per the requirements of Companies Act 2013, the auditor should express his opinion whether the published accounts give a true and fair profit and loss.

Q. 24. Explain the concept of true & fair view ?

14.4 Independence

It is a state of mind and character. It is a very subjective matter. It is quite possible that one person may feel that he is independent, in another situation he may feel that he is not independent. The auditor should not place himself in a situation which would affect his independence.

Auditor's independence should be real and it should be evident. It implies that the Auditor should not come under the influence of the management and modify his opinion as per the desire of the management. He should be free from bias and prejudice. He should adopt an independent approach. No person should doubt his objectivity and integrity.

In order to ensure independence of the auditor, the companies Act provides for his appointment, qualifications, disqualifications, rights, duties, remuneration etc.

Guidance Note

Quality Control Policies

1. Professional Requirements

Integrity, objectivity, confidentiality and professional behavior are the principles of independence to be adhered to while conducting audit.

2. Skills & Competence

The audit firm is to be staffed with people who have attained and maintained technical standards and professional competence required to enable them to discharge their responsibilities with due care.

3. Assignment

The audit work should be assigned to such persons who have the degree of professional training and proficiency.

4. Delegation

There is sufficient delegation at all the levels to provide sufficient assurance that the work done meets appropriate standards.

5. Consultation

Wherever necessary consultation should occur with those who have professional experience.

6. Acceptance and retention of clients

In acceptance and retention of clients, the firm's independence and ability to serve the clients is to be considered.

7. Monitoring

The operational effectiveness of quality control policies is to be monitored.

Safe guards to independence

The chartered accountant has a responsibility to remain independent. For this purpose following guiding principles should be followed :

1. In order to have confidence in the quality of audit, the auditor should be independent of the entities that they are auditing.
2. The key fundamental principles i.e. integrity, objectivity and professional skepticism are required for the auditor to be independent.
3. Before taking any work, the auditor must consider whether it involves any threats to independence.
4. In the case of any threats the auditor should desist from the task or take necessary safeguards to eliminate them.
5. The auditor must not accept the work if he is unable to implement adequate safeguards.

In order to ensure independence the Companies Act 2013, the Chartered Accountants Act, 1949, the Chartered Accountants Regulations 1988 and code of ethics have made provisions to put restrictions on appointment as auditor.

Q. 25. What are the provisions of Guidance Note on Independence of Auditor?

15. OBJECTIVE QUESTIONS**I. State with reasons whether following statements are True or False :**

1. Primary responsibility of auditor is to detect errors and frauds.
2. Presence of fraud risk factors indicate the existence of fraud.
3. Auditor's duty is to detect and prevent frauds.
4. As per AASI an entity should disclose all accounting policies followed by them.
5. Preparation of financial statements is the primary responsibility of the management.
6. Audit should be systematically planned.
7. After examination of records the auditor has to formulate his judgement.
8. Fraud is unintentional error.
9. Auditor is a watchdog and not a blood hound.
10. In case of suspicion of fraud the auditor should inform to the CID.
11. Auditing begins where accounting ends.
12. Complete commission of a transaction does not affect agreement of a Trial Balance.
13. Audited statements create dispute among the traders.

14. Auditing ensures legal compliance
15. Auditor must examine all the transactions.
16. Auditing should be conducted objectively.
17. Primary objective of auditing is prevention and detection of errors and fraud.
18. Financial statement can give true and fair view if errors are there in the books of accounts.
19. Frauds do not affects financial statements
20. Partial omission of transaction does not affect trial balance.
21. Errors of principle affect the trial balance.
22. In a small organization there are less chances of frauds than a big organization.
23. Window dressing is provided in the company law.
24. The accountant need not be a chartered Accountant.
25. An auditor cannot take the help of experts.
26. Agreement of a Trial Balance indicates that the books are error free.
27. Compensating errors affect the trial balance.
28. Error of omission does not affect the trial balance.
29. The object of auditing is to enable the auditor to express an opinion whether financial statements are as per the identified financial reporting frame work.
30. Wages paid to Jignesh debited to Jignesh A/c is an error of principle.
31. The error, total of purchase journal is short by ₹ 3,000 affects the Trial Balance.
32. Total of purchase book is not posted to the ledger is an error of commission.
33. Sales to Deepak ₹ 2,300 is posted to Deepali's A/c is an error of omission.
34. Credit sales ₹ 30,000 is recorded in the purchase book is an error of omission.
35. Repairs to building is debited to building A/c is an error of principle.
36. Goods distributed as free sample is not recorded is an error of principle.
37. Management can prevent frauds.
38. The risk of fraud is maximum when a single person does the management.

[Ans. : True : 3, 5, 6, 7, 9, 11, 12, 14, 16, 22, 24, 28, 29, 30, 31, 35, 37, 38]

False : 1, 2, 4, 8, 10, 13, 15, 17, 18, 19, 20, 21, 23, 25, 26, 27, 32, 33, 34, 36]

II. A. Match the Following :

	Group 'A'		Group 'B'
a)	Financial Statement	i)	Users of information
b)	Bankers	ii)	As obtain credit worthiness.
c)	Trade creditors	iii)	Systematic recording of transactions
d)	Book-keeping	iv)	Expression of opinion
e)	Primary objective of auditing	v)	Intentional error
f)	Fraud	vi)	Balance Sheet
g)	Theft of asset	vii)	Employee fraud
h)	Manipulation of accounts	viii)	Management fraud

[Ans. : (a) - (vi), (b) - (i), (c) - (ii), (d) - (iii), (e) - (iv), (f) - (v), (g) - (vii), (h) - (viii)]

B. Match the Following :

	Group 'A'		Group 'B'
a)	Accounting	i)	Begins when book keeping ends

b)	Auditing	ii)	Goes beyond auditing
c)	Investigation	iii)	A technique of fraud
d)	Teeming & lading	iv)	Not restricted to books of accounts only
e)	Auditors	v)	Report to shareholders

[Ans. : (a) - (i), (b) - (iv), (c) - (ii), (d) - (iii), (e) - (v)]

III. Multiple Choice Questions

- The main object of an audit is
 - Expression of opinion
 - detection and prevention of fraud and error
 - depend on the type of audit
 - both (a) and (b)
- Which of the following is not true about auditor's duty?
 - The auditor should express an opinion on financial statements
 - His opinion is not a guarantee to future validity of business
 - He should examine whether recognised accounting principles have been consistently followed
 - He is responsible for detection and prevention of frauds and errors.
- A sale of ₹ 1,00,000 to Deepali was entered as sale to Rupali. This is an example of
 - Error of commission
 - Error of omission
 - Compensating error
 - Error of Principle
- Salary paid to Ranjita ₹ 50,000 is debited to her account. It is an error of _____.
 - Principle
 - commission
 - omission
 - duplication
- Which of the following is not true?
 - Management fraud is more difficult to detect than employee fraud
 - Internal control reduces the possibility of occurrence of employee fraud and management fraud
 - Auditor's responsibility for detection and prevention of errors and fraud is similar.
- As per AAS4 if the auditor detects an error then
 - He should inform the management
 - He should communicate it to the management if it is material
 - The auditor should ensure financial statements are adjusted for detected errors
 - Both (b) and (c)
- How many principles are listed in AASI which govern auditor's professional obligation?
 - Nine
 - fourteen
 - seven
 - eight
- The risk of management fraud increases in the presence of :
 - Frequent changes in supplies
 - Improved internal control system
 - Substantial increase in sales
 - Management incentive system based on sales done in a quarter.
- After examination of records the auditor has to communicate his judgement to _____.
 - shareholder's
 - Board of directors
 - public
 - central government

10. An auditor is a watch dog and not a blood hound. This decision is given in
 - a) Kingston Cotton Mills Case
 - b) West Ministers Road construction case
 - c) Caparo Case
 - d) Lalji case
11. Fraud through defalcation is an
 - a) employee fraud
 - b) management fraud
 - c) both (a) and (b)
12. Manipulation of accounts is a
 - a) Management fraud
 - b) employee fraud
 - c) both (a) and (b)
13. Audited statement are helpful in
 - a) Settlement of disputes
 - b) Settlement of accounts
 - c) resolving conflict among the employees
14. AAS 4 has mentioned
 - a) two limitations
 - b) four limitations
 - c) nine limitations
15. Main object of audit is
 - a) expression of opinion
 - b) detection of errors of frauds,
 - c) both (a) & (b)
 - d) depends on the type of audit
16. Misappropriation of goods is conducted by
 - a) auditors
 - b) employees
 - c) management
 - d) all the above
17. Payment of salary to Mr. Sanjay is debited to Sanjay's A/c is an error of
 - a) Principle
 - b) commission
 - c) error of omission
 - d) compensating error
18. Manipulation of accounts to show a better position is called as :
 - a) window dressing
 - b) error of omission
 - c) error of commission
 - d) none of the above
19. Goods sent on consignment recorded as credit sales is an error of
 - a) Commission
 - b) omission
 - c) principle
 - d) none of the above
20. The objective of auditing financial statements is to enable the auditor to express an opinion
 - a) Whether financial statements are prepared according to Double Entry System.
 - b) Whether financial statements are prepared according to accounting policies of the management.
 - c) Whether financial statements are prepared as per identified Financial Reporting Framework.
 - d) Whether financial statements are prepared as per Income Tax Act.
21. The error of omission is
 - a) Sale of goods recorded in the Sales Journal.
 - b) Wages paid to Suresh, debited to Suresh A/c.
 - c) Total of purchase Journal is not posted to purchase A/c.
 - d) None of the above.
22. The error will affect the Trial Balance.
 - a) Repairs to machinery is debited to Machinery A/c.
 - b) Total of sales journal is short by ₹ 2,500.

- c) Carriage on machinery debited to carriage A/c.
d) None of the above.
23. The error will not affect the Trial balance.
a) Wrong balancing of an A/c.
b) Wrong totaling of an A/c.
c) Writing an amount in the wrong A/c but on correct side.
d) None of the above.
24. Total of purchase book is not posted to the ledger is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
25. Sales Journal overcast by ₹ 10,000 is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
26. Sales to Ramchandra ₹ 153 posted to his A/c as 135 is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
27. Sales to Dipti ₹ 163 is posted to Deepali's A/c is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
28. A credit sales of ₹ 20,000 is recorded in the purchase book is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
29. Repairs to machinery is debited to Machinery A/c is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
30. Goods worth ₹ 5,000 taken by the proprietor for personal use not recorded is an error of
a) Omission
b) Commission
c) Principle
d) None of the above
31. Prevention and detection of errors and frauds can be done by
a) Auditor
b) Accountant
c) Cashier
d) Management
32. The risk of fraud increases when
a) Working capital is low.
b) Cash sales are high.
c) Same auditor is appointed every year.
d) Single person does the management.

[Ans. : (1 - a), (2 - d), (3 - a), (4 - a), (5 - b), (6 - d), (7 - a), (8 - d), (9) - (a), (10 - a), (11 - a), (12 - a), (13 - a), (14 - b), (15 - c), (16 - b), (17 - a), (18 - a), (19 - c), (20 - c), (21 - c), (22 - b), (23 - c), (24 - a), (25 - b), (26 - b), (27 - b), (28 - b), (29 - c), (30 - a), (31 - d), (32 - d)]

IV. Fill in the blanks with appropriate word / words

- Auditing is a _____ examination of books.
- The auditor has to _____ and _____ it.
- Book keeping starts when business transactions _____.
- A Book keeper is an _____ of an organisation.
- Accounting _____ when Book keeping _____.

6. Auditing _____ when accounting _____.
7. An Auditor needs _____.
8. Investigation is _____ in scope.
9. Auditor's main duty is to report on _____.
10. Error arising by violating accounts principles is error of _____.
11. Complete _____ does not affect the agreement of trial balance.
12. Fraud is an _____.
13. _____ means showing cosmetic view of the state of affairs.
14. _____ issued by ICAI spells out the responsibility of an auditor.
15. Auditing exercises _____ check on the employees.
16. Auditor should form his opinion about the accounts on the basis of _____.
17. Financial statements include _____ and _____.
18. _____ A/c shows result of business activities.

[Ans. : (1) systematic, (2) evidence, evaluate, (3) take place, (4) employee, (5) begins, ends, (6) begins, ends, (7) Prescribed qualification, (8) wide, (9) accounts examined, (10) principle, (11) omission, (12) intentional mistake, (13) window dressing, (14) SAP, (15) moral, (16) audit evidence, (17) – Balance sheet, P & L A/c, (18) P & L]

V. Short Questions

1. What do you mean by financial statements?
2. Define Auditing?
3. What do you mean by book-keeping?
4. Explain in brief accountancy?
5. What do you mean by investigation?
6. What is the primary objects of auditing?
7. What is an error of principle?
8. What do you mean by error of duplication?
9. What do you mean by error of commission?
10. What are compensating errors?
11. Define fraud?
12. Explain window dressing?
13. What do you mean by auditing principles?
14. Explain the concept of true and fair view?
15. What do you mean by omission?
16. Explain the meaning of the word, 'auditing'?
17. What do you mean by the term "Error"?
18. Explain the classification of clerical errors?
19. What do you mean by audit evidence?
20. What do you mean by misappropriation of goods?

VI. Write Short Notes on :

1. Investigation
2. Objects of Auditing
3. Fraud
4. Defalcation
5. Window dressing
6. Auditing principles
7. True & Fair view

2

TYPES OF AUDIT

SYNOPSIS

1. Introduction
2. Types of Audit
 - 2.1 Based on Authority
 - 2.2 Based on Scope
 - 2.3 Based on Time
 - 2.4 Based on Object
 - 2.5 Other Types of Audit
 - 2.6 Green Audit
3. Qualities of Auditor
4. Accounting Concepts
5. Exercises
 - 5.1 Objective Questions

1. INTRODUCTION

The entire process of audit depends upon the type of audit. Hence, it is essential to study the various types of audits before laying down the programme for any audit.

R. Robert Coomber has classified audits on the following four bases :

1. Audit on the basis of authority.
2. Audit on the basis of scope
3. Audit on the basis of time.
4. Audit on the basis of objective.

2. TYPES OF AUDIT

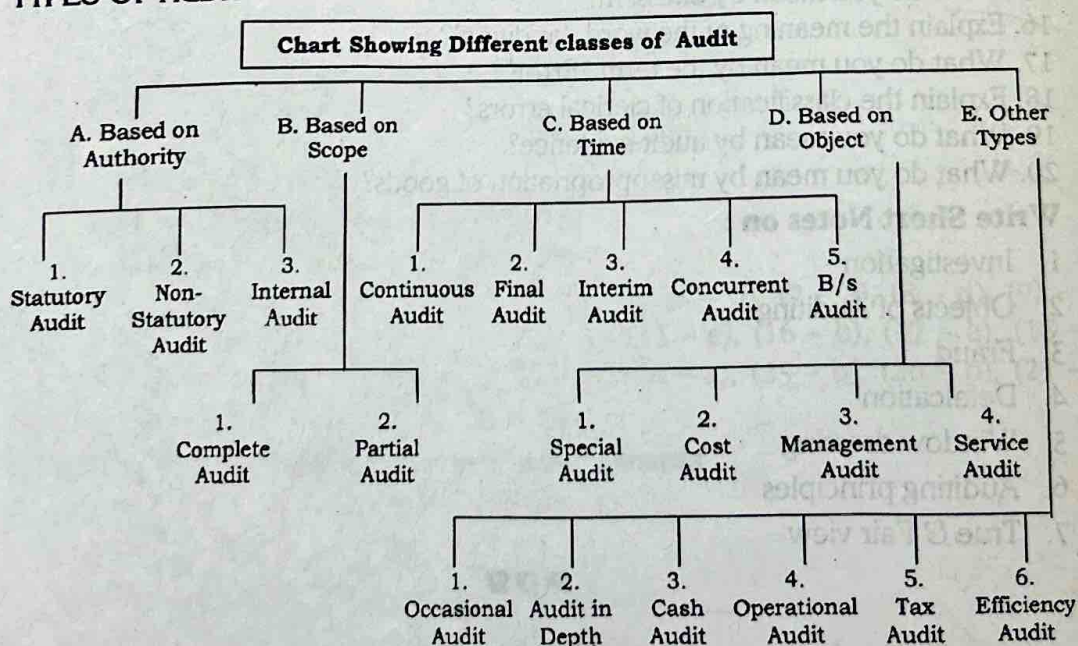


Fig. 2.1

2.1 Based on Authority

2.1.1 Statutory Audit

It is the audit which is compulsory under the law. Appointment of auditors, removal, remuneration, rights, duties, liabilities are governed as per the provisions of the respective law applicable to the organization. Scope of audit work and all other terms are as laid down by the law. It can be conducted only by a qualified Chartered Accountant. Audits are compulsory in the following cases :

1. Companies registered under the Companies Act 2013.
2. Banking Companies governed by the Banking Companies Act 1949.
3. Insurance Companies governed by the respective insurance Act.
4. Cooperative societies registered under the Cooperative Societies Act.
5. Public and Charitable trusts registered under concerned Acts.
6. Local authorities, government undertakings and departments.
7. All business organisations having annual sales over ₹ 40 lakh.

Essentials of Statutory Audit

1. It is mandatory in nature.
2. The auditor must be a qualified Chartered Accountant or a Cost and Works Accountants (for permitted audits only).
3. The auditors must not incur any prescribed disqualifications during the course of audit.
4. Appointment of auditor is made as per the provisions of the relevant Acts.
5. It is always a complete audit.
6. It enables the appointing authority to get full disclosure of all material facts.

Q. 1. What is Statutory Audit? What are its essentials?

2.1.2 Non-Statutory Audit

It is a voluntary audit. It is optional and not compulsory. It is carried at the discretion of the proprietor. There is no specific law which governs the conduct of such audit. Terms and conditions of audit are determined as per the agreement made between the auditor and the proprietor. For example, audit of individuals, firms, private trusts etc.

2.1.2.1 Private Audit

The audit which is done for the satisfaction of the owner is called private audit. This type of audit is not compulsory at all. It may be conducted by sole proprietors, partnership firms, family trusts, private trusts etc.

Q. 2. What do you mean by private Audit?

2.1.2.2 Audit of Sole Proprietor

Audit of accounts of a sole proprietor is advantageous as follows :

1. It becomes easy to file income tax returns and sales tax returns.
2. Audited accounts help in getting reliable information about wealth tax of the proprietor.
3. Frauds and errors can be prevented.
4. Audit ensures accuracy of the accounts of the business.
5. Raising loans becomes easy.

Q. 3. What are the advantages of Audit of accounts of a sole proprietor?

2.1.2.3 Partnership Audit

1. It helps valuation of goodwill at the time of admission, retirement and death of a partner.
2. Sleeping partners can ensure that their funds are being utilised effectively.

3. It helps to prevent disputes among the partners.
4. It facilitates borrowing from banks.
5. Audited accounts are preferred by income tax and sales tax departments.
6. Audited accounts can be helpful in case of litigation.
7. In case of sale of business, audited accounts facilitate calculation of purchase consideration.

Q. 4. What are the advantages of an Audit of partnership firm?

Following are the circumstances under which audit of partnership accounts becomes necessary :

1. There are many partners in a firm and hence there is a possibility of conflict.
2. Only employees undertake the charge of writing accounts.
3. Partners may not get enough time to look after finance and accounts.
4. Dormant partners do not take part in any of the activities of the firm.
5. On death or retirement of a partner, it becomes necessary to find out his share accurately.

Q. 5. Under what circumstances Audit of partnership accounts becomes necessary?

2.1.2.4 Audit of Trusts

1. It helps to ensure that the affairs of the trust are managed properly.
2. Exemption from income tax can be claimed if the accounts are audited by a qualified auditor.
3. Trustees can ensure accuracy of the books of accounts.
4. Errors and frauds are prevented.

Q. 6. What are the advantages of Audit of trust accounts?

2.1.2.5 Distinction between Company Audit and Partnership Audit

Point	Company Audit	Firm Audit
1. Legal requirements	It is obligatory by the Act.	It is not obligatory by the Act.
2. Appointment of auditors	Shareholders appoint auditors in general meeting	Partners appoint auditors.
3. Qualifications	The auditor must be a Chartered Accountants.	The auditor need not be a Chartered Accountant.
4. Scope	It is defined by the Companies Act 2013.	It is defined by the agreement.
5. Report	Report in prescribed form to be sent to the shareholders.	Report is to be sent to the partners. It need not be in a prescribed form.
6. Rights and Powers	Defined by the Companies Act, 1956.	Defined by the agreement made.
7. Status	Auditor acts as an agent of shareholders	Auditor acts for partners or the proprietor.
8. Liability	Auditor is liable for negligence and misfeasance. The court only can relieve him from such liability	Auditor is liable under common law. He may be exonerated by the virtue of the agreement.
9. Documents	Auditor should go through M/A, A/A, company law, resolutions, etc.	Auditor should go through Partnership Deed and instructions from the employer.

Q. 7. What is the difference between Audit of a company and a firm?

2.1.3 Internal Audit

It is an independent management function which involves a continuous and critical appraisal of the function of the entity. The objective is to suggest improvement to the functions of the entity and add value to and strengthen the overall governance mechanism of the entity including its strategic risk management and internal control system. This type of audit is also optional. It is conducted by the internal auditor who is appointed by the proprietor. Even the employee of the organization may be appointed as an internal auditor to examine the books of accounts. All the terms and conditions of audit work are determined by the agreement. The basic purpose of internal audit is not only to examine the books of accounts but also to review the present working and make valuable suggestions to improve it.

The purpose behind internal audit is to assure the management that the accounts are being properly maintained and the system provides adequate safeguards for detection and prevention of any frauds. The scope and objective of internal audit vary from business to business. It may even extend to many matters which are not directly related to accounting aspects. It is more managerial than accounting. It is a part of the system of internal control.

Q. 8. What is Internal Audit?

Objectives

1. To verify the accuracy of the records.
2. To ensure that the transactions have a proper authority.
3. To facilitate prevention and detection of frauds and errors.
4. To ensure that purchase and sale of fixed asset is authorised.
5. To improve the system of internal check.
6. To examine the protection given to fixed assets.
7. To make investigations for management.
8. To review the entire system of working and make it more effective.

In India internal audit assumed special significance with the introduction of manufacturing and other companies (Audit's Report) order 1988. It has been superseded by the Companies (Auditor's Report) order 2016. As per this order in case of listed and specified companies the statutory auditor is required to report whether internal audit system of the company commensurates with the size and nature of the business of the company. An unlisted company whose paid up capital and reserves are more than 50 lakhs or whose annual turnover for last three financial years preceding the present financial year exceeds five crore rupees.

Q. 9. What are the objectives of Internal Audit?

2.1.4 Distinction between Internal Audit and Statutory Audit

Point of Difference	Internal Audit	Statutory Audit/ External Audit
1. Appointment	Internal Auditor is appointed by the management.	External Auditor is appointed by the shareholders or the Government.
2. Remuneration	It is fixed up by the Management.	It is fixed up by the Share-holders or the Government.
3. Qualifications	There are no prescribed qualifications for Internal Auditor.	The Auditor must possess qualifications as prescribed by the Law.
4. Responsibility	He is responsible to the management.	He is responsible to the shareholders or the Government.
5. Period	It may cover any period.	It covers normally one year.

6. Object	To improve the existing system of operation.	To ensure reliability of the financial statements.
7. Rights, Scope	It is determined by the management.	It is determined by the law.
8. Test Check	He cannot rely on test check.	He can rely on test check.
9. Internal Check	He cannot depend on internal check.	He can depend on internal check if it is satisfactory.
10. Termination	It is as per the agreement.	It is as per the law.

Q. 10. What are the objectives of Internal Audit? Distinguish between Internal Audit and Statutory Audit.

2.2 Based on Scope

2.2.1 Complete Audit

In this type of audit, the auditor is required to check each and every transaction recorded in the books of accounts.

He has to examine each and every voucher, document or correspondence relating to the transaction. This type of audit is not possible for large sized organizations.

2.2.2 Partial Audit

In this type of audit, the auditor is not required to examine all the books of accounts. Only a part of the accounts or some transactions as desired by the clients may be scrutinised. The auditor has to state the area covered by the audit. This type of audit cannot be followed in the case of statutory audit. It may be followed in the case of non-statutory audit. This audit is not convenient when the audit is legally required.

2.3 Based on Time

2.3.1 Continuous Audit

Continuous audit is defined by R.C. Williams as "one where the auditor, or his staff, is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends at regular or irregular intervals during the period."

When the audit is carried out during the accounting period with some interval, it is called as a continuous audit. In continuous audit, the audit staff remains occupied continuously on the accounts during the whole year where they attend at frequent intervals. Audit work remains in progress throughout the accounting period. Audit is conducted at some fixed interval throughout the accounting period. By the end of the accounting period, substantial portion of the routine checking is completed. It is called as 'each and every item audit' because all the transactions are checked upto date. In continuous audit, the audit flows simultaneously during the accounting period. At the end of accounting period, the auditor verifies the final statements of accounts, viz., the profit and loss account and balance sheet.

Features :

1. It is carried out throughout the year.
2. It is conducted at regular or irregular intervals
3. The accounts are subject to scrutiny as and when prepared.
4. Full verification of assets and liabilities is left until the balance sheet is prepared.
5. Trial balance, profit and loss account and balance sheet are audited at the end of the year.

This type of audit is more appropriate in the following situations / organizations :

1. Where the business is large, complex and involves numerous transactions.
2. Where the system of internal control and internal check are not satisfactory.

3. Where the management requires monthly or quarterly audited statements of accounts or the statements of accounts are required immediately after the accounting year.
4. Sometimes continuous audit becomes necessary for self survival against cut-throat business competition.
5. When interim dividend is to be declared.

Q. 11. What is Continuous Audit?

2.3.1.1 Advantages of Continuous Audit

Advantages

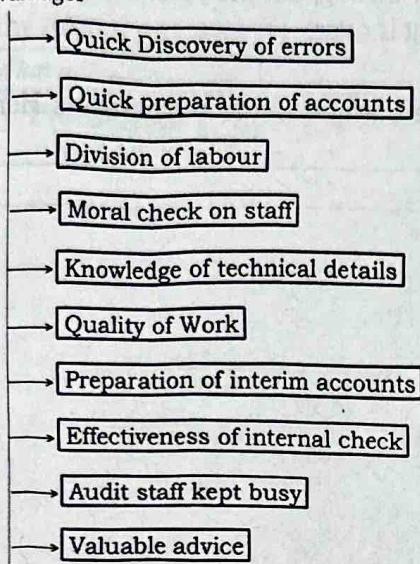


Fig. 2.2

1. Quick Discovery of Errors

It enables the auditor to detect errors and frauds promptly and thereby the management can take timely action to rectify them.

2. Quick preparation of Accounts

It ensures quick preparation of accounts and the audit report.

3. Division of Labour

There is even distribution of audit work because audit and accounts flow simultaneously and the audit is possible in detail. Therefore, the quality of audit can be maintained properly.

4. Moral Check on Staff

Chances of frauds are considerably reduced because of the moral check caused by frequent periodical visits of the audit staff and the fraudulent persons getting less time to plan for concealment of fraud and its detection in time.

5. Knowledge of technical details

Frequent visits enable the auditor to get detailed ideas about the nature of the client's business and the technicalities of business transactions so that he can discover the dark areas requiring greater attention. Thus, the quality of audit work and audit report can be improved.

6. Improvement in quality of audit work

Auditor finds ample time to carry out audit in great details and the time saved is utilised for applying different audit techniques in an intelligent manner e.g. he can make use of various accounting ratios, comparison of figures, confirmation of balances etc. Thus, the quality of audit work improves.

7. Preparation of Interim Accounts

Directors can declare interim dividend on the basis of interim audited statements of accounts which is possible only if there is a continuous type of audit.

8. Effectiveness of Internal Check System

The very operation of continuous audit provides for an efficient and effective system of internal control and internal check which is absolutely necessary for efficient conduct of the business and audit.

9. Audit Staff kept busy

The whole of the audit staff can be kept busy throughout the year. The audit staff can be sent to other clients once the work of one client is over.

10. Valuable advice

The auditor becomes more familiar with the business of the organisation. Hence, he can give valuable advice to the proprietor.

Q. 12. What are the advantages of continuous Audit?

2.3.1.2 Disadvantages of Continuous Audit

Disadvantages

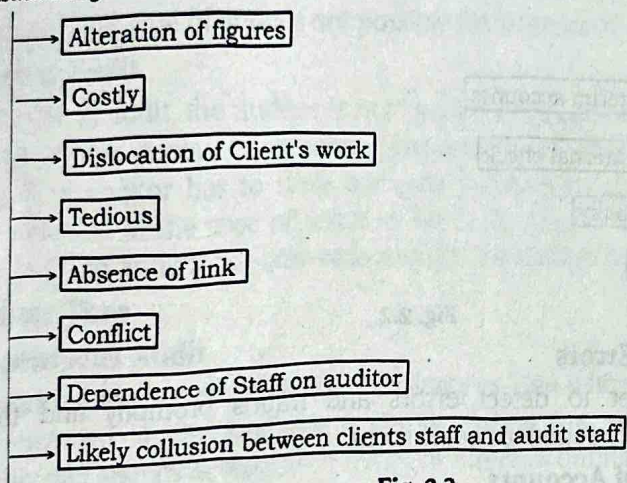


Fig. 2.3

1. Fraudulent alteration of audited figures

Continuous audit is done in stages when the books of fraudulent alteration of the audited figures and also tampering with the vouchers and other records.

2. Costly or Expensive

It is costly because the auditor has to devote more time and therefore, the charges will be high. Small concerns cannot afford to have a continuous type of audit. Expenses on refreshment and conveyance add to the cost.

3. Dislocation of client's work

If a proper audit programme is not adopted, continuous audit may disrupt the routine accounting work of the client. Either the audit staff may have to sit idle or the accounts staff of the client may waste time for want of books of accounts. Employees have to attend the auditor for explanation. They have to keep aside their usual work and attend to the auditor.

4. Monotonous - tiresome - tedious

Continuous visits to the client's place may make the work tedious and the audit staff loses interest from work consequently. The quality of audit suffers.

5. Absence of link

In the absence of well-planned audit work, an auditor may miss the thread of audit work. Further, some important queries may be overlooked if no proper audit notes and queries are recorded by the audit staff during the course of the audit.

6. Conflict between audit and accounts staff

The members of audit and accounts staff come in close contact and sometimes it may result in spoiling the healthy relations between them and thereby the quality of audit may suffer.

7. Dependence of the accounts staff on auditor

The accounts staff may depend on the audit staff. They may require the help of auditor for even small errors which they can discover or avoid by taking proper care.

8. Likely Collusion

Frequent interaction of the client's staff with audit staff may provide a scope for unhealthy relationship between the two to perpetuate fraud.

Q. 13. What are the drawbacks of Continuous Audit?

2.3.1.3 Precautions to remove drawbacks of continuous audit

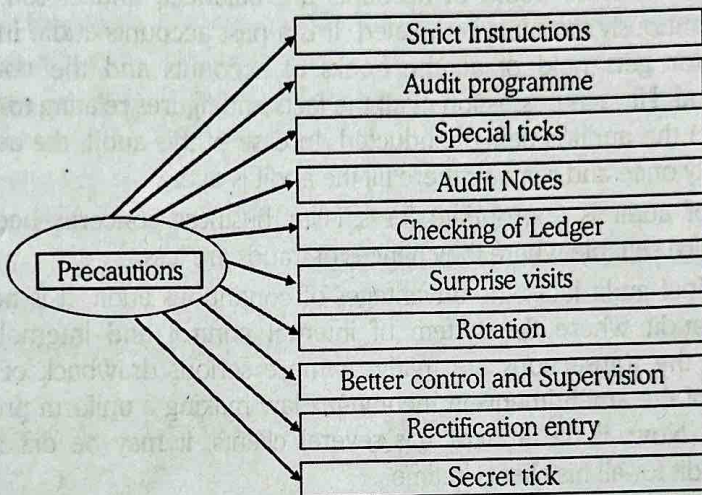


Fig. 2.4

1. Strict instructions

Strict instructions should be given to the client's staff not to alter the audited figures. Mistakes, if any, should be rectified by passing rectification journal entries and not by alteration of figures.

2. Audit programme

Proper audit programme should be prepared by the auditor, so that the time of accounts and audit staff is not wasted.

3. Special ticks

Special ticks should be used for unaudited altered figures. Auditors should write in the margin the actual figures audited with his audit pencil.

4. Audit Notes

Exhaustive audit notes should be kept by the auditor. The queries and their explanation by the client should be properly recorded.

5. Checking of Ledger

Checking of impersonal ledger should be done only after the close of accounting year.

6. Surprise visits

Surprise visits should be made in addition to the regular visits.

7. Rotation

There should be reasonable rotation of audit staff and their duties so that they may not lose interest in their work.

8. Better control and Supervision

There should be better control and supervision over the audit staff. All the important figures in the balance sheet should be noted in the audit diary and they should be rechecked at the time of subsequent visits.

9. Rectification entry

Any alteration should be done by means of a rectification entry in the journal.

10. Secret tick

The auditor should put a secret tick against any figure already altered.

The purpose of such ticks should not be disclosed to the client's staff.

Q. 14. How would you remove drawbacks of Continuous Audit?

2.3.2 Final or Completed Audit/Periodic Audit / Annual audit

It is also known as periodical audit. It generally starts after the completion of accounting year when the books of accounts are balanced and closed. Final audit is carried out continuously until it is completed. It is a past accounts audit. In case of a final audit, the auditor gets hold of all the books of accounts and the vouchers for the accounting period. He is in possession of all the facts and figures relating to the accounting period for which the audit is being conducted. In case of this audit, the auditor visits the client's place only once and remains there till the audit is over.

This type of audit is appropriate for smaller business concerns because it is less expensive. It is also suitable where the chances of frauds are less.

However, final audit lacks the advantages of continuous audit. It is not advisable to introduce this audit where the system of internal control and internal check is not satisfactory and the transactions are many. A more serious drawback of this audit has arisen because of the amendments in Income-tax law making a uniform previous year for all the assesses. Now, if the auditor has several clients, it may be difficult for him to complete the audit for all his clients in time.

This type of audit is generally preferred by the auditors because the chances of alteration of figures are less. Besides the final and continuous audit, there may be two more types of audit, viz. Interim Audit and Balance Sheet Audit.

2.3.2.1 Advantages of Final Audit

1. No disturbance of routine work.
2. It is less expensive.
3. Proper planning of audit work is facilitated.
4. Maintenance of link in work becomes easy.
5. Elimination of all limitations of continuous audit work can be completed without any break.
6. There are no chances of alteration of figures.

2.3.2.2 Disadvantages

1. Consequences of errors are experienced by clients first.
2. Difficult to detect frauds committed with proper planning.
3. Delay in finalisation of accounts.
4. Less moral force on the client staff.
5. Not convenient for large sized business concerns.
6. It becomes difficult for the auditor to arrange audit when many clients have the same financial year.

Q. 15. What are the advantages and disadvantages of Final Audit?

2.3.3 Interim Audit

It is a kind of audit which is conducted between two annual completed or final audits. It is conducted to find out the interim profit and know the financial position at the end of a part of the accounting year.

Interim audit should not be confused with continuous audit. The scope of interim audit falls within the purview of final audit or the annual audit which is carried out later.

Circumstances

Under following circumstances Interim Audit is desirable :

- i) **Half yearly results** : Public limited companies are required to publish half yearly results. Hence, though not compulsory, it is advisable to get the accounts audited half yearly.
- ii) **Interim Dividends** : Interim audit becomes necessary when interim dividend is to be declared.
- iii) **Sale of business** : In the case of sale of business interim audit is necessary to calculate purchase consideration.
- iv) **Changes in firm** : In case of admission, retirement or death of a partner, it becomes necessary to do interim audit.

The main purposes of interim audit are as follows :

1. To get periodical data on sales, production, profits etc.
2. To arrive at the profit which is necessary for the purpose of declaration of interim dividend.

2.3.3.1 Advantages of Interim Audit

Advantages

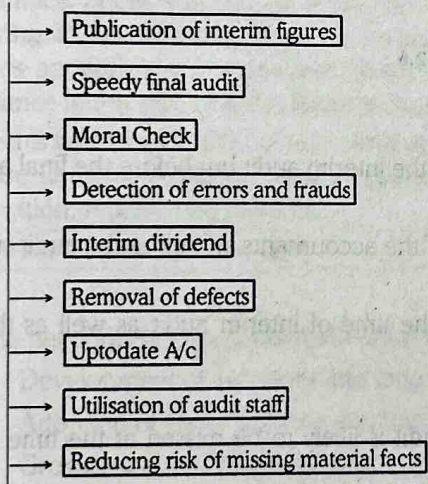


Fig. 2.5

1. Publication of interim figures

Interim audit is necessary where it is required to publish the interim figures of sales, production, expenses, etc.

2. Speedy final audit

If an interim audit has been carried out, completion of final audit would be speedy.

3. Moral Check

There is a moral check on the client's staff as the auditor examines the accounts after six months.

4. Detection of errors and frauds

The chances of frauds are reduced and also there is a faster detection of accounting errors and frauds.

5. Declaration of interim dividend

It helps in declaration of interim dividend.

6. Removal of defects

The management can take timely action to remove the defects, if any.

7. Up to date A/c

Up to date accounts can be prepared half yearly and used by banks and investors for taking decisions regarding loans and investments.

8. Utilisation of audit staff

Audit staff can be utilised in a better manner. The work can be done by the employees when they are free.

9. Reduced risk of missing material facts

The auditor gets ample time at the time of final audit. Hence material facts cannot be missed by the auditor.

2.3.3.2 Disadvantages of Interim Audit

Disadvantages

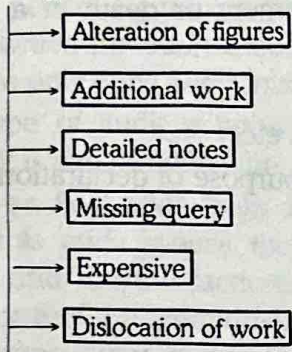


Fig. 2.6

1. Alteration of figures

Figures may be altered in the books after the interim audit but before the final audit.

2. Additional work

Additional work is involved on the part of the accountants as well as the audit staff.

3. Notes to be prepared

The audit staff has to prepare notes at the time of interim audit as well as the final audit.

4. Possibility of missing the query

A query missed at the time of interim audit is likely to be missed at the time of final audit.

5. Expensive

It is more expensive than final audit.

6. Dislocation of work

The normal working of the client may be dislocated due to frequent call given by the auditor.

Q. 16. What is Interim Audit? What are its advantages and disadvantages?

2.3.4 Concurrent audit**Meaning**

It is a system of audit which is prevalent in large banks. It is an examination which is contemporaneous with the occurrence of transactions or examination which is carried out at the earliest. It is a comprehensive, continuous and systematic examination of all the

transactions by a person other than those implied in operations to ensure accuracy and compliance with the internal systems.

Object

The object is to ensure adherence to prescribed systems and procedures and timely detection of irregularities

Scope

The Scope of concurrent audit includes

- i) Checking daily cash transactions with special reference to abnormal receipts and payments if any.
- ii) Ensuring appropriate accounting of cash receipts and payments.
- iii) Verifying the purchase and sale of investments and that they are within the powers of the central office.
- iv) Verifying that advances are in accordance with the guidelines of central office and RBI.
- v) Verification of stock declaration statement and timely payment of instalment.
- vi) Verification of timely reconciliation and confirmation of accounts.

Auditor

Any bank officer or external auditor can be appointed as concurrent auditor. He has to report services irregularities to the head office. Minor cases should be brought to the notice of the branch manager.

Q. 17. What is Concurrent Audit? What is its Scope?

2.3.5 Balance Sheet Audit

Balance Sheet audit is an American term which means verification of the items appearing in the Balance Sheet. It includes verification and valuation of assets and liabilities appearing in the Balance Sheet. Profit and Loss Account is not given much importance in this type of audit. Balance Sheet Audit is also referred to as 'Limited Audit'.

In this type of audit the balance sheet accounts are verified and tests are imposed only on those items in Profit and Loss Account which are directly related to assets such as depreciation, repairs, bad debts etc.

Q. 18. What is Balance Sheet Audit?

Need

The need for Balance sheet audit arises due to the following :

1. Development of industries into large economic units.
2. Adoption of very elaborate and formal control system by the organisation.
3. Growth in size of business units.
4. Increase in the number of transactions of homogenous nature.
5. Use of information control system in financial data processing.

Procedure to conduct Balance Sheet Audit

1. Before commencing the audit see that the system of internal control is effective and qualified staff is appointed.
2. Examine the minute book and consider those items which have bearing on final accounts.
3. Compare the Profit and Loss Account and Balance Sheet of the current year with that of the previous year and find out any material difference.
4. Compare the increase and decrease in each item appearing in Profit and Loss Account and Balance Sheet.



5. Investigate into the causes of any variations in gross Profit and consider the valuation of stock.
6. Examine reconciliation of material consumed and stock.
7. Examine the details of material consumed and find out its ratio to production.
8. Find out whether there is any change in depreciation and see its effects on the Profit and Loss Account and Balance Sheet.
9. Investigate into the items of non-recurring nature and see that profit or loss on sale of fixed asset is properly ascertained.
10. Get the details of assets and liabilities as on the date of Balance sheet.
11. Verify the statement of fixed assets additions made and deductions made. Also verify changes if any.
12. Pay attention to the valuation of fixed assets.
13. Consider the details of current assets and enquire into the variations in current assets.
14. Consider, in detail, any substantial changes in items of balance sheet from the normal figure.
15. Verify the assets and properties held and liabilities arising.
16. See that adequate provision is made for all the known liabilities.
17. Ascertain any capital commitment.
18. Scrutinise contingent liabilities.
19. See that adequate provision is made for actual liability.
20. Collect a list of contingent liabilities from the officer of the company.
21. See the resolutions regarding transfers.
22. Obtain a copy of all suits filed by the company or against the company.
23. Evaluate the system of internal control and see how far it is effective.
24. See whether the presentation of financial statements is done properly as per the provisions of law.
25. Check the Statement of Sources and Application of funds.

Q. 19. Explain the procedure to conduct Balance Sheet Audit.

Advantages of Balance Sheet

1. No dislocation

Audit is done at the end of the year. Hence, day to day working is not dislocated.

2. Verification of Status

It focuses on items in Balance sheet. Hence, financial status is verified.

3. Full verification

All the assets and liabilities are fully verified.

4. No possibility of alteration

As the audit is done at the end of the year there is no possibility of alteration of figures.

5. No problem of link

There is no botheration of establishment of link as audit is done continuously.

6. Less Expensive

As audit is done at the end of the year, the cost is also reduced.

Q. 20. What are the advantages of Balance sheet audit ?

Disadvantages

Balance sheet audit is subject to following limitations :

1. No moral check

As the auditor visits at the end of the year, no moral check is created on the employees.

2. Difficult to detect frauds

As the audit is done at the end of the year it becomes difficult to detect errors and frauds.

3. Delay in finalization of accounts

As the audit is done at the end of the year, financial statements are delayed.

4. No verification of Profit and loss account

Items in Profit and loss account are not verified. Hence, correctness of incomes and expenses cannot be established.

5. Difficult to audit

It becomes difficult for the auditor to conduct audit of many firms.

6. Consequence of error

Consequences of errors are experienced by the clients first.

Q. 21. What are the disadvantages of Balance sheet audit ?**Position of Auditor**

In Balance sheet audit, the auditor checks the items appearing in Balance sheet. He does not follow the normal procedure of audit. He does not check all the transactions taken place. U/S 227 (3) the auditor is required to state in his report, "whether the Balance sheet and the Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns."

Now the question arises as to when the auditor can say so when he does not check all the transactions. It may be informed that he has not done his duty honestly. However, the law does not prescribe any procedure to conduct the audit. If the auditor is satisfied with the books of accounts, he may say so.

According to Mr. Irish, The Australian Accountant, Balance Sheet audit is an American Term which conveys two things :

- i) It means limited audit since it is confined to the items connected with Balance Sheet.
- ii) In such audit tests are imposed on internal control. The tests include scrutiny of records, comparison of income and expenses, investigation of material information and analysis of appropriations.

Q. 22. What is the position of an Auditor in Balance Sheet Audit?**Suitability**

Balance sheet audit is suitable under the following circumstances :

1. Where the volume of transactions is very large.
2. Where the system of internal check/internal control is very effective.
3. Where qualified accountants are employed to record the transactions.
4. Where mechanised system of accounting is in operation.

Q. 23. Under what circumstances Balance Sheet Audit is suitable?**Following are the liabilities of auditors in Balance Sheet Audit :**

Auditors' liabilities remain the same as given in the law, even if there is any change in the method of audit work. In case of negligence the auditor cannot escape from his liabilities.

Q. 24. What are the liabilities of auditors in Balance Sheet Audit?

2.3.6 Distinction between Continuous Audit and Periodic Audit

Point of Difference	Continuous Audit	Periodic Audit
1. Nature	Work of examination of records is done in detail.	Work is not done in detail.
2. Time	It is conducted throughout the year.	It is conducted after the close of the financial year.
3. Moral Check	It creates moral check on the employees.	It does not create moral check on the employees.
4. Applicability	It is applicable to large sized organizations.	It is applicable to small sized organizations.
5. Economy	It is costly.	It is not so costly.
6. Errors and Frauds	It helps to detect errors and frauds faster.	It does not help to detect errors and frauds faster.
7. Updating the accounts	Frequent visits of the auditor compels the accounts staff to update the accounts.	Accounting work may fall in arrears.
8. Pressure of work	Auditor can spread the work and can ensure uniform pressure of work throughout the year.	Periodic audit cannot ensure uniform pressure of work.
9. Alteration of figures	There is a possibility of alteration of figures.	There is no possibility of alteration of figures.
10. Dislocation of work	Frequent visits dislocate the work of the client.	The work is not dislocated as the auditor does the audit at the end of the year.
11. Audit Queries	Queries of last visit may remain pending till next visit.	Queries can be solved on the spot.
12. Audit planning	Audit plan must be elaborate.	Audit plan is simple.
13. Familiarity with Client's business	Auditor gets familiar with client's business.	Auditor cannot get familiar with client's business.
14. Extent of checking	The checking is done thoroughly.	The checking is done on sample basis.

Q. 25. Distinguish between Continuous Audit and Periodic Audit.

2.3.7 Distinction between Continuous Audit and Interim Audit

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

Q. 26. Distinguish between Continuous Audit and Interim Audit.

2.3.8 Distinction between Continuous Audit and Balance Sheet Audit

Point of distinction	Continuous audit	Balance sheet audit
1. Nature	The audit staff is continuously engaged in checking the accounts during the year.	Audit takes place at the end of the year.
2. Thorough-ness	It involves detailed and exhaustive checking of accounts.	It involves audit of items in Balance sheet.
3. Suitability	It is suitable to big organisations	It is suitable to those organisations which have efficient system of internal control.
4. Verification of assets	All assets and liabilities are fully verified cash and inventory are verified at every visit	All assets and liabilities are fully verified.
5. Popularity	It is widely used in India, England and European countries	It is most popular in America.

Q. 27. Distinguish between Continuous Audit and Balance Sheet Audit.

2.4 Based on Object

2.4.1 Special Audit

Under Section 233A of the Companies Act, 1956, the Central Government has power to direct special audit under the following circumstances :

1. When affairs of any company are not managed as per the sound business principles.
2. When company is being managed in a manner which is likely to cause serious injury or damage to the interest of trade or industry.
3. When financial position of the company is such as to endanger its solvency.

The central government decides the terms and conditions and scope of the audit work. The auditor appointed by the government is required to report to the government. The government gives directives to the company on the basis of the auditor's report.

The scope of a special audit is wider than the scope of an annual audit. The special auditor appointed under section 233A is to specially ascertain whether the business of the company is conducted according to sound principles and prudent practices. It may be pointed out that the role of a special auditor is more akin to that of an inspector appointed to investigate into the affairs of a company than to that of a regular auditor.

It is provided that a company's own auditor or any other Chartered Accountant as may be directed by the Government, may conduct a special audit.

The special auditor will have the same powers and duties as provided U/s 227. The report will include all matters required to be included in a auditor's report. The report will also include statements on any other matter as may be directed by the Central Government.

Special audit may be conducted under sec. 142 (2A) of Income Tax Act, 1961.

Under the Central Excise Act, 1944 also special audit can be conducted under sec. 14 A.

Note : There is no provision for special audit under the companies Act, 2013.

2.4.2 Branch Audit [Sec. 143 (8)]

As per the provisions of Companies Act, accounts of branch office of a company are required to be audited by the company auditor. In the case of foreign branches the

accountant duly qualified under the laws of the country can be appointed as Branch Auditor.

A separate branch auditor may be appointed by the company in general meeting in consultation with the company auditor.

Remuneration of such auditor is to be fixed by general meeting or by the Board of directors, if so authorized.

Branch Auditor is responsible for proper audit of branch accounts.

The company auditor must study the points raised by the branch auditor and judge the effect on company accounts. He should make the qualifications specified by the branch auditor.

As per section 143 of 2013 Act, there is no provision which empowers the Central Government to exempt branch offices from audit. Only those offices which are described by the company as 'Branch Office' shall be regarded as 'Branch Office'. If a company wants exemption of any branch office from audit, it can get such exemption by merely not describing it as 'Branch Office'.

Duties and Powers

1. The duties and powers of the auditor w.r.t. branch shall be as per sec. 143 (1 to 4).
2. The branch auditor shall submit his report to the company auditor.
3. The provisions relating to reporting of fraud shall also extend to the branch.

2.4.3 Joint Audit (SA 299)

Meaning

The audit conducted by one or more auditors jointly is Joint Audit. The auditors are known as Joint Auditors. Joint audit is conducted due to voluminous work involved.

Division of Work

The joint auditors should divide the work among themselves on the basis of :

- i) Period
- ii) Functional areas
- iii) Components of Financial Statements
- iv) Geographical Location

Division of work should be documented adequately. Each Joint Auditor is entitled to rely on other Joint Auditor.

Responsibility

Each joint auditor is separately responsible for :

- i) Work allotted to him.
- ii) Drafting his own audit programme.
- iii) Keeping appropriate documentation
- iv) Components allocated to him in case of large entities.

Joint Responsibility

Joint Auditors are jointly and severally responsible for :

- i) Audit work not divided.
- ii) Collective decisions.
- iii) Matters brought to the knowledge of all by any one of them and on which they all agree.
- iv) Disclosure requirements in Financial Statement.
- v) Compliance of Audit Report with Statutory requirements.

Difference of Opinion

Generally all the joint auditors arrive at unanimous opinion. However, any joint auditor is not bound by majority opinion. In such a case he may provide his own opinion through a separate Report.

2.5 Other Types of Audit

2.5.1 Occasional Audit

This type of audit is carried out occasionally as per the need of the business. This is applicable to the proprietary concerns such as sole trader and partnerships. It is just a need based audit. It is conducted at the desire of the owner of the business.

2.5.2 Audit in Depth

Taylor and Perry define auditing in depth as it implies the examination of the system applied within a business entailing the tracing of certain transactions from their origin to their conclusion investigating at each stage the records created and their appropriate authorisation.

Under this type of audit, the auditor examines thoroughly selected transactions right from their origin to the conclusion. All records and documents pertaining to the transactions are checked in detail. The basic purpose of this type of audit is to see whether the system of internal check or control system is effective. This type of audit enables the auditor to suggest to the management a better procedure for recording the transactions to avoid any loop holes for committing frauds.

For example, the item sales will be examined as follows :

1. Order from the customer.
2. Acceptance of the order.
3. Intimation to the despatch section to send goods.
4. Gate pass.
5. Challans outward duly acknowledged by the recipient.
6. Goods outward Register.
7. Stock Register.
8. Copy of Invoice.
9. Cash Book.
10. Bank Pass Book.
11. Customer's Ledger.

Q. 28. Write a short note on Audit in Depth.

2.5.3 Cash Audit

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

Q. 29. What is cash audit?

2.5.4 Operational Audit

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

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

Q. 30. What is operational audit?

2.5.5 Tax Audit

It is the audit done for assessing the correctness of calculation of taxable profits. It is done to ensure compliance with the provisions of the Income Tax Act 1961. The Income Tax Act has made tax audit compulsory for special persons under section 44 AB. The assessing officer is empowered to direct the assessee to get his accounts audited by an accountant nominated by the Commissioner of Income Tax.

Q. 31. What is Tax Audit?

2.5.6 Efficiency Audit

Efficiency audit is a part of performance audit. It is also known as efficiency cum performance audit. It is concerned with evaluation of performance. Actual performance is compared with pre-determined standard and deviation if any, are investigated into. The auditor may give suggestions for improvement of performance. Performed audit is closely related to management audit. Efficiency cum performance audit encompasses economy audit, efficiency audit and effectiveness audit.

Economy audit : is concerned with using financial, human and physical resources at minimum cost.

Efficiency audit : It refers to relationship between goods and services. The efficiency auditor examines whether operations have produced maximum output for a given set of inputs.

Effectiveness : It is designed to examine whether the purpose of a programme of individual project has actually been achieved.

Q. 32. What is Efficiency Audit?

2.5.7 Concurrent Audit

It is an examination which is contemporaneous with the occurrence of transactions. It cuts short the interval between a transaction and its examination by an independent person. It is considered as part of bank's early warning system to ensure timely detection of irregularities.

Coverage

It should cover the following :

1. Exceptionally large, very large and large branches.
2. Special branches handling foreign exchange business.
3. Branches rated as poor.
4. H.O. departments dealing with treasury and handling investment portfolio.
5. Other branches where in opinion of the Bank concurrent audit is desirable.

Scope

The scope includes the following :

1. Daily cash transactions with abnormal receipts and payments.
2. Purchase and sale of shares securities etc.
3. Verification of documents to open new current, savings and them deposits A/c.
4. Verification of advances, overdrafts etc.
5. Foreign Exchange transactions with reference to RBI guidelines.
6. Verification of balancing of all ledgers and registers.
7. Revenue leakage detection.
8. Fraud prone areas.
9. Verification of high value transactions.
10. Procedure for sale custody of security forms with the branch.
11. Verification of returns, statements, calculation of capital adequacy ratio.

12. Study of RBI and internal inspection reports, Statutory Audit Report and compliance.
13. Dealing with customer's complaints.

Q. 33. Write a Note on Concurrent Audit.

2.6 Green Audit

Green audit, also known as environmental audit is a systematic approach aimed at identifying areas for improvement and proposing measures to reduce environmental impact and improve sustainability. It begins with the aim of reviewing work in organizations whose exercises may entail risks to the health of residents and the environment. It also provides guidance on how to minimize a company's impact on the environment to support sustainability.

Green audit is a process of systematic identification, quantification, recording, reporting and analysis of components of the environmental diversity of an organization.

In Green audit, the assessors have to :

- Check current processes
- Evaluate the impact of operations on the environment and collect evidence
- The evidence received will be evaluated
- Conclusions are drawn on the basis of the collected evidence and to communicate the results to interested users.

Benefits

1. This will help the company to avoid fines and penalties.
2. It helps companies to create safer working conditions.
3. To Identify methods of reducing costs through waste management, energy saving methods, recycling, reuse and waste minimization.
4. Creates a good image of the company / institution in the minds of stakeholders.

Gender Audit

- A gender audit aims to evaluate the policies, programs, projects and/or the provision of services, structures and budgets of organizations in relation to gender in an organization. Gender audits establish a baseline against which progress can be measured over time, identify critical gender gaps and challenges, and make recommendations on how they can be addressed through improvements and innovations. It Assesses the amount of resources allocated and spent on activities related to the integration of the gender dimension and gender equality;
- It provides information on the extent to which gender is integrated into personnel policy and whether there is a gender balance within employees at different levels of the organization; it also evaluates an organization's approach to gender equality within the organization and communicates and demonstrates its support through concrete measures. It also evaluates the mechanisms by which an organization integrates and fleshes out its commitment to gender equality values in its policies, programs, projects, services and products. A gender examination improves the collective ability of the organization to look at its activities from a gender perspective and to identify strengths and weaknesses in promoting gender equality issues, as it is necessary to integrate a fair gender policy for equal treatment and opportunities in the workplace.

The Gender Audit will :

- Understand the practices and the current situation of the organization from a gender perspective and identify gaps and strengths.
- Collect qualitative and quantitative data for analysis purposes.

- Create the basis on which the design of the equality plan is based.
- Creation of a fund for common awareness and understanding in the organization. This will contribute to the future implementation of the equality plan.
- Propose measures to reduce the gender gap.

3. QUALITIES OF AUDITOR

An auditor must possess the following qualities in order to discharge the responsibilities efficiently :

According to AAS-1 the auditor should have the following qualities :

1. Integrity

The auditor must be straightforward, honest, sincere, fair and objective in the performance of his professional duties. As remarked by Lord Justic Lindley, in the case of London and General Bank, 'an auditor must be honest. He should not certify what he does not believe to be true. He must exercise reasonable care and skill before he believes that what he certifies is true.

2. Objectivity

The auditor should be free from any prejudice or bias. The auditor should act like a watchdog but not like a bloodhound. As remarked by Justice Lopes in Kingston Cotton Mills case an auditor is not hound to be detective. The auditor should have an attitude of "professional scepticism". He should neither assume that the management is honest nor that it is dishonest.

3. Independence

An auditor must be independent. He should be impartial, fearless while discharging his duties. He should not have any vested interest that affect his independence. Auditor's judgement should not be subject to the wishes of the management.

4. Confidentiality

The auditor should not disclose any information to anyone without any authorisation or unless it is legally mandatory. The auditor should keep his eyes and ears open but his mouth shut.

5. Skills

The audit should be performed with due professional care. It should be done by a competent person.

The auditor should have a general knowledge of the economy and the industry and a more particular knowledge of the clients business.

In order to be successful, an auditor should possess following qualities :

1. He should have expert knowledge of accounting techniques and principles.
2. He must have knowledge of the recent developments in accounting and auditing.
3. He must have knowledge of various legislations governing the company.
4. He must be well versed in taxation.
5. He should have good knowledge of industrial management, finance, administration etc.
6. He must be honest and tactful.
7. He must be painstaking.
8. He must have reasonable degree of intelligence.
9. He must be accurate and systematic.
10. He must have alert mind and common sense.
11. He must be impartial.
12. He must have common sense.
13. He must be independent.

14. He must have integrity.

15. He must be cautious and vigilant.

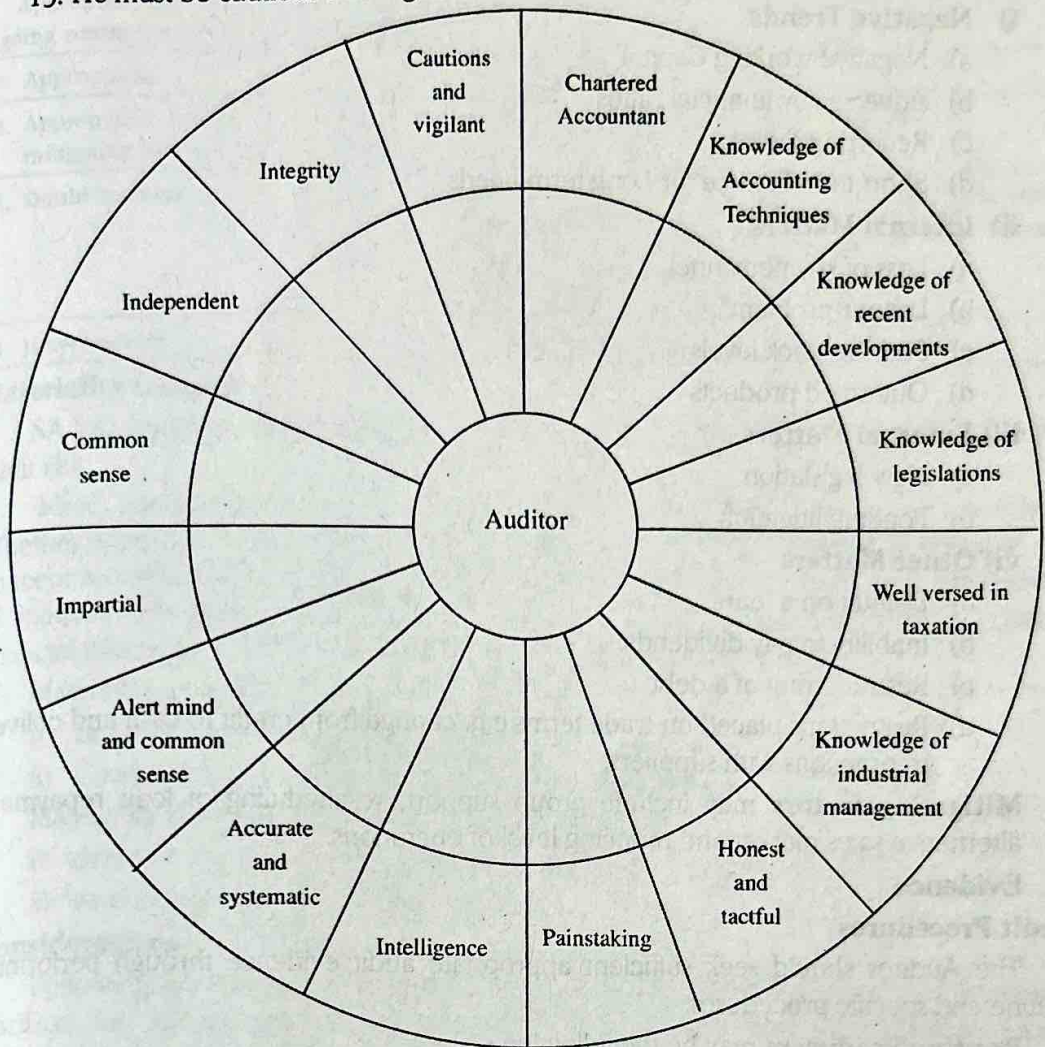


Fig. 2.7

Q. 34. What qualities must be possessed by an auditor to be successful?

4. ACCOUNTING CONCEPTS

Going Concern Concept

The enterprise is normally treated as going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing the scale of the operations. In other words, there is neither intention of discontinuance of business, nor necessity of liquidation of organisation or discontinuance of major operations of the business.

According to AS - 1, Going Concern is one of the fundamental accounting assumptions. Specific disclosure of the same is not required unless the assumption is not followed in the financial statements.

According to SA - 570 the auditor's duties are as given below :

A. Appropriateness

1. When planning and performing audit procedures and in evaluating the results thereof, the Auditors should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements.
2. The Auditor should also consider the risk that the concern assumption may no longer be appropriate. The entity's inability to continue as a going concern may be

shown by various factors. Some potential indicators of going concern problem can be listed as under :

i) Negative Trends

- a) Negative working Capital
- b) Adverse key financial ratios
- c) Recurring losses
- d) Short term finance for Long term needs.

ii) Internal Matters

- a) Loss of key personnel
- b) Labour problem
- c) Soaring stock levels
- d) Out-dated products

iii) External Matters

- a) New legislation
- b) Pending litigation

vi) Other Matters

- a) Default on a loan
- b) Inability to pay dividends
- c) Restructuring of a debt
- d) Restrictions placed on trade terms e.g. change from credit to cash and delivery transactions with suppliers.

B. Mitigating factors may include group support, rescheduling of loan repayment, alternative sales market and reducing level of operations.

C. Evidence

Audit Procedures

The Auditor should seek sufficient appropriate audit evidence through performing routine and specific procedures.

1. Routing Procedures may be the following :

- i) Reading minutes of various meetings
- ii) Reviewing the terms of debenture and loan and whether they have been breached.
- iii) Reviewing status of claims under litigation.

2. Specific Procedures can be classified as under :

i) Assessing client's plan of recovery for feasibility may include the following :

- a) Analysing forecasts such as cash flows and other relevant variables and examining appropriateness of assumptions underlying.
- b) Examining reliability of entity's system for generating such information.
- c) Discussing with management and obtaining written representations from management.

ii) Reviewing subsequent events such as restrictions of debt on the date of balance sheet or availability of additional borrowings.

iii) Assessing group support : This may involve examining whether agreements are legally binding, examining financial statements of related companies, obtaining legal advice etc.

D. Auditor's Report

The auditor, after considering management's plan and other evidence will issue his report. As stated above, he would base his report upon the appropriateness of going concern accounting concept. The following table summarises various aspects related to the kind of report and going concern accounting concept.

Kinds of Audit Report and Going Concern Concept

Appropriateness of going concern concept	Adequacy of disclosure	Kinds of audit opinion
1. Appropriate	–	Unqualified
2. Appropriate due to mitigating factors	Yes No	Unqualified Qualified or adverse Opinion
3. Doubt remains	Yes No	Emphasis of Matter paragraph in an unqualified report or a disclaimer of opinion qualified or adverse report Qualified or adverse report
4. Inappropriate	–	Qualified or adverse report

Materiality Concept

SA 320 Audit materiality deals with the concept of materiality and its relationship with audit risk.

While conducting audit the auditor should consider the concept of materiality. Whether a particular item is material or not depends on the professional judgement. The concept recognises that some matters are relatively important for true & fair presentation of financial information. The auditor considers materiality at both the levels i.e. overall financial information level and in relation to individual account balances.

Materiality may be influenced by :

- Legal and regularity requirements
- Considerations relating to individual account balances

Materiality should be considered by the auditor when :

- deciding the nature, timing & extent of audit procedures
- evaluating the effect of misstatements.

Considerations

Following are the various considerations which influence the concept of materiality. Such as size, nature, relative importance of the matter for true and fair presentation of financial information.

Legal Requirements

Materiality is influenced by law which requires compulsory disclosure of all the items which are material.

Schedule III disclosure requirements ensure that financial statements disclose all material items. This also affect materiality.

Professional requirements

As per AS 5 extra-ordinary items should be disclosed separately and its effect on current profit should be started.

Incomes & expenses of ordinary items also should be disclosed separately.

Prior period items should be disclosed separately to show its effect on current profit.

Any change in accounting policies which has a material effect should be disclosed separately in the financial statements.

Q. 35. What is the relevance of Going concern and Materiality in Auditing?

5. EXERCISES**5.1 Objective Questions**

I. State with reasons whether following statements are True or False :

- Statutory audit is voluntary.
- It is compulsory for a proprietor to appoint a statutory auditor.
- Internal auditor is appointed by the management.

4. In complete audit every voucher need not be examined.
5. Continuous audit is done at the end of the year.
6. Continuous audit is very costly.
7. Annual audit is also known as final audit.
8. Periodic audit dislocates the work of the organisation.
9. Balance sheet audit verifies the assets & liabilities appearing in the balance sheet.
10. Concurrent audit is done with the occurrence of the transactions.
11. Final audit is less costly.
12. Continuous audit dislocates the working of an organisation.
13. Interim audit is compulsory for companies.
14. In Balance Sheet audit the auditor has not to audit P & L A/c.
15. Statutory audit is compulsory for sole proprietor.
16. In continuous audit errors can be detected immediately.
17. There is no scope for alteration of figures in continuous audit.
18. Internal audit is compulsory under the companies Act 1956.
19. Occasional audit is carried out occasionally as per the need of the organisation.
20. Tax audit is done to assess correctness of taxable profit.
21. Efficiency auditor is a part of performance audit.
22. The audit need not have knowledge of law governing the organisation.

[Ans. : True : 3, 6, 7, 9, 10, 11, 12, 16, 19, 20, 21]

False : 1, 2, 4, 5, 8, 13, 14, 15, 17, 18, 22]

II. Match the Following :

	Group A		Group B
a)	Concurrent audit	i)	done by frequent visit to the organization
b)	Continuous audit	ii)	done to evaluate efficiency
c)	Efficiency audit	iii)	mandatory
d)	Statutory audit	iv)	some transactions examined
e)	Partial audit	v)	done at the end of the year
f)	Final audit	vi)	audit with the occurrence of the transactions
g)	Special audit	vii)	under section 233A of the Companies Act, 1956.

[Ans. : (a - v), (b - i), (c - ii), (d - iii), (e - iv), (f - v), (g - vii)]

III. Multiple Choice Questions :

1. Audit of banks is an example of -
 - a) Statutory audit
 - b) Continuous audit
 - c) Balance sheet audit
 - d) Both (b) and (c)
2. Concurrent audit is a part of -
 - a) Internal check system
 - b) Continuous audit
 - c) Internal audit system
 - d) None of the above
3. In India Balance Sheet audit is synonymous to -
 - a) Annual audit
 - b) Continuous audit
 - c) Detailed audit
 - d) Statutory audit
4. Audit in depth is a synonymous for -
 - a) Complete audit
 - b) Completed audit
 - c) Final audit
 - d) Detailed audit

5. Balance sheet audit includes verification of –
 - a) Assets
 - b) Liabilities
 - c) Income and expenditure
 - d) All of the above
6. Which of the following statement is not true about continuous audit
 - a) It is conducted at regular interval
 - b) It may be carried out on a daily basis
 - c) It is needed when the organization
 - d) It is expensive internal control system has a good.
7. Which of the following is not a fact of Efficiency cum Performance Audit?
 - a) Economy audit
 - b) Efficiency audit
 - c) Expenditure audit
 - d) Effectiveness audit
8. Balance sheet audit does not include
 - a) Verification of assets and liabilities
 - b) Vouching of income and expenditure
 - c) Examination of adjusting
 - d) Routine checking and closing entries
9. Manufacture and other Companies (Audit Report) order 1988 is superseded by –
 - a) Companies Audit Report
 - b) Companies Act 1956 order 2003
 - c) Banking Companies Act
 - d) Chartered Accountants Act
10. Special audit can be ordered by –
 - a) Central Government
 - b) State Government
 - c) Municipality
 - d) Grampanchayat

[Ans. : (1 – a), (2 – c), (3 – a), (4 – d), (5 – d), (6 – c), (7 – c), (8 – d), (9 – a), (10 – a)]

IV. Fill in the blanks with appropriate word :

1. _____ is compulsory under law.
2. The audit which is done for satisfaction of the owner is _____.
3. The objective of _____ is to suggest improvement to the functions of the organisation.
4. Internal auditor is appointed by the _____.
5. _____ is carried out through out the year.
6. Continuous audit is _____.
7. There is no chance of alteration of figures in _____.
8. _____ is completed between two final audits.
9. _____ means verification of items in Balance Sheet.
10. Under section _____ of the companies Act, 1956, the Central Government has power to appoint special auditor.
11. _____ is verification of cost records.
12. _____ is examination of plans, policies, procedures and methods.
13. _____ contributes to national growth.
14. Cash Audit is a _____ audit.
15. Operational audit goes beyond _____.
16. _____ is done to ascertain correctness of taxable profit.
17. _____ is a part of performance Audit.
18. _____ is conducted occasionally.

[Ans. : (1) statutory audit, (2) internal audit, (3) internal audit, (4) management (5) continuous audit, (6) costly, (7) final Audit, (8) interim audit, (9) Balance sheet

audit, (10) 233 A, (11) cost audit, (12) management audit, (13) social audit, (14) partial, (15) financial audit, (16) Tax audit, (17) efficiency audit, (18) occasional.]

V. Short Questions :

1. Define statutory audit.
2. What do you mean by non-statutory audit?
3. Explain the meaning of the word, 'private audit'.
4. Explain the meaning of the word, 'internal audit'.
5. What is complete audit?
6. What is partial audit?
7. What is continuous audit?
8. Explain completed audit.
9. Explain final audit.
10. What do you mean by periodic audit?
11. Explain interim audit.
12. Explain concurrent audit.
13. What is balance sheet audit?
14. What is special audit?
15. What is audit in depth?
16. What is cash audit?
17. Explain the meaning of the term, 'operational audit'.
18. What is tax audit?
19. What is efficiency audit?
20. Explain going concern concept.
21. What is materiality concept?
22. Audit in depth means audit of full books of accounts? If no, then what do you mean by audit in depth?

VI. Write short note on :

1. Statutory Audit
2. Complete Audit
3. Interim Audit
4. Concurrent Audit
5. Balance Sheet Audit
6. Special Audit
7. Occasional Audit
8. Audit in depth
9. Tax Audit
10. Efficiency Audit

3

AUDIT PLANNING, PROCEDURES AND DOCUMENTATION

SYNOPSIS

1. *Meaning*
2. *Objectives of Audit Planning*
3. *Planning Activities*
4. *Factors to be Considered*
5. *Sources of Obtaining Information*
6. *Discussion with Clients*
7. *Overall Audit Plan*
8. *Audit Programme*
 - 8.1 *Meaning*
 - 8.2 *Development of an Audit Programme*
 - 8.3 *Contents of an Audit Programme*
 - 8.4 *Essentials of an Audit Programme*
 - 8.5 *Advantages of Audit Programme*
 - 8.6 *Disadvantages of Audit Programme*
 - 8.7 *Remedies to Remove the Drawbacks of Audit Programme*
 - 8.8 *Methods of Work*
 - 8.9 *Instructions before Commencing Work*
 - 8.10 *Overall Audit Approach*
9. *Audit Working Papers*
 - 9.1 *Working Papers*
 - 9.2 *Importance of Working Papers*
 - 9.3 *Factors Determining Form and Contents of Audit Working Papers*
 - 9.4 *Main Functions of the audit working papers*
 - 9.5 *Filing of Working Papers*
 - 9.6 *Ownership, Custody, Access of the other Parties to Audit Working Papers*
 - 9.7 *Auditor's Lien on Working Papers*
 - 9.8 *Auditor's Lien on Client's Books*
10. *Audit Note Book*
 - 10.1 *Meaning*
 - 10.2 *Structure of Audit Note Books*
 - 10.3 *Importance of Audit Note Book*
 - 10.4 *Distinction between Audit Note Book & Audit Working papers*
 - 10.5 *Sample Audit Note Book*
11. *Objective Questions*

1. MEANING

Audit planning refers to the planning by the auditor to enable them to conduct an effective audit in an efficient and timely manner and includes planning about area, scope, depth of transactions to be audited, time to be devoted, persons to be deployed for audit etc.

Auditing and Assurance standard SA 300, "Audit Planning" was issued by the council of the Institute of Chartered Accountants of India (ICAI) in 1989. This statement should be read in conjunction with the "Preface to the Statements on Standard Auditing Practices" issued by the Institute.

SA 200 "Basic Principles Governing an Audit" states (paragraphs 12-14) : "The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover among other things :

- acquiring knowledge of the client's nature of business accounting systems, policies and internal control procedures,
- establishing the expected degree of reliance to be placed on internal control,
- determining and programming the nature, timing and extent of the audit procedures to be performed, and
- coordinating the work to be performed.

Plans should be further developed and revised as necessary during the course of the audit.

The purpose of this standard is to amplify the basic principles outlined above.

SA 300 applies to the planning process of the audit of both financial statements and other financial information. The statement is framed in the context of recurring audits. Planning should be continuous throughout the engagement. It involves developing an audit programme, showing nature, timing and extent of audit procedures. Changes in conditions or unexpected results of audit procedures may necessitate revision of the overall plan as well as the audit programme. However, the auditor should state the reasons for significant changes which should be documented.

Q. 1. What is Audit Planning ?

2. OBJECTIVES OF AUDIT PLANNING

Audit planning involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. These are as under :

- It helps the Auditors to devote appropriate attention to important areas of the audit.
- It helps the Auditor to identify and resolve potential problems on a timely basis.
- Planning helps the Auditor to properly organise and manage the audit engagement so that it is performed in an effective and efficient manner.
- Planning assists in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risk, and the proper assignment of work to them.
- Adequate planning facilitates the direction and supervision of engagement team members and the review of their work.
- It assists, where applicable, in coordination of work by Auditors of companies and experts.

Q. 2. What are the objectives of Audit Planning ?

3. PLANNING ACTIVITIES

1. Establishment of Audit Strategy

The auditor shall establish audit strategies that sets the scope, timing and direction of audit and that guides the development of audit plan. In establishment of audit strategy the auditor shall :

- Identify the characteristics of the engagement;
- Ascertain the reporting objectives of the engagement to plan the timing of audit;
- Consider the factors that direct the efforts of engagement team.
- Consider the results of preliminary engagement activities.
- Ascertain the procedure to perform.

2. Development of Audit Plan :

The audit plan shall include :

- The nature, timing of extent of planned risk assessment procedures.
- The nature, timing and extent of planned further audit procedures
- Other planned audit procedures that are required to comply with SAs.

Q. 3. What are the Planning Activities?**4. FACTORS TO BE CONSIDERED**

While planning his audit, the auditor should consider the factors such as complexity of the audit, the environment in which the enterprise operates, his precious experience with the client and knowledge of client's business. The auditor may wish to discuss elements of his overall plan and certain audit procedure with the client. This may help the auditor to improve the efficiency of the audit and to coordinate audit procedures with work of the employees of the client. It should however, be noted that the overall plan of audit and the audit programme remain the responsibility of the auditor.

Audit plan cannot be formulated by sitting in isolation. Preparation of audit plan is a brain storming exercise. An audit plan is a brain child of wisdom, foresight, professional knowledge, previous experience, knowledge about the industry, knowledge about the entity, its business management people, management, and operating system. As stated earlier the audit plan is often subject to revision in the light of new experiences encountered as one performs.

The auditor should consider the following factors while planning audit :

- Complexity of Audit
- The environment in which the entity operates.
- Previous experience with the clients
- Knowledge of client's business

Q. 4. What factors are considered before planning the Audit?**5. SOURCES OF OBTAINING INFORMATION**

As per SA 315 the auditor should carry out a business review. The information and understanding so obtained forms the basis of risk assessment and evaluation of audit evidence. It gives the auditor an insight into the operations of the organization.

Sources of information

SA 300 identifies the sources from which knowledge about client's business can be acquired. Following are the sources of information :

Sources**Examples**

Internal reports	:	Annual report to shareholders
		Minutes of meetings
		Budgets forecasts and projections
		Last year's working papers
		Policy manuals
		Internal audit reports
External reports	:	Trade journals, magazines and newspapers
		Text books
		Publications of professional bodies
		Industry publications
		Web-sites

Discussions with management

- : The auditor should meet the client or senior management and have a discussion on the issues relating to client's business. The issues may include :
- i) Change in management, organizational structure and activities.
 - ii) Current government legislation, rules and regulations affecting the client's business.
 - iii) Current business developments affecting client.
 - iv) Current or expected financial difficulties or accounting problems.
 - v) Plant facilities.
 - vi) Recent changes in technology, types of products or services and production and distribution methods.
 - vii) Significant matters arising from previous year's financial statements, audit report and management letters.
 - viii) Changes in accounting practices and procedures and in the system of internal control.

Visit to client's premises

- : The auditor may visit the clients premises to get information about :
- Plant layout
 - Manufacturing process
 - Internal documents generated etc.

Q. 5. What are the sources of obtaining information about client's business?

6. DISCUSSION WITH CLIENTS

Many auditors see that the clients prepare certain data and schedules before commencement of audit work. Such preparation is necessary generally on the following items :

1. Trial Balance
 - a) General ledger.
 - b) Debtors' ledger.
 - c) Creditors' ledger.
2. Cash
 - a) Bank Reconciliation Statement.
 - b) Arrangement of Vouchers.
 - c) Statement of Cash in transit.
 - d) Statement of Cheques returned from banks.
3. Debtors
 - a) Statement of debtors.
 - b) Aging of debtors.
 - c) Confirmation of the balances.
 - d) Statement of bills receivables.
4. Investments
 - a) Schedule of investments.
 - b) Statement of investments purchased and sold during the year.
 - c) Statement of dividend received and receivables.

5. Inventories
 - a) List of inventories with classification.
 - b) Location of inventories.
 - c) Valuation of inventories.
6. Fixed Assets

Schedule of fixed assets showing

 - a) opening balance.
 - b) additions made.
 - c) disposal during the year.
 - d) repairs.
 - e) depreciation.
7. Prepaid expenses and outstanding expenses

Schedule of all prepaid expenses and outstanding expenses.
8. Current Liabilities
 - a) Statement of creditors.
 - b) Copies of tax returns prepared by the client.
9. Long term liabilities
 - a) List of bond owners.
 - b) Schedule of interest payments.
 - c) Cancelled bonds retired during the year.
10. Corporate capital
 - a) Schedules of ownership of capital stock.
 - b) Names and number of shares.
11. Profit and Loss Account
 - a) Details of expenses.
 - b) Details of tax payment.

Q. 6. What preparation is necessary by the client before audit work?

7. OVERALL AUDIT PLAN

As per SA 315 the auditor should consider the following matters while developing an overall audit plan :

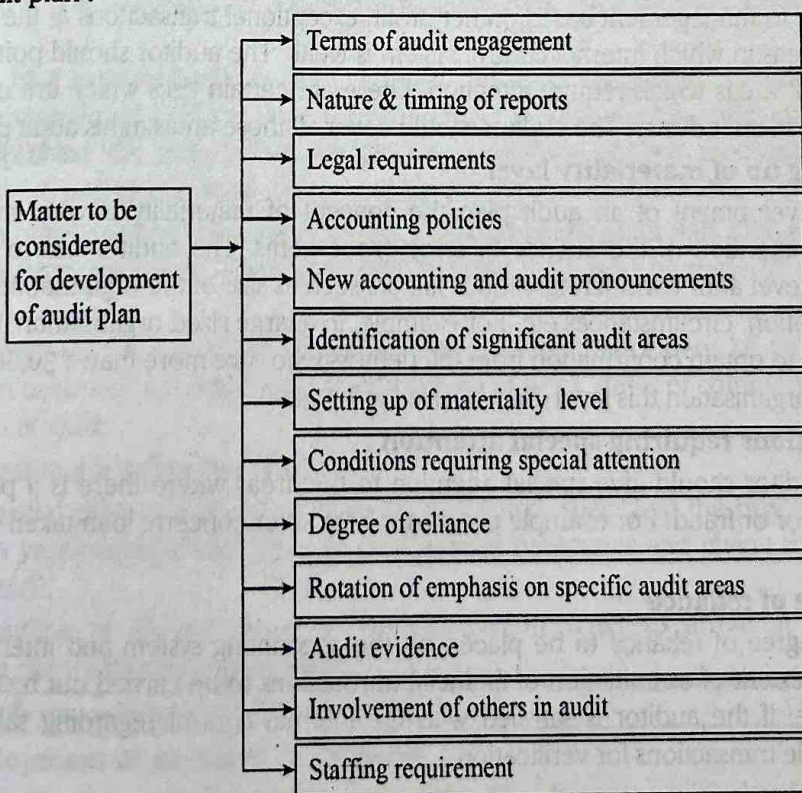


Fig. : 3.1

1. Terms of audit engagements

Statutory requirements :

The letter of engagement specifying the scope of audit work. Section 227 of the Companies Act lays down the scope of audit work. In the case of non-statutory audit the letter of engagement lays down the scope of audit work.

2. Nature and timing of reports and other communications.

The terms of engagement decide the reports to be given by the auditor. For drafting audit plan, the timing of the report is important. For example for listing a certificate from the auditor regulating compliance of corporate governance is necessary. This certificate is also required with the Director's Report which is sent to the shareholders. It is also to be sent to the stock exchanges along with the Annual Returns

3. Legal requirements

For developing audit plan consideration of legal requirements is also necessary. For examples every listed public company with paid up capital of ₹ five crores or more should have an Audit committee. The committee may request the auditor to expand the scope of audit work.

4. Accounting policies of the clients and any changes there in

An organisation may choose alternate accounting policies for various accounting aspects. If the policy is valuation of inventory to be done by using verified average method, then the work of the auditor involves lot of calculations. In case of changes, the plan must consider the procedure for transition to the new policy.

5. New accounting and audit pronouncement

The financial statements should be prepared by the management as per the requirements of the accounting standards. The audit work has to be within the framework of the pronouncement of any professional body. The effect of any change must be considered in the audit plan.

6. Identification of significant audit areas

Due to the risk of fraud, there are certain areas which are significant. For example, commission to management based on net profit, exceptional transactions at the end of the year, the areas in which internal control system is weak. The auditor should point out such special audit areas which require attention. There are certain risks which are common to all the firms in an industry. The auditor should cover all those areas in his audit plan.

7. Setting up of materiality level

For development of an audit plan the concept of materiality is very important. It directs the attention of the auditor to error prone items. The auditor has to set up the materiality level after considering various factors such as size of the organisation, nature of the organisation, circumstances etc. For example, in a large sized organisation, the auditor may decide to obtain confirmation from the debtors who owe more than ₹ 30,000 whereas for a small organisation this level may be fixed at ₹ 10,000.

8. Conditions requiring special attention

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

9. Degree of reliance

The degree of reliance to be placed on the accounting system and internal control decide the extent of examination of financial transactions to be carried out by the auditor for example, if the auditor is satisfied with the internal control regarding sales he may select sample transactions for verification.

10. Rotation of emphasis on specific audit areas

For an organisation major audit areas may be sales, purchases, salary conditions, fixed assets, store, debtors, cash etc. In case of recurring audit the auditor should rotate the emphasis in such a manner that the management does not know the area of emphasis.

11. Audit evidence

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

12. Involvement of others in audit

While developing audit plan, the auditor should consider the need of involvement of internal auditors, joint auditors and experts in audit work and decide the extent to which he can rely on their work.

13. Staffing requirement

The auditor should consider the quantum of audit work, time required and competence of the staff to decide the staffing requirements.

The auditor should announce his audit plan. And the important part of documentation is development of an audit programme.

Q. 7. What factors are to be considered by an Auditor while developing an Audit plan?

8. AUDIT PROGRAMME

8.1 Meaning

SA 315 suggests that the Auditor should prepare an Audit plan.

An Audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

It is a planning made by the auditor for the purpose of conduct of audit. It contains instructions, hints and serves as a guidance for the audit staff. It is a written plan giving full instructions, hints, and guidance to the audit staff as to how they should proceed with the audit work. It is a guide for arrangement and distribution of audit work among the audit assistants.

It is a blue print of audit work to be done. An audit programme is thus a logically planned examination specifying the audit procedures to be applied in given circumstances for accomplishing the audit objectives giving an estimate of time required to finish a particular work and laying down responsibilities of members of audit team.

It is an outline of how the audit is to be conducted by the audit staff, who is to do what work and within what time. It is a time table of what work is to be done by whom, how and when.

It is prepared by the Chief Auditor before the commencement of an audit. It is prepared in columnar form with columns for nature of work, dates of commencement and completion of work.

Audit programme is defined as follows :

"A detailed plan of auditing work to be performed, specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required".

Megis

"An outline of all procedures to be followed in order to arrive at an opinion concerning client's financial statements."

Stettler

Q. 8. What do you mean by an Audit Programme?

8.2 Development of an Audit Programme

The audit firm should consider the following factors while developing audit programme :

1. Internal control

The quality of internal control system of the client should be considered. The auditor may go for test checking if the internal control is strong. If the system of documentation of purchases and approval of such purchases is proper, perpetual inventory records are reliable.

2. Client's activities

It should be tailored to fit the requirement of entity. The nature of activities of the client should be considered while designing audit programme. The audit programme must fit to the requirement of the client. The audit programme for bank will be different from that of manufacturing organisation. In case of bank audit the auditor will have to focus on verification of loans receivable and performing assets. In the case of manufacturing concern, concentration should be on purchases, plant and machinery, sales and audit of resources.

3. Cost benefit

While developing audit programme the auditor should consider the cost of performing the procedure and the benefits likely to accrue. The auditor should select the audit procedure which is less costly.

4. Scope of Limitation of the assignments

Audit programme should cover only those areas for audit which fall within the scope of his assignment.

5. Evidence reasonably available

Audit programme contains procedures and techniques to collect evidence. The auditor should determine the evidence reasonably available and he should identify the best evidence.

6. Verification

Auditing programme should consider those steps and procedures which are useful in accomplishing the objective of verification of assets and liabilities.

7. Possibility of error

The auditor should consider all the possibilities of errors while drafting the audit programme.

8. Co-ordination

The audit programme should be drawn in such a manner that the procedures are coordinated.

9. Assistants

The auditor should consider the number of assistants available for audit work.

10. Other Auditors

The auditor should consider to what extent he can rely on internal auditor, branch auditor, experts etc.

Q. 9. What factors the Auditor should consider while developing Audit Programme?
8.3 Contents of an Audit Programme

Contents of the audit programme differs from client to client. It may differ from year to year also. It includes the items of verification of M/A and A/A in case of limited company or Partnership Deed in case of partnership. The various items are listed under appropriate heads. The persons who are supposed to do the work are also listed.

Contents of audit programme depends on the nature of business. The programme for trading concern is different from a manufacturing concern.

An audit programme contains information about the following :

1. Name and object of the undertaking.
2. Date of commencement of audit and duration of audit.

3. System of accounting, internal check, internal control and its effectiveness.
4. Previous year's accounts with the report of the auditors.
5. Outline of various books of accounts to be examined.
6. Type and number of transactions to be selected.
7. Nature of documents to be examined.
8. Persons in-charge of audit work.
9. Datewise schedule of work to be carried.
 - a) Routine audit items.
 - b) Checking of evidences.
 - c) Scrutiny.
 - d) Review of transactions.
 - e) Examination of final statements.
 - f) Comparison of figures of this year with the previous year.
 - g) Comparison of various ratios.
 - h) Checking minute books.
 - i) Preparation of audit reports.

Q. 10. What are the contents of an Audit Programme?

8.4 Essentials of an Audit Programme

1. It must be in writing.
2. It must contain full details of work to be done.
3. There should be a clear cut distribution of work among the audit staff.
4. It should pinpoint the responsibility of the audit staff.
5. It should be a time bound programme.
6. It should be flexible.
7. It should be simple to understand.

Q. 11. What are the essentials of a good Audit Programme?

8.5 Advantages of Audit Programme

Advantages

- Instructions to audit staff
- Overview of work
- Selection of staff
- Systematic
- Audit Control
- Guidance
- Evidence
- Uniformity in work
- Enhances efficiency
- Facilitates reporting
- Review of work
- Fixed Responsibility
- More Clients

Fig. 3.2

1. Instructions to audit staff

It provides clear cut instructions to the audit staff in carrying out the work.

2. Overview of work / Total Perspective

It gives an overview of the total work to be done or perspective of audit work.

3. Ease in selection of staff

It becomes easy to select the assistants for carrying out the audit work.

4. Systematic

It facilitates systematic auditing.

5. Audit Control

The chief auditor can control the audit work effectively.

6. Guidance

It serves as a guide for audit work in future.

7. Evidence against charge of negligence

It serves as an evidence in the court of law in the case of any charge of negligence against the auditor.

8. Uniformity in work

It maintains uniformity in audit work.

9. Enhances efficiency

It enhances the efficiency of audit staff.

10. Facilitates reporting

It helps the auditor to draft the report properly.

11. Review of work

The auditor can assess progress of audit work done.

12. Fixed Responsibility

Responsibility for any mistake or negligence on the part of the clerk can be clearly laid down.

13. More Clients

Due to systematic working the auditor may get more clients.

14. Basis of subsequent revision

The audit procedure may be modified in the light of any changes in circumstances.

Q. 12. What are the advantages of an Audit Programme?

8.6 Disadvantages of Audit Programme

Disadvantages

- Mechanical
- Rigidity
- No adequate reward
- Deficiency
- Incomplete
- Shelter to inefficient
- Not applicable to all
- Insufficient evidence

Fig. 3.3

1. Mechanical

The Audit work becomes mechanical which kills the initiative of the audit staff. It affects efficiency of staff. Audit work becomes monotonous.

2. Rigidity

The work becomes rigid. No initiative to staff. Listed procedures are to be carried out despite changes in business conditions.

3. No adequate reward

The efforts involved in the preparation of audit programme may not be rewarded adequately.

4. Deficiency

Audit staff may hurry up to complete the work in time as per the programme. This may lead to deterioration inequality of audit work.

5. Incomplete

The programme may not cover all the aspects of the organization.

6. Shelter to inefficient

Inefficient audit assistants may take shelter behind the programme. They may defend their deficiencies on the plea that there were no instructions.

7. Not applicable to all the units

It cannot be applied uniformly to all the units.

8. Insufficient Evidence

Audit programme cannot reveal quality of evidence. It shows only the quantity of work.

Q. 13. What are the disadvantages of an Audit Programme?**8.7 Remedies to Remove the Drawbacks of Audit Programme**

Following remedies should be taken to overcome the disadvantages of audit programme :

1. Changes in controls

The internal control should be reviewed so that the auditor becomes aware of the changes in the control and systems and procedures. The weaker aspects should be pinpointed and removed by revising the programme.

2. Changes in operations and practices

The auditor should obtain information about the new lines of business or new systems to carry the old business and the programme should be recast accordingly

3. Suggestions of the Assistants

The audit assistants should be encouraged to make suggestions for revising the programme. The assistants are in a better position to make suggestions for improvement.

4. Revision

The audit programme should not be rigid. There should be a revision from time to time according to the changes in circumstances.

5. Additional tests

It should be impressed on the minds of the assistants that the programme provides minimum tests to be carried out. It also provides for tests and surprise checks.

Q. 14. How would you remove drawbacks of an Audit Programme?**8.8 Methods of Work**

Methods of work refer to the steps that an auditor should take to make sure that audit work is carried out in a systematic and efficient manner. These steps can be stated as under :

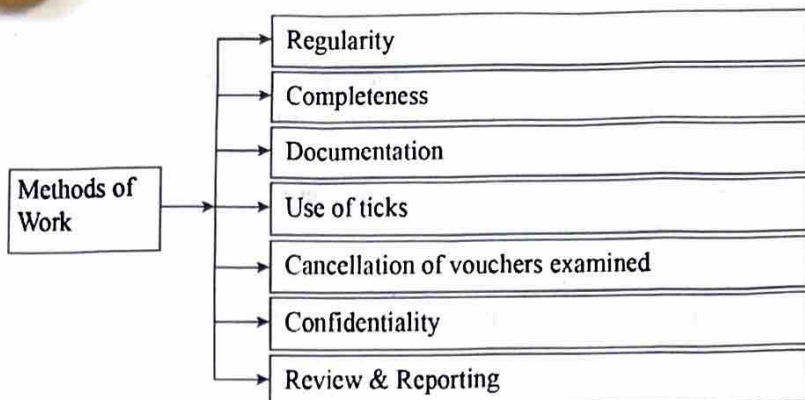


Fig. : 3.4

1. Regularity

The Auditor should ensure that audit is carried out regularly and records showing arrival and departure time of audit staff be maintained.

2. Completeness

The audit should make sure that a definite portion of the work be completed each day so that loose ends are not left over for being tied up at a later date.

3. Adequate Documentation

Entries should be made in the audit notebook and audit programme, alongwith the signature of the concerned audit staff.

4. Use of coloured pencils and different ticks

It is necessary that coloured pencils and different types of ticks must be used for indicating the various processes which have been applied. Their significance should not be disclosed to the client.

5. Cancellation of vouchers examined

After examination, the vouchers must be immediately cancelled with an audit stamp.

6. Confidentiality

Audit staff should refrain from discussing the client's affairs among themselves and with outsiders.

7. Review and Reporting

The Leader of Audit Team should report periodically to the Auditor or member in charge of the audit. It is also necessary to review the audit work at the highest level of decision making.

Q. 15. What steps the auditor should take to ensure systematic Audit?

8.9 Instructions before Commencing Work

Before Commencing the audit work, an auditor should issue detailed instructions to the client to prepare and keep ready :

- i) All registers such as cash book, bank book, sales register, purchase register, journal along with voucher files.
- ii) All ledgers duly posted and balanced.
- iii) Trial Balance duly prepared.
- iv) Financial statements with schedules.
- v) Fixed Asset schedule showing computation of depreciation.
- vi) Particulars of investments.
- vii) Particulars of cash in hand and cheques in transit at the end of the year.
- viii) Bank Reconciliation statement
- ix) Bank balance confirmation.

- x) Balance confirmation from various parties, lenders etc.
- xi) Billwise statement of debtors and creditors.
- xii) Quantity reconciliation
- xiii) Statement of stock
- xiv) Particulars of prepaid and outstanding expenses.
- xv) Accounts list

A complete list of books of accounts maintained by the company along with the names of those who are responsible for their maintenance.

xvi) Management

A list of important officials including directors of the company, organization chart etc.

xvii) Accounting Policies

A statement of Accounting policies adopted by the company

xviii) Various documents viz.

- a) Letter of appointment
- b) M/A in the case of a company
- c) A/A in the case of a company
- d) Partnership Deed in the case of partnership
- e) Organisation Chart
- f) List of directors, partners, and officers who are authorised to sanction payment.
- g) List of offices, branches and factories
- h) Internal Auditor's reports
- i) Annual Report
- j) Extracts of Minute Books
- k) Bye laws in the case of cooperative societies
- l) Will in the case of trusts.
- m) Lists of books of accounts
- n) Internal control manual
- o) Internal Auditor's Reports
- p) Lists of products manufactured and raw material purchased
- q) List of relatives or directors, interested persons etc.

These documents should be studied.

Q. 16. What instructions should be given to the client by the auditor before Commencement of audit?

8.10 Overall Audit Approach

The Auditor must gather sufficient appropriate audit evidence as a basis for forming his opinion on the following :

- a) Truth and fairness of the financial statements and their compliance with Statutory Provisions, Rules etc.
- b) Proper maintenance of accounting records and other records, books and registers.

The Auditor should make sure that the following requirements are fulfilled :

1. That all the assets and Liabilities have been properly stated and classified on a basis consistent with that of the previous year.
2. Securities for Liabilities in respect of assets charged or secured, etc. are properly disclosed.

3. Statutory Provisions, Rules and Regulations laid down thereunder, documents created under law e.g. Memorandum of Association, Loan Agreements and other documents, etc. to which the client is a party have been complied with.
4. Income and Expenses have been properly classified, disclosed and are properly matched. It must also be ensured that they relate to the period in which they are reported and that they have been determined on a basis consistent with that of the previous year.
5. All contingencies and commitments are properly disclosed.
6. No material omissions have been made in the financial statements.
7. No material error or inaccuracy in reporting or disclosing Income, Expenses, Assets and Liabilities has been created in the financial statements.

9. AUDIT WORKING PAPERS (SA 230)

9.1 Working Papers

Audit working papers are the written records kept by the auditor as regards evidence accumulated during the course of audit, methods, procedures followed and the conclusions drawn. These papers contain information about important facts and explanation of working notes in connection with the accounts under audit.

Audit working papers include the following :

1. Trial balance prepared by the client.
2. Various schedules viz. Schedule of Fixed Assets, debtors, creditors. Investments and other items of the Balance Sheet and Profit and Loss Account.
3. Correspondence between the auditor and the outsiders viz. Banking Companies, Insurance Companies, debtors, creditors etc.
4. Details regarding valuation of stock and quantitative reconciliation and adjustments for discrepancies.
5. Certificate from the management regarding stock and its valuation.
6. Bank Reconciliation statement.
7. Adjustment entries.
8. Depreciation provided on fixed assets with date of put to use for new additions.
9. Extracts from minutes books.
10. Details of investments.
11. Audit programme.
12. Contingent liabilities, certificate from the bank regarding confirmation of balance.
13. Certificate from the management regarding accrued liabilities.
14. Verification of cash.
15. Any other working papers like copy of report or order passed by authorities like excise duty, service tax etc.

Q. 17. What do you mean by Working Papers?

9.2 Importance of Working Papers

Working papers are important due to the following :

1. The auditor can understand the sincerity of his assistants.
2. These papers help the auditor in finalisation of audit report without any delay.
3. In case of change in audit staff, working papers are very much helpful to the new staff in establishment of link.
4. It provides training to audit staff.
5. It helps the auditor in planning next year's audit work.
6. The auditor can understand the weaknesses of the Internal Control System.
7. The auditor can protect himself from a suit brought against him for negligence.

8. The auditor can answer the queries of earlier days easily.
9. It provides a means to control the audit work.
10. Working papers are the property of the Auditor.

Q. 18. What is the importance of Working Papers?

Form, contents and extent

Working papers shall demonstrate that :

1. Audit was properly planned and carried out.
2. Adequate supervision was exercised.
3. Review of assigned work was undertaken.
4. Names of engagement team members who performed the work.
5. Nature, timing and extent of audit procedures performed to comply with SAS.
6. Results of audit procedures performed.
7. Details of audit evidence obtained.
8. Significant matters arising during audit conclusions reached.
9. The method of addressing inconsistency.
10. Management explanation for queries raised during audit.
11. Management stand for any special treatment in the books of accounts.

Q. 19. What does working papers demonstrate?

9.3 Factors Determining Form and Contents of Audit Working Papers

Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

The form and content of working papers are determined by matters such as :

1. The nature of the engagement.
2. The form of the auditor's report.
3. The nature and complexity of the client's business and also size of the organization.
4. The nature and condition of the client's records and degree of reliance on internal controls.
5. The needs in particular circumstances for direction, supervision and review of work performed by assistants.

Contents of Working Papers

Working papers are varied in nature but the foundation of all working papers can be traced to :

- a) Basic constitutional documents viz. Memorandum of Association, Articles of Association, Partnership Deed, Trust Deed etc.
- b) Contents of the Balance Sheet and the Profit and Loss Account, and
- c) Letter of Engagement.

The main principles governing form and contents of Audit working papers are :

1. Working Papers should be designed and properly organised to meet the circumstances of each audit and the auditor's needs in respect thereof.
2. The standardization specimen (for example, check lists, specimen letters, standard forms) improves the efficiency with which they are prepared and reviewed. It also facilitates the delegation of work while providing a means to control its quality

Q. 20. What are the contents of working papers?

9.4 Main Functions of the audit working papers

Audit working papers perform the following functions :

1. Aid in planning and performance of the audit.

2. Aid in the supervision and review of the audit work.
3. Provide evidence of the audit work performed to support the Auditor's opinion.
4. Record and demonstrate the audit work from one year to another.
5. Plan the timing and extent of procedures to be performed.
6. Draw conclusions from the evidence obtained.
7. Standardisation of working papers and audit procedures to improve the efficiency of the audit.
8. Facilitate the delegation of work as a means to control quality of work to be performed.
9. Provide guidance to the audit staff with regard to the manner of checking the schedules.
10. Fix responsibility on the staff members who sign each schedule checked by him.
11. Act as evidence in a court of law when a charge of negligence is brought against the auditor.

Q. 21. What are the functions of Audit working papers?

9.5 Filing of Working Papers

Working papers are valuable documents for the clients as well as for the auditor. Hence, they should be filed systematically. They must be preserved in a proper manner. For the sake of convenience, working papers may be divided between current and permanent files.

Current file / Temporary Audit File

It is a file which contains working papers of the year under audit. The current file should include the following documents :

1. Correspondence relating to acceptance of annual reappointment.
2. Extracts of important matters in the minutes of Board meetings and general meetings as are relevant to audit.
3. Audit plan.
4. Audit programme.
5. Analysis of transactions and balances.
6. Record of Audit procedures and their results.
7. Evidence regarding the suspension and review of the work of assistants.
8. Communications with other auditors and other third parties.
9. Copies of letters or notes concerning audit matters communicated with the clients.
10. Management representations.
11. Auditors conclusions regarding significant matters.
12. Copies of financial statements and related audit report.

Q. 22. What do you mean by current file? What are its Contents?

Permanent file

It is a file which contains papers of continuing importance affecting the company and the audit. The purpose of this file is to provide background information about the company. The file should include the following papers :

1. Information regarding legal and organisational structure of the organization.
2. Extracts of important legal documents, agreements, minutes etc.
3. Record of study and evaluation of internal controls relating to Accounting system.
4. Copies of audited financial statements for previous years.
5. Analysis of significant ratios and trends.
6. Copies of management letters issued by the auditors.

7. Communication with the retiring auditor.
8. Notes regarding significant accounting policies.
9. Significant audit observations of earlier years.

Q. 23. What do you mean by permanent file? What are its contents?

Advantages of a Permanent file :

Permanent file has the following advantages :

- a) Important data are available in one file.
- b) It is convenient for handling.
- c) Previous year's file enables the auditor to prepare the audit programme.
- d) It acts as a handy reference to the new comers.
- e) It is useful for finalising the accounts.
- f) It helps the auditor to review the complete working of the client.

Q. 24. What are the advantages of Permanent file?

9.6 Ownership, Custody, Access of the other Parties to Audit Working Papers

Working papers are the property of the auditor. The auditor may at his discretion make portions of or extracts from his working papers available to his client.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers. He should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention. The ICAI has recommended that an Auditor should maintain his records relating to audit and other work done, including routine correspondence and other papers, for a minimum period of 10 years.

9.7 Auditor's Lien on Working Papers

Lien refers to the right of a person for lawful possession of somebody else's property on which he has worked. He has a right to retain such properties for non-payment of his dues for the work done.

Lien arises only in case of other person's property. Therefore, the question of Lien on the working papers does not arise since they belong to the Auditor.

9.8 Auditor's Lien on Client's Books

A question can arise as to whether the Auditor can exercise his Lien on client's books and documents in his possession for non-payment of fees by the client for the work done on the books and documents.

In this regard the following pronouncements are noteworthy.

1. ICAEW Pronouncements

The Institute of Chartered Accountants of England and Wales has expressed a view that an Auditor may exercise Lien on his clients book, subject to the following conditions :

- a) Documents retained must belong to the client who owes money.
- b) Such documents must have come into the Auditor's possession on the client's authority and not received through irregular or illegal means. In case of a Company, the books must have been received by the Auditor on the authority of the Board of Directors.
- c) Some work must have been done in relation to such documents.
- d) The fees for which the Lien is exercised must be outstanding in respect of such work and also undisputed.

2. View of Supreme Court

In R.D. Saxena Vs. Balram Pradas Sharma (2000) 7 SCC 264, the Supreme Court has held that "no professional can be given the right to withhold the returnable records relating to the work done by him with his client's matter, on the strength of any claim for

unpaid remuneration. The alternative is that the professional concerned can resort to other legal remedies for such unpaid remuneration".

In view of the above mentioned views, it can be concluded that, generally the Auditor cannot exercise Lien on his client's books and records for unpaid remuneration.

3. Provisions of Companies Act, 2013

Section 129 (i) of the Companies Act, 2013 provides that the books of accounts shall be kept at the registered office of the company. The books are open for inspection by directors, shareholders, officers and Govt. In such a case, the auditor cannot have any lien on 'the books of accounts of the company which are audited by him.

Q. 25. Explain Auditors Lien on Working Papers?

10. AUDIT NOTE BOOK

10.1 Meaning

It is a note book maintained by the auditor for recording a large variety of matters observed during the course of audit. It is a part of record of the auditor available for future reference. It contains errors, difficulties, doubtful queries of various accounting records. It is also called as Audit Memoranda. It is a written record of the queries made, replies received there to, correspondence entered into etc. It may be in the form of Register or Loose sheets filed together.

10.2 Structure of Audit Note Books

The Audit Note Book is generally divided into two parts viz., (a) for keeping a record of general information as regards the audit as a whole and (b) for recording special points which have been observed during the course of audit of the accounts of particular years.

Contents of Audit Note Book

1. General Information includes the following :

- Nature of the business carried on.
- Important provisions affecting its functioning such as Memorandum of Association, Articles of Association, Partnership Deed etc.
- Structure of the financial and administrative organisation.
- A list of the books of accounts.
- Names of Principal officers, their duties and responsibilities.
- Particulars of the system of accounts and informal control which are in operation.
- Particulars of the accounting and financial policies followed.
- Important contracts to which the client is a party e.g. collaboration contracts, Royalty contracts etc.

Q. 26. What is Audit Note Book? What are its contents?

2. Current Information

Current information contains the following :

- Audit queries not cleared immediately e.g. missing receipts, vouchers etc.
- Mistakes or irregularities observed during the course of audit e.g. failure to comply with requirements of the Companies Act, or the provisions of the Memorandum of Association or Articles of Association, a change in the basis of valuation of Finished Stock and work in progress or in computation of depreciation, failure to provide adequate depreciation etc.
- Unsatisfactory book keeping arrangements, casting method, internal or financial administration or organisation.
- Important information about the company which is not apparent from the accounts.
- Special points requiring consideration at the time of verification of final accounts.

- g) Important matters for future reference.

Q. 27. What is Current Information?

10.3 Importance of Audit Note Book

Audit note book forms an important part of the documentation for the Auditor. The following points indicate its usefulness from different points of view :

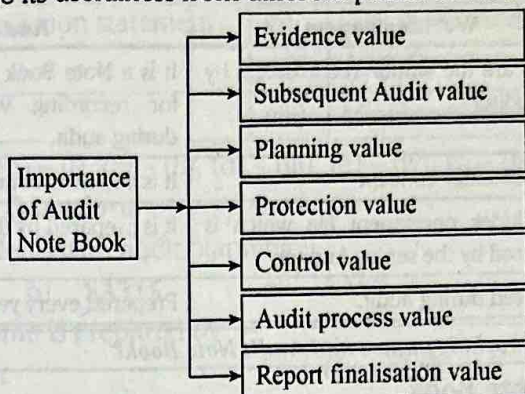


Fig. 3.5

1. Evidence Value

In case notes have been properly made in the Audit Note book, it might prove of great value to the auditor later on. It has an evidence value in case a suit is filed against him for negligence or misfeasance. Such a note book will be a documentary evidence in favour of the auditor even after several years by which time the auditor might have forgotten everything about that particular audit. The importance of such an Audit Note Book was emphasized by Lord Justice Vaughan Williams in the London and General Bank case. In the same way, the Audit Note book which contained detailed information was of great assistance to the auditor in the case of the City Equitable Fire Insurance Company.

2. Subsequent Audit Value

The Audit note book should be clear, concise and complete so that it may be quite intelligible to the clerk who audits the accounts of the same company next year. Such a note book can be a useful guide to such a clerk.

3. Planning Value

The Audit note book is quite useful document in planning the next audit of the entity. It is also useful in preparing the next audit programme as the weaknesses shown in the Audit note book on various aspects and segments of accounting would require close follow-up.

4. Protection Value

The audit note book is a comprehensive record of work done and audit observations. Hence, it is extremely valuable to the Auditors as a document of defence when a charge is brought against the Auditor for negligence and other shortcomings in the audit work (for example in the case of Recity Equitable Fire Insurance Company).

5. Control Value

It has also control value as it will show the extent and coverage of work done when the assistants are shifted or when there is a temporary stoppage of work.

6. Audit Process Value

The Audit note book provides new thrusts and direction in the manner, extent and timing of audit checkings.

7. Report finanlisation Value

The Audit note book is also very useful at the time of finalising the Audit Report. In the case of follow-up observations made by the Auditor, may get settled with explanation and evidence given by the management at a subsequent stage. After that, the Auditor has to

consider only the unsettled observations from various relevant angles for preparing the Audit Report. Thus, Audit note book is the primary basic document in preparing the Audit Report on the true and fair view of the financial statements.

Q. 28. Explain the Importance of Audit Note Book?

10.4 Distinction between Audit Note Book & Audit Working papers

Point	Working papers	Audit Note Book
1. Meaning	These are the written records kept by the auditor	It is a Note Book maintained by the auditor for recording various matters observed during audit.
2. Scope	It is a broader concept	It is a narrow concept.
3. Prepared by	It includes permanent file which is prepared by the senior Auditor.	It is prepared by the Audit assistants.
4. Frequency	Prepared during audit.	Prepared every year.

Q. 29. Distinguish between working papers and Audit Note Book?

10.5 Sample Audit Note Book

Voucher No.	A/c Debited	₹	Query	Disposal
75	Rent of premises	1,25,000	Rent Bill and Receipt required	Rent Bill and Receipt produced
91	Machinery A/c	2,57,000	Board Resolution required	Board Resolution produced
132	Abhi & Co.	23,530	Receipt required	Paid by D.D. The company is reminded about the receipt.

Q. 30. Develop a sample Audit Note Book?

11. OBJECTIVE QUESTIONS

I. State with reasons whether following statements are true or false :

- Potential successor auditor should communicate with the predecessor before accepting the engagement.
- After accepting engagement letter, the auditor should obtain knowledge about a new client's business.
- Audit Note Book is maintained by an auditor.
- While preparing audit programme the auditor should keep into consideration the scope of audit.
- Audit in depth is part of test checking.
- Audit memorandum contains information about the business of the client.
- SA 315 suggest that the auditor should prepare a written audit programme.
- Audit programme must be in writing.
- Audit note book contains information about errors, difficulties and doubtful queries of various accounting records.

[Ans. : True : 1, 2, 3, 4, 5, 6, 7, 8, 9.]

II. Match the Following :

	Group 'A'		Group 'B'
a)	Terms of engagement	i)	Identified by AAS8
b)	Sources of information	ii)	Contains useful information about

			client's business
c)	Audit memorandum	iii)	A blue print of audit work to be done
d)	Audit programme	iv)	Available for future reference
e)	Audit Note Book	v)	Audit working papers
f)	Bank reconciliation statement	vi)	Tick mark used in original record
		vii)	AAS 26
		viii)	Minutes of meetings

[Ans. : (a) – (vii), (b) – (i), (c) – (ii), (d) – (iii), (e) – (iv), (f) – (v)]

III. Multiple Choice Questions

- The standard deals with audit planning
 - AAS7
 - SA315
 - AAS9
 - AAS3
- Audit programme is prepared by
 - The auditor
 - The client
 - The audit assistant
 - The auditor and his assistant
- Working papers are
 - Evidence of audit conclusions
 - Owned by the clients
 - Owned by the auditor
 - None of the above
- The audit engagement letter should make reference to
 - Limitations of auditing
 - Management responsibilities with respect of audit work
 - Expectation of receiving a written management representation letter
 - A description of the auditor's method of sample selection.
- Which of the following best describes the primary purpose of audit programme preparation?
 - Detection of errors and fraud
 - Compliance with GAAP
 - Collection of sufficient evidence
 - Assessment of audit risk
- Letter of engagement provided by
 - SA 210
 - AAS 3
 - AAS 8
 - AAS 9
- Internal reports include
 - Annual report
 - Trade journal
 - Web sites
 - Publications of professional bodies
- Setting up of materiality level
 - Controls the materials
 - Diverts the attention of the auditor to error prone items
 - Controls the audit assistants
 - None of the above.
- While developing audit programme the following factor should be considered.
 - Client's activities
 - Letter of communication
 - Audit Note Book
 - Audit working papers
- Audit programme should be
 - Oral
 - Flexible
 - Rigid
 - None of the above

11. Ownership of working papers is with
 - a) Assistant b) Auditor c) Client d) Government
12. Objective of audit planning is
 - a) Identification of potential problems
 - b) Inefficient work
 - c) Deadline of work
 - d) None of these
13. If the auditor is satisfied with internal control then the extent of examination is
 - a) Reduced b) Increased
 - c) a & b d) None of the above
14. The auditor can obtain information from
 - a) Text books b) Newspapers
 - c) Last year's working papers d) Any of the above
15. Audit programme contains information about
 - a) Audit plans b) Mistakes observed
 - c) Unsatisfactory account system d) None of the above
16. Due to audit programme the work
 - a) Becomes mechanical b) Gives shelter to inefficient assistants
 - c) Fixes responsibility d) None of the above
17. Current file contains
 - a) Audit notes b) List of directors
 - c) Details of holding company d) Any of the above
18. Audit plan should be based on client's
 - a) Profits b) Business c) Networth d) Reputation
19. — papers are the link between the client records and audit report.
 - a) Working papers b) News
 - c) Loose d) Rules
20. Working papers are the property of the
 - a) Auditor b) Client
 - c) Client & the auditor d) None of the above
21. Audit programme is prepared by
 - a) The client b) The client & auditor
 - c) The auditor and his assistant d) The chief accountant

[Ans. : (1 - b), (2 - d), (3 - c), (4 - d), (5 - c), (6 - a), (7 - a), (8 - b), (9 - a), (10 - b), (11 - b), (12 - a), (13 - a), (14 - c), (15 - a), (16 - c), (17) - (a), (18 - b), (19 - a), (20 - a), (21 - c)]

IV. Fill in the blanks with appropriate word / words :

1. SA _____ is in connection with audit planning.
2. Audit plan should be based on knowledge of _____ business.
3. The purpose of Audit planning is devote attention to important _____ of audit.
4. Preparation of audit plan is a _____ exercise.
5. Auditor should ensure that audit is carried at _____.
6. Written Audit plan is called as _____.
7. Audit programme is prepared by _____ before commencing the audit work.
8. While designing audit programme, nature of _____ should be considered
9. Audit programme must be in _____.

10. Audit programme should ____ the responsibility of audit staff.
11. Audit programme facilitates ____ audits.
12. Audit programme cannot reveal ____ of evidence.
13. ____ is a written record of queries made replies received, correspondence entered in to.
14. Bank Reconciliation is included in ____.
15. List of books of accounts is a ____ in Audit Note Book.
16. Trial Balance is a ____.
17. ____ provide a means to control audit work.
18. Working papers are the ____ of the auditor.
19. Audit programme is included in ____.
20. M/A is included in ____.
21. The auditor should ____ his work in order to ensure smooth audit.
22. Audit planning should be based on applicable ____ and regulations.
23. Development of audit plan is the responsibility of the ____.
24. ____ is a blue print of audit work to be done.
25. ____ helps the auditor to assign the work to audit assistants.
26. Audit ____ facilitates systematic audit.
27. Specific ____ helps the auditor to identify transactions.
28. Audit working papers serve as an ____ of audit work done.
29. Audit working papers is the property of the ____.
30. Audit Note Book, is also called as audit ____.
31. Audit Note Book records ____ which may be required for a subsequent audit.
32. Audit work papers establish a ____ between auditor's report and client records.
33. Audit planning is dealt with by AAS ____.
34. SA ____ deals with audit working papers.
35. Steps taken to obtain audit evidence is ____.
36. ____ consists of examination of records, documents etc.
37. ____ consists of observation of the procedure followed by the auditor.
38. ____ is concerned with seeking information from others.
39. ____ means formal enquiry from outsiders.

[Ans. : (1) 315, (2) Client's, (3) Aspects, (4) thinking, (5) Right time, (6) Audit programme, (7) Chief Auditor, (8) Business, (9) writing, (10) fix up, (11) efficient, (12) absence, (13) Audit Note Book, (14) working papers, (15) content, (16) working paper, (17) Audit programme, (18) properties, (19) Audit planning, (20) Working papers, (21) Plan, (22) Law, (23) Auditor, (24) Audit programme, (25) Audit, (26) programme, (27) Tick mark, (28) evidence, (29) Auditor, (30) Memoranda, (31) Queries, (32) Link, (33) 8, (34) 230, (35) Audit procedure, (36) Inspection, (37) Observation, (38) Enquiry, (39) Confirmation.]

V. Short Questions

1. Explain the meaning of the term, 'Audit planning'.
2. What do you mean by audit programme?
3. What do you mean by internal control?
4. What are audit working papers?
5. Explain the term current file.
6. Explain the term permanent file.
7. What is audit note book?

8. What are the contents of current file?
9. What are the contents of permanent file?
10. Working papers are the property of auditor explain.
11. What are the contents of audit note book?
12. What are the contents of audit programme?
13. What are the contents of working papers?
14. Distinguish between working papers & Audit Note Book?

VI. Write Short Note on :

1. Audit programme
2. Audit working papers
3. Lien on working papers
4. Audit Note Book

SIMPLE CASE STUDY FOR REFERENCE ONLY

(Not in Syllabus)

1. You are appointed as the Statutory Auditor of Mr. Ashok, proprietor of M/s. Ashok & Sons. He is into the business of trading in chemicals.
 - a) What planning would you undertake before the commencement of audit?
 - b) What factors have you to take into consideration before drawing up the Audit Plan?
2. Ms. Avani has been appointed as the statutory Auditor of Avantika Private Limited. At the time of appointment, she was produced with the following set of documents. You are required to explain how each of this documents can help her achieve her audit objective and help her plan the audit for the forthcoming year :

Documents Produced	Nature of Information to be sought	How it would help in Audit Planning
1. Memorandum and Articles of Association		
2. Minutes of Annual General Meeting		
3. Minutes of Board Meeting		
4. Internal Audit Report		
5. Plant Layout and Manufacturing Process		
6. Accounting Manual and Chart of Accounts		
7. Industrial Journals		
8. Details of Companies Website		
9. Earlier years Audit Reports		
10. Annual Returns of the Registrar of Companies (ROC)		
11. Fixed Asset Register		
12. Agreements with lenders and bankers		
13. Credit Policies of the company		

3. As a senior Accountant of your firms, your auditor has sought a meeting with you. What information shall you compile that is required to be shared with the auditors, before the commencement of the audit?
4. You have been appointed as statutory Auditor of MDB Estate Private Limited. You have instructed your 3 staff members to follow the audit programme on a strict basis. Is it a good practice, in adhering to such strict methodology of Audit Programming? Justify your answers.
5. Ms. Desai has been appointed as the special Auditor of Patel Products Private Limited. She intends to draw up an audit Programme for her team for the audit to be

conducted. You are required to explain how each of the following items should be considered while formulating the audit Programme :

Nature of details	Nature of Information to be sought	How it would help in Audit Programming
1. Internal Audit Report		
2. Internal Control system of Client		
3. Scope of Audit work		
4. Collection of Audit Evidences		
5. Work assignment to Audit staff		
6. Methodology of Audit - Random auditing / Test Check Audit etc.		

6. You are the senior Audit Assistant of M/s Victory Impressions Pvt. Ltd. You have to instruct your Juniors as to the content to be written in the Audit Note Book, that is to be maintained while Auditing the following Books of accounts :

- Cash Book
- Bank Book
- Ledger
- Journal Proper