CS EXECUTIVE

AUDITING (30 Marks)

UNIT 1: AUDITING CONCEPTS

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<tr><td>Features in Auditing</td><td>
1. Audit is a systematic and scientific examination of the books of accounts of a business;

2. Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

3. Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

4. Audit is a critical review of the system of accounting and internal control.

5. Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

6. The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

7. The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.
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<tr><td>Objectives of Auditing</td><td>
<u>Primary Objective</u> – The primary objective of the auditors is to report to the owners whether the balance sheet give a true and fair view of the company’s state of affairs and the correct figure of the profit or loss for the financial year.

<u>Secondary objective</u> – It is also called the incidental objective as it is incidental to the satisfaction of the main objective. The incidental objectives of auditing are:
(i) Detection and prevention of frauds, and
(ii) Detection and prevention of errors.
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<tr><td>Basic Principles governing an Audit: “SO READ IPC”</td><td>
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<tr><td>Integrity, Objectivity and Independence</td><td>
• The Auditor should be straight forward, honest and sincere in his approach to his professional work.
• He must be fair and must not allow bias to override his objectivity.
• He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity.
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<tr><td>Confidentiality</td><td>
• The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.
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	Skills and Competence	• The audit should be performed and the report prepared with due professional care by person who have adequate training, experience and competence in auditing. • The auditor requires specialized skills and competence which are acquired through a combination of general education, knowledge obtained through study and formal courses concluded by qualifying examination recognized for this purpose and practical experience under proper supervision. • In addition, the auditor requires a continuing awareness of developments including pronouncements of ICAI on accounting and auditing matters and relevant regulations and statutory requirements.
	Work performed by Others	• When the auditor delegates work to assistants or uses work performed by other auditors and experts he continues to be responsible for forming and expressing his opinion on the financial information. • However, he will be entitled to rely on the work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. • In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, as in the case of work of branch auditors appointed under companies act, 2013 the auditor's report should expressly state the fact of such reliance. The auditor should carefully direct, supervise and review work delegated to assistants. • The auditor should obtain reasonable assurance that work performed by other auditor or experts is adequate for his purpose.
	Documentation	The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with basic principles.
	Planning	The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Plans should be made to cover, among other things: (a) acquiring knowledge of the client's accounting system, policies and internal control procedures; (b) establishing the expected degree of reliance to be placed on internal control; (c) determining and programming the nature, timing and extent of the audit procedures to be performed and (d) coordinating the work to be performed. Plans should be further developed and revised as

	necessary during the course of the audit.
Audit Evidence	The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. They are of two types: (i) tests of details of transactions and balances; (ii) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.
Accounting system and Internal Control	The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.
Audit conclusions & Reporting	The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information.

Concept of True and Fair View in Auditing

- The concept of true and fair is a **fundamental concept** in auditing.
- The phrase "True and Fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.
- This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amount which are in accordance with accounting principles and policies which are relevant and no material amount, item or transaction has been omitted.
- What constitutes "true and fair" has **not been defined** in any legislation.
- In the context of audit of companies, Companies act provides that the accounts of the company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Revised Schedule VI of Companies Act, 1956.

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- Thus, Auditor will have to see that the accounts are drawn up in conformity with the provisions of Revised Schedule VI and whether they contain all the matters required to be disclosed therein. Also books should be kept on accrual basis and according to the double entry system of accounting.
- It must be noted that the disclosure requirement laid down by the law are the minimum requirements. If certain information is vital for showing a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so.
- Thus what constitutes a true and fair view is a matter of an auditor's judgment in the particular circumstance of a case.
- In more specific terms, to ensure that true and fair view, an auditor has to see:
  a) That the assets are neither undervalued or overvalued; (**Valuation**)
  b) No material asset is omitted; (**Omission**)
  c) The charge, if any, on assets are disclosed; (**Disclosure**)
  d) Material liabilities should not be omitted; (**Omission**)
  e) The Profit and Loss account and Balance Sheet discloses all the matters required to be disclosed as per Schedule VI; (**Disclosure**)
  f) All unusual, exceptional or non Recurring items have been disclosed separately; (**Disclosure**)

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<td>Advantages of Independent Audit: "MIND GAAP"</td>
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<tr><td>PROTECTION OF INTEREST</td><td>It safeguards the financial interest of persons who are not associated with the management of the organisation whether they are partners or shareholders.</td></tr>
<tr><td>MORAL CHECK</td><td>It acts as a moral check on the employees from committing defalcations.</td></tr>
<tr><td>TAX LIABILITY</td><td>Audited statements of accounts are helpful in setting liability for taxes.</td></tr>
<tr><td>CREDIT NEGOTIATION</td><td>Financiers and Bankers use audited financial statements in evaluating the credit worthiness of individuals in negotiating loans.</td></tr>
<tr><td>TRADE DISPUTE SETTLEMENT</td><td>Audited statement is useful in settling the trade disputes for higher wages or bonus, etc.</td></tr>
<tr><td>CONTROL OVER INEFFICIENCY</td><td>It helps in detection of wastages and losses and also helps in recommending ways to correct it.</td></tr>
<tr><td>ARBITRATION</td><td>It is helpful in settling disputes by arbitration.</td></tr>
<tr><td>ASSISTANCE TO GOVERNMENT</td><td>Government may required audited and certified statements before it gives assistance or issues a license for a particular trade.</td></tr>
<tr><td>APPRAISAL:</td><td>Audit reviews the existence and operations of various controls in the orgaisation and report in adequacies, weaknesses, etc in them. Management can take suitable</td></tr>
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	action based on the reports.

Inherent Limitations of Auditing: “C JET”

JUDGEMENT	Absolute certainty is not attainable in auditing because of the need to exercise Judgement: (i) The auditor’s work involves exercise of Judgement e.g. in deciding the extent of audit procedures. (ii) The auditor is also required to examine the reasonableness of the Judgement exercised by the management in selecting appropriate accounting policies and in preparing the financial statements.
NATURE OF AUDIT EVIDENCE	Audit opinion is governed by the nature of audit evidence obtained: (i) The evidence is generally persuasive rather than conclusive in nature. (ii) Most of the evidences available with him lead to reasonable conclusions.
INTERNAL CONTROL	Audit process is dependent on the existence of effective internal control, which itself suffers from certain inherent limitations like: (i) It may be ineffective against fraud, involving collusion among employees; or (ii) Fraud committed by management at certain levels of management may be in a position to override controls.
TEST CHECKING	Detailed testing is not possible because: (i) it is not cost effective (ii) it would not guarantee that all types of fraud would be discovered. Hence, an audit cannot be relied on to ensure discovery of all material misstatements. It does not guarantee that report once signed and there is not misstatement in the accounts.

Auditing vs. Investigation

Basis of Diff	Investigation	Audit
Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
Scope	The scope of investigation may be governed by	The Scope of audit is wide and in case of statutory

	statute or it may be non – statutory.	audit the scope of work is determined by provision of relevant law.
Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain	The audit is carried on either quarterly, half-yearly or yearly
Nature	Requires a detailed study and examination of facts and figures	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion
Inherent limitations	No inherent limitation owing to its nature of engagement	Audit suffers from inherent Limitation
Evidences	It seeks conclusive evidences	Audit is mainly concerned with prima- facie evidence
Observance of Accounting policies	It is analytical in nature and requires a thorough mind capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

Reasons for carrying out investigation

The common reasons of getting the investigation done are listed below:
(1) Proposed purchase of business.
(2) Proposed sale of business.
(3) Reasons for low profitability.
(4) Cause of high employee turnover.
(5) Reliability of business data.
(6) Proposed investment in particular securities.
(7) Suspected fraud.
(8) Joining in existing partnership business.
(9) Borrowing funds.
(10) Lending funds.
(11) Proposed purchase of controlling shares in a company.
(12) Suspected misfeasance against directors.
(13) Detection of undisclosed income for tax purposes.
(14) Suspected misappropriation by trustees

Concept of Materiality in Auditing

- SA-320 on Materiality in Planning and Performing an Audit lays down standard on the concept of materiality and its relationship with audit risk. It deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.

	➢ SA 450, “Evaluation of Misstatements Identified during the Audit”, explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. ➢ Obviously, an auditor requires more reliable evidence in support of material items. He also has to ensure that such items are properly and distinctly disclosed in the financial statements. ➢ “Accounting Standard 1 defines material items as relatively important and relevant items, i.e. “items the knowledge of which would influence the decisions of the users of the financial statements”. Whether or not the knowledge of an item would influence the decisions of the users of the financial statements is dependent on the particular facts and circumstances of each case. It is not possible to lay down precisely either in terms of specific account or in terms of amounts the items which could be considered as material in all circumstances. ➢ Materiality is a <u>*relative term*</u> and what may be material in one circumstance may not be material in another. Therefore, the decision to judge the materiality of the item whether in the aggregation of items, presentation or classification of items shall depend upon the judgment of preparers of the account in the circumstances of the particular case. ➢ In many cases percentage comparison may be useful in indicating the materiality of an item. As per SA 320, this percentage criteria for determining materiality levels is known as Benchmarking. ➢ For example, Part II of Schedule III to the Companies Act, 2013 requires that any expense exceeding one per cent of the total revenue of the company or Rs. 1,00,000 whichever is higher, shall be disclosed by way of notes as additional information and shall not be combined with any other item to be shown under miscellaneous expenses. ➢ Another angle to judge the materiality of the item can be to <u>*compare it with the corresponding figure in the previous year*</u>. Suppose the item is of a low amount this year but it was of a much higher amount in the previous year then it becomes material when compared to the corresponding figure of the previous year. ➢ Thus, materiality of an item can be judged: (a) from the <u>*impact*</u> that the item has on the <u>*profit or loss or on the balance sheet*</u>, or on the total of the category of items to which it pertains, and (b) on its comparison with the corresponding figure of the previous year. In many circumstances even small amount may be considered material. ➢ Thus, if there is a statutory requirement of disclosure of amount paid as sitting fee to directors the amount so paid must be disclosed precisely and separately. Similarly, a payment of Rs. 100 to directors as remuneration in excess of statutory limits may be material. A small inaccuracy may be considered material if it further depresses or boosts a low profit or converts a small loss into a profit or vice versa.

	➢ Thus, materiality is an important and relevant consideration for the auditor also because he has to evaluate whether an item is material in giving or distorting a true and fair view of financial statement. He also has to ensure that a material item is disclosed separately and distinctly or atleast clear information about the item is available in the accounting statements.
Procedure of Issuing Standards of Auditing	1. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection. 2. In the preparation of the auditing standards, the Board is normally, assisted by study groups comprising of a cross section of members of the Institute. 3. On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members. 4. After taking into the comments received, the draft of the proposed auditing standard is finalized by the Board and submitted to the Council of the Institute. 5. The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council.
Need of Harmonization of Indian Auditing Standards and International Standards	The Institute of Chartered Accountants of India (ICAI) is a founder member of the International Federation of Accountants (IFAC). It is one of the membership obligations of the Institute to actively propagate the pronouncements of the International Auditing and Assurance Standards Board (IAASB) of the IFAC to contribute towards global harmonization and acceptance of the Standards issued by the IAASB. Accordingly, while formulating Engagement and Quality Control Standards, the AASB takes into consideration the corresponding Standards, if any, issued by the IAASB. In addition, the AASB also takes into consideration the applicable laws, customs, usages and business environment prevailing in India. With effect from 1st April, 2008, the AASB re-categorised and re-numbered the existing Auditing and Assurance Standards on the lines as followed by the IAASB. With this change, all auditing and assurance standards (AAS) were renamed as standards on Auditing (SAs)

UNIT 2: TYPES OF COMPANY AUDIT

Types of Audit under Companies Act 2013	The Companies Act, 2013 is focused on transparency and disclosure. In the new Act, attempt has been made to cover each aspect of corporate functioning under audit by prescribing various types of audits like internal audit and secretarial audit. The various types of audits prescribed under the Companies Act, 2013 are: • Statutory Audit • Internal Audit • Secretarial Audit • Cost Audit

STATUTORY AUDIT:

QUALIFICATION & DISQUALIFICATION OF AUDITOR (SECTION 141)

The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by section 141 of the Companies Act, 2013 (hereinafter referred as the Act). The Main provisions are stated below:

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<tr><td>(1)</td><td>A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant:

Provided that a firm whereof <u>majority of partners</u> practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.</td></tr>
<tr><td>(2)</td><td>Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and <u>sign</u> on behalf of the firm.</td></tr>
<tr><td>(3)</td><td>Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely:- (Disqualifications)
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<tr><td>BODY CORPORATE</td><td>(a) A Body Corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;</td></tr>
<tr><td>OFFICER OR EMPLOYEE</td><td>(b) An Officer Or Employee of the company;</td></tr>
<tr><td>PARTNER/ EMPLOYEE</td><td>(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;</td></tr>
<tr><td>HOLDING ANY SECURITY OF OR INTEREST</td><td><u>(d) A person who, or his relative or partner -</u>

(i) Is HOLDING ANY SECURITY OF OR INTEREST in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh;</td></tr>
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		Provided that the condition of rupees one lakh shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities: **Provided further that** in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest. (ii) is **INDEBTED TO THE COMPANY**, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh; or (iii) has given a **GUARANTEE** or provided any **SECURITY** in connection with the indebtedness of any third person to the Company or its Subsidiary, or its Holding or Associate Company or a Subsidiary of such Holding Company, in excess of one lakh rupees;
	BUSINESS RELATIONSHIP	(e) a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed; Student may note that for the purpose of clause (e) above, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, **except** – (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts; (ii) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
	RELATIVE IS A DIRECTOR OR IS IN THE EMPLOYMENT	(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel; **<u>Meaning of Relative:</u>** i) Members of HUF; ii) They are husband & Wife; iii) They are related to another in the following manner: a. Father b. Mother c. Son d. Daughter

	e. Brother f. Sister
FULL TIME EMPLOYMENT ELSEWHERE OR BREACH OF CEILING	(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of **MORE THAN TWENTY COMPANIES**;
OFFENCE	(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.
PROVIDING CONULSTING & SPECIALISED SERVICES	(i) Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144. Section 144 of the Companies Act, 2013 is a new provision which prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely: (i) accounting and book keeping services; (ii) internal audit; (iii) design and implementation of any financial information system; (iv) actuarial services; (v) investment advisory services; (vi) investment banking services; (vii) rendering of outsourced financial services; (viii) management services; and (ix) any other kind of services as may be prescribed. **Provided that** an auditor or audit firm who or which has been performing any non audit services on or before the commencement of this Act shall comply with the provisions of this section **before the closure of the first financial year after the date of such commencement**. Further, in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual; and in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

(4)	Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) **AFTER HIS APPOINTMENT**, he shall **VACATE** his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

APPOINTMENT OF AUDITOR (SECTION 139)

Section 139 of the Companies Act, 2013 contains provisions regarding Appointment of Auditors. Discussion on appointment of auditors may be grouped under two broad headings-
I Appointment of First Auditors.
II Appointment of Subsequent Auditors

APPOINTMENT OF FIRST AUDITORS IN THE CASE OF A COMPANY, OTHER THAN A GOVERNMENT COMPANY	As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the **Board of Directors** within 30 days from the date of registration of the company. In the case of failure of the Board to appoint the auditor, it shall inform the **members of the company**. The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.
APPOINTMENT OF FIRST AUDITORS IN THE CASE OF GOVERNMENT COMPANY:	Section 139(7) provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the **Comptroller and Auditor-General of India** within 60 days from the date of registration of the company. In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the **Board of Directors of the company** shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the **members of the company** who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.
APPOINTMENT OF SUBSEQUENT AUDITOR/REAPPOINTMENT OF AUDITOR IN CASE OF COMPANIES OTHER THAN GOVERNMENT COMPANY	Section139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting. The following points need to be noted in this regard- (i) The company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting. (ii) Before such appointment is made, the written consent of the auditor to

	such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor. (iii) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141. (iv) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.
APPOINTMENT OF SUBSEQUENT AUDITORS IN CASE OF GOVERNMENT COMPANIES:	As per Section 139(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the **Comptroller and Auditor-General of India** shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.
FILLING OF A CASUAL VACANCY	As per Section 139(8), any casual vacancy in the office of an auditor shall- <u>COMPANIES OTHER THAN GOVERNMENT COMPANY:</u> (i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the **Board of Directors** within thirty days. If such casual vacancy is as a result of the <u>RESIGNATION OF AN AUDITOR</u>, such appointment shall also be approved by the **company at a general meeting** convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting; <u>GOVERNMENT COMPANY:</u> (ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the **Comptroller and Auditor-General of India** within thirty days: It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the **Board of Directors** shall fill the vacancy within next thirty day.
CASUAL VACANCY BY RESIGNATION:	As per section 140 (2) the auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form ADT–3 (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. subsequent auditor of Government company, the auditor shall also file such statement with the Comptroller and Auditor General of India, indicating the reasons and other facts as may be relevant with regard to his resignation.

	In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per section 140 (3).
OTHER IMPORTANT PROVISIONS REGARDING APPOINTMENT OF AUDITORS	1. A retiring auditor may be re-appointed at an annual general meeting, if- (a) he is not disqualified for re-appointment; (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed. 2. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company

ROTATION OF AUDITOR

Applicability of section 139(2) Rotation of Auditor : As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies:-

(I) all unlisted public companies having paid up share capital of rupees ten crore or more;

(II) all private limited companies having paid up share capital of rupees twenty crore or more;

(III) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

As per Section 139(2) , No listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-
(a) an individual as auditor for more than one term of five consecutive years; and
(b) an audit firm as auditor for more than two terms of five consecutive years: Provided that -
(i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

(ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.

The following points merit consideration in this regard-
1. As on the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

2. Every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act:

3. It has also been provided that right of the company to remove an auditor or the right of the auditor to resign from such office of the company shall not be prejudiced.

4 Subject to the provisions of this Act, members of a company may resolve to provide that-
(a) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
(b) The audit shall be conducted by more than one auditor.

5. The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.

Manner of Rotation of Auditors by the Companies on Expiry of their Term:
Rule 6 of the Companies (Audit and Auditors) Rules, 2014 prescribes the manner of rotation of auditors on expiry of their term which is given below:

(1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

(2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

(3) For the purpose of the rotation of auditors-
(i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
(ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.
Explanation. I - For the purposes of these rules the term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Explanation. II - For the purpose of rotation of auditors,-
(a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
(b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years

(4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

REMOVAL OF AUDITORS

REMOVAL OF AUDITOR BEFORE EXPIRY OF TERM:	According to Section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014:

	(1) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014. (2) The application shall be made to the Central Government within thirty days of the resolution passed by the Board. (3) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution. It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.
APPOINTMENT OF AUDITOR OTHER THAN RETIRING AUDITOR:	Section 140 lays down procedure to appoint an auditor other than retiring auditor who was removed: 1. Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided under sub-section (2) of section 139. 2. On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor. 3. Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,- (a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and (b) Send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting: Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be field with the Registrar.

DUTY OF AUDITOR TO INQUIRE ON CERTAIN MATTERS	It is the duty of auditor to inquire into the following matters: (a) Whether loans and advances made by the company on the basis of security have been **properly secured** and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

	(b) Whether transactions of the company which are represented merely by **book entries** are prejudicial to the interests of the company; (c) Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company; (d) Whether **loans and advances** made by the company have been shown as deposits; (e) Whether **personal expenses** have been charged to revenue account; (f) Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading. The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below : "The auditor is not required to report on the matters specified in sub-section (1) **unless he has any special comments to make** on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor's Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1)." Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters **in adverse**.

DUTY TO REPORT ON FRAUDS	As per sub section 12 of section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner prescribed in rule 13. Rules 13 of the Companies (Audit and Auditors) Rules, 2014, prescribes that in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below: (i) auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud,

	seeking their reply or observations within forty-five days; (ii) on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations; (iii) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time. Further, the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same. This report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number. The report shall be in the form of a statement as specified in Form ADT-4. No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter above if it is done in good faith. It is very important to note that the provision of this rule shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12) of section 143, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees)

COST AUDIT

CONCEPT	It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.
LEGAL PROVISIONS	Cost Audit is covered by Section 148 of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143. As per the section 148 the Central Government may by order specify audit of items of cost in respect of certain companies. Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be

	prescribed shall also be included in the books of account kept by that class of companies: Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act. If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.
WHO CAN BE COST AUDITOR	The audit shall be conducted by a *<u>Cost Accountant in Practice</u>* who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed: Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records: *<u>(Statutory Auditor & Cost Auditor cannot be same person)</u>* Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards ("cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government).
APPOINTMENT OF COST AUDITOR	As per rule 14 of the Companies (Audit and Auditors) Rules, 2014 (a) in the case of companies which are required to constitute an audit committee- (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor; (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders; (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.
QUALIFICATION, DISQUALIFICATION, RIGHTS, DUTIES AND OBLIGATIONS OF COST AUDITOR	The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company: Provided that the report on the audit of cost records shall be submitted by

	the cost accountant in practice to the Board of Directors of the company.
SUBMISSION OF COST AUDIT REPORT	A company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein. If, after considering the cost audit report referred to under this section and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Internal Audit (Covered in detail in next unit)

SECRETARIAL AUDIT:

The Companies Act 2013 has introduced a new requirement of Secretarial Audit for bigger companies, which has been prescribed under Section 204 of the Act. The provisions regarding secretarial audit of the company according to section 204 of the Companies Act, 2013 and the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 are discussed below-

Companies required conducting secretarial audit:
(1) Every listed company and
(2) Company belonging to other class of companies: The other class of companies are
• every public company having a paid-up share capital of fifty crore rupees or more; or
• every public company having a turnover of two hundred fifty crore rupees or more.

Qualifications for the secretarial auditor: A Secretarial Audit has to be conducted by a Practising Company Secretary in respect of the secretarial and other records of the company.
Report of the secretarial audit: A secretarial audit report shall be annexed with the Board's report of the company. The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1). The format of the Secretarial Audit Report shall be in Form No.MR.3.

JOINT AUDIT:

Meaning of Joint Audit	when two or more auditors are appointed for the execution of same audit assignment, it is termed as joint audit. Joint auditors are mainly appointed for audit assignment of public enterprises and big companies.
Division of Work among Joint Auditors	Where joint auditors are appointed, they should, by *mutual discussion*, divide the audit work among themselves in terms of audit of identifiable units or specified areas. If due to the nature of the business of the entity under audit, such a division of work may not be possible the division of work may be with reference to *items of assets or liabilities or income or expenditure or with reference to*

	periods of time. The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.
Coordination	Where, in the course of his work, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgement by, other joint auditors, he should communicate the same to all the other joint auditors in writing. Thus should be done by the submission of a report or note prior to the finalisation of the audit.
Relationship among joint auditors	In respect of audit work divided among the joint auditors, each joint auditor is _responsible only for the work allocated to him_, whether or not he has prepared as separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible: (a) In respect of the audit work which is not divided among the joint auditors and is carried out by all of them; (b) In respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned; (c) In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors; (d) For examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and (e) For ensuring that the audit report complies with the requirements of the relevant statute.
Reporting Responsibilities	Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, _each one of them should express his own opinion through a separate report_. A joint auditor is not bound by the view of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

C & AG AUDIT

1. In India, government audit is performed by an independent constitutional authority, i.e. Comptroller and Audit General of India (C&AG), through the Indian Audit and Accounts Department.

2. The Constitution of India gives a special status to the C&AG and contains provisions to safeguard his independence.

3. Article 148 of the constitution provides that the C&AG shall be appointed by the President and can be removed from the office only in a like manner and on the like grounds as a judge of the Supreme Court.

4. Article 151 of the Constitution requires that the audit reports of the C&AG relating to the accounts of the Central/State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative.

5. The Comptroller and Audit General's (Duties, Power and Conditions of Services) Act, 1971, prescribes that the C&AG shall hold office for a term of six years or upto the age of 65 years, which is earlier. He can resign at any time through a resignation letter addressed to the President. The Act also assigns the duties regarding the audit to be followed by C&AG

6. Organizations subject to the audit of the Comptroller and Auditor General of India

– All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications.
– About 1500 public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations.
– Around 400 non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.
– Over 4400 authorities and bodies substantially financed from Union or State revenues.

UNIT 3: INTERNAL AUDIT

Propriety Audit	1. Kohler has defined propriety as that which <u>meets the test of public interest</u>, commonly accepted customs and standard of conduct and particularly as applied to professional performance, requirements of Government regulations and professional codes. 2. Propriety Audit carry out to check, mean whether the transactions have been done in conformity with established rules, principles and established standard. 3. The Propriety Audit means the verification of following main aspects to find out whether: (i) Proper recording has been done in appropriate books of accounts. (ii) The assets have not been misused and have been properly safeguarded. (iii) The business funds have been utilized properly. (iv) The concern is yielding the expected results. 4. The system of Propriety Audit is applied in respect to Government companies, Government Department because public money and public interest are involved therein. 5. It is an essential function of audit to bring to light not only cases of clear irregularity but also every matter which in its judgement appears to involve improper expenditure or waste of public money or stores, even though the accounts themselves may be insufficient to see that sundry rules or orders of competent authority have been observed. 6. It is of equal importance to ensure that the broad principles of orthodox finance are borne in mind not only by disbursing officers but also by sanctioning authorities.
Compliance Audit	1. A compliance audit is a comprehensive review of an organization's adherence to regulatory guidelines. 2. What, precisely, is examined in a compliance audit will vary depending upon whether an organization is a public or private company, what kind of data it handles and if it transmits or stores sensitive financial data. 3. It is common to us that the business undertakings require some certified statement on various matters and the auditors certify such statements after carrying out audit which might be necessary under the particular cases. All such audits are called Compliance Audit. 4. Benefits of Compliance Audit i. Adherence to the established standards. ii. Improvement of internal processes and technologies. iii. Maintenance of Certifications. iv. Adherence to governmental regulations. v. Cost recovery. vi. Elevate fraud awareness and deter fraudulent activity. vii. Manage contract areas of risk.

Efficiency Audit	1. In essence, efficiency indicates how well an organization uses its resources to produce goods and services. 2. It focuses on resources (inputs), goods and services (outputs), and the rate (productivity) at which inputs are used to produce or deliver the outputs. 3. To understand the meaning of "efficiency", it is necessary to understand the following terms: inputs, outputs (including quantity and quality), productivity, and level of service. 4. Efficiency is a relative concept. 5. It is measured by comparing achieved productivity with a desired norm, target, or standard. Output quantity and quality achieved and the level of service provided are also compared to targets or standards to determine to what extent they may have caused changes in efficiency. 6. Efficiency is improved when more outputs of a given quality are produced with the same or fewer resource inputs, or when the same amount of output is produced with fewer resources. 7. Efficiency audit refers to comparing the actual results with the desired/projected results. It is directed towards the measurement of whether plans have been effectively executed. 8. It is concerned with the utilisation of the resources in economic and most remunerative manner to achieve the objectives of the concern. 9. It comprises of studying the plans of organisation, comparing actual performance with plans and investigating the reasons for variances to take remedial action. 10. The **objectives of auditing efficiency** can include assessing one or more of the following: i) the level of efficiency achieved by an organization or operation in relation to reasonable standards; ii) the adequacy and reliability of systems or procedures used to measure and report efficiency; iii) an organization's efforts to explore and exploit opportunities to improve efficiency; and iv) whether the management processes and information systems, operational systems, and practices of an organization help to achieve efficiency. 11. **Advantages of Efficiency Audit:** i) help managers and staff to be more sensitive to their obligation of due regard to efficiency; ii) underline the importance of measuring efficiency and of using that information for managing operations and providing accountability; iii) identify means for improving efficiency, even in operations where efficiency is difficult to measure; iv) demonstrate the scope for lowering the cost of delivering programs without reducing the quantity or quality of outputs or the level of service;

	v) increase the quantity or improve the quality of outputs and level of service without increasing spending; and vi) identify needed improvements in existing controls, operational systems, and work processes for better use of resources.
Internal Audit	"Internal Audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's risk management and internal control system." The **objects & Scope of internal audit** can be stated as follows: (1) To verify the ***accuracy and authenticity of the financial accounting*** and statistical records presented to the management. (2) To ascertain that the standard *accounting practices*, as have been decided to be followed by the organisation, are being adhered to. (3) To establish that there is a *proper authority* for every acquisition, retirement and disposal of assets. (4) To confirm that liabilities have been incurred only for the *legitimate activities* of the organisation. (5) To analyse and *improve the system of internal check*; in particular to see (i) that it is working; (ii) that it is sound; and (iii) that it is economical. (6) To facilitate the *prevention and detection of frauds*. (7) To examine the *protection afforded to assets* and the uses to which they are put. (8) To make special investigations for management. (9) To provide a channel whereby *new ideas* can be brought to the attention of management. (10) To *review the operation of the overall internal control system* and to bring material departures and non-compliances to the notice of the appropriate level of management ; the review also generally aims at locating unnecessary and weak controls for making the entire control system effective and economical. ***Provisions of Internal Audit in Companies Act, 2013:*** *As per section 138 of the Companies Act, 2013 the following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014). shall be required to appoint an internal auditor or a firm of internal auditors, namely:-* *(a) every listed company;* *(b) every unlisted public company having-* *(i) paid up share capital of fifty crore rupees or more during the preceding financial year; or*

	(ii) turnover of two hundred crore rupees or more during the preceding financial year; or *(iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or* *(iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and* *(c) every private company having-* *(i) turnover of two hundred crore rupees or more during the preceding financial year; or* *(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:* *Provided that an existing company covered under any of the above criteria shall comply with the requirements within six months of commencement of such section. Who can be appointed as Internal Auditor? : As per section 138 the internal auditor, who shall either be a chartered accountant whether engaged in practice or not or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies auditor may or may not be an employee of the company.* *To be effective, the internal auditor must be regarded as part of the management and not merely as an assistant thereto. He must have authority to investigate from the financial angles, every phase of the organizational activity under any circumstances. In recent years, there has been a growing tendency in Western countries to make the internal auditor responsible directly to the Board of Directors for the maintenance of adequate accounting procedures and for the preparation of financial statements and reports as regards the functioning of the business. His main responsibility, however, must be to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safeguards against misappropriation of assets. In carrying out these functions, he must operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him. He should also not involve himself in the performance of executive functions in order that his objective outlook does not get obscured by the creation of vested interest.* *It may be further pointed out that internal auditors who are qualified accountants, because of their training and experience, can be of great assistance to the management even in fields other than accounting. They can observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, they critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected. In order that an internal auditor may be able to play such a role in the field of management, he must be closely associated with it and his knowledge must be kept up to date by his being kept informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies. Also, he must enjoy an independent status.* *In addition, the Audit Committee of the company or the Board shall, in*

	consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit. <u>NATURE OF INTERNAL AUDIT:</u> 1. **A Management tool**: Internal Audit is management tool performed by the employees of the organisation or the engaged professional firm to check the appropriateness of internal checks and control in the organisation. The reporting authority is generally board of directors and audit committee. 2. **A continuous Exercise**: Internal Audit is a continuous and systematic process of examining and reporting the operations and records of a concern by its employees or external agencies specially assigned for this purpose. It is, in essence, auditing for the management and its scope may vary depending upon the nature and size of the concern. 3. **A Control System**: It is a control system concerned with examination and appraisal of other control mechanisms. 4. **A Risk Management Tool**: The internal audit work encompasses fostering the creation of a risk management process and ensuring it addresses key objectives, and the subsequent evaluation of the process. The internal audit work also encompasses an identical role in the creation and subsequent evaluation of, the business continuity planning process, and the information security and privacy system. <u>INTERNAL AUDIT PROCESS</u>: 1. Establish and communicate the scope and objectives for the audit to appropriate management. 2. Develop an understanding of the business area under review. This includes objectives, measurements and key transaction types. This involves review of documents and interviews. Flow charts and narratives may be created if necessary. 3. Describe the key risks facing the business activities within the scope of the audit. 4. Identify control procedures used to ensure each key risk and transaction type is properly controlled and monitored. 5. Develop and execute a risk-based sampling and testing approach to determine whether the most important controls are operating as intended. 6. Report problems identified and negotiate action plans with management to address the problems. 7. Follow-up on reported findings at appropriate intervals. Internal audit departments maintain a follow-up database for this purpose.

ADVANTAGES OF INTERNAL AUDIT:

1. Internal Auditing is a specialized service to look into the standards of efficiency of business operation.

2. Internal Auditing can evaluate various problems independently in terms of overall management control and suggest improvement.

3. Internal Audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.

4. Internal Audit system makes sure the internal control system including accounting control system in an organization is effective.

5. Internal Audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.

6. Internal Audit is an integral part of "Management by System".

7. Internal Audit can break through the power ego and personality factors and possible conflicts of interest within the organization.

8. It ensures compliance of accounting procedures and accounting policies.

9. Internal Auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.

LIMITATIONS OF INTERNAL AUDIT:

1. The installation and operation of internal audit involve extra expenditure which cannot be met by many small concerns. As a matter of fact, internal audit is confined to larger business.

2. The limitation of internal audit starts when there is time lag between recording and checking of entries. The accounting and internal audit must go side by side with minimum time gap

3. Internal audit becomes as better as it is used by managers. There are occasions when managers cannot accept the finding of internal audit and take consequent actions. This defect arises mainly from the deficiencies of the internal auditing staff, because of their advisory staff position, unfamiliarity with operating aspects of work and accounting bias, internal auditors fail to be of any real help to the manager in many cases.

4. Internal audits are employed by the organization and this can be impair their independence and objectivity and ability to report fraud/error to senior management because of perceived threats to their continued employment within the company to ensure the transparency. Best practice indicates that the internal audit should report both to management and those charged with governance (audit committee).

<table>
<tr><td></td><td>5. Internal auditors are not required to be professionally qualified and so there may be limitations in their knowledge and technical expertise</td></tr>
<tr><td>Statutory Audit vs Internal Audit</td><td>
<table>
<tr><th>STATUTORY AUDITOR</th><th>INTERNAL AUDITOR</th></tr>
<tr><td>1. The extent of the work undertaken by statutory auditor arises from the responsibility placed on him by the statutes.</td><td>It is statutory requirement too as per section 138 of the Companies Act, 2013 where the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, Formulate the scope, functioning, periodicity and methodology for conducting the internal audit.</td></tr>
<tr><td>2. The approach of this auditor is governed
by his statutory duty to satisfy himself that the accounts to be presented to the shareholder show a true and fair view of the financial position.</td><td>The approach of this auditor is with a view to satisfy that the accounting system is efficient, so that the accounting information presented to the management is accurate and discloses material facts.</td></tr>
<tr><td>3. This auditor is responsible directly to the shareholder.</td><td>This auditor is responsible to management.</td></tr>
<tr><td>4. External auditor is not the employee of the company so he has independent status.</td><td>If internal auditor is an employee of the company. He cannot enjoy independence that statutory auditor has.</td></tr>
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UNIT 4: INTERNAL CONTROL

ADVANTAGES OF INTERNAL CONTROL SYSTEM:	
Increase in operational efficiency	One advantage of internal controls involves the efficiency they create. Technological advances to improve the accuracy of each transaction also streamline manual processes.
Accurate Recording	Another advantage of internal controls revolves around the accuracy in recording each transaction. Internal controls help prevent errors and irregularities from occurring. If errors or irregularities do occur, internal controls will help ensure they are detected in a timely manner. It creates confidence that only authorized transactions have taken place.
Safeguarding Assets	It minimizes of the risk of fraud and misappropriation of assets. It involves fraud monitoring and prevention techniques. For example in case of a banking internal control system, monitoring activities include security cameras and security guards and prevention activities include cash counting by two employees at a time and cash reconciliation by non-tellers.
Compliance	Another advantage of using internal controls includes increasing compliance with regulatory agencies. Internal controls encourage adherence to prescribed policies and procedures. It assures that adequate documentation supporting transactions is created and retained.
Protection of Employees	Internal controls protect employees: 1) by clearly outlining tasks and responsibilities, 2) by providing checks and balances, and, 3) from being accused of misappropriations, errors or irregularities.

INHERENT LIMITATIONS OF INTERNAL CONTROL:

Internal control can provide only reasonable, but not absolute, assurance that the objectives stated above are achieved. This is because there are some inherent limitations of internal control, such as:

COST	Management's consideration that a control be cost-effective.
NO CONTROL FOR UNUSUAL TRANSACTION	The fact that most controls do not tend to be directed at transactions of unusual nature;
HUMAN ERROR	The potential for human error; These include the realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control.
COLLUSION AMONG EMPLOYEES	The possibility of circumvention of controls through collusion with parties outside the entity or with employees of entity; For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition.
ABUSE OF	The possibility that a person responsible for exercising control could abuse

AUTHORITY	that authority, for example, a member of management overriding a control;
INADEQUATE PROCEDURE	The possibility that procedures may become inadequate due to changes in conditions and compliance with procedures may deteriorate;
MANIPULATIONS BY MANAGEMENT	With respect to transactions or estimates and judgments required in the preparation of financial statements.

INTERNAL CHECK

Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.

A system of internal check in accounting implies organisation of system of book keeping and arrangement of staff duties in such a manner that no one person can completely carry through a transaction and record every aspect thereof. The essential elements of a goods system of internal check are:
(i) Existence of checks on the day-to-day transaction.
(ii) Which operate continuously as a part of the routine system.
(iii) Whereby the work of each person is either proved independently or is made complementary to the work of another.

TECHNIQUES OF INTERNAL CONTROL SYSTEM

There are two types of techniques used in internal control system Preventive internal control techniques and Detective internal control techniques controls. Both types of internal control techniques are essential to an effective internal control system. From a quality standpoint, preventive controls techniques are essential because they are proactive and emphasize quality. However, detective controls techniques play a critical role by providing evidence that the preventive controls techniques are functioning as intended

Preventive Controls techniques are designed to discourage errors or irregularities from occurring. They are proactive in nature that helps to ensure departmental objectives are being met. Examples of preventive controls techniques are:

1. **Segregation of Duties**: Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.

2. **Approvals, Authorizations, and Verifications**: Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor’s approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.

3. **Security of Assets (Preventive and Detective):** Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

Detective Controls techniques are designed to find errors or irregularities after they have occurred. Examples of detective controls techniques are:

1. **Reviews of Performance**: Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.

2. **Reconciliations**: An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.

3. Physical Inventories

4. Internal Audits

REVIEW OF INTERNAL CONTROL BY THE AUDITOR:

The review of internal controls will enable the auditor to know:

(i) Whether errors and frauds are likely to be located in the ordinary course of operations of the business;

(ii) Whether an **adequate internal control system** is in use and operating as planned by the management;

(iii) Whether an **effective internal auditing** department is operating;

(iv) Whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);

(v) Whether the controls adequately **safeguard the assets;**

(vi) How far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;

(vii) How **reliable the reports**, records and the certificates to the management can be;

(viii) The extent and the depth of the examination that he needs to carry out in the different areas of accounting;

(ix) What would be appropriate audit technique and the audit procedure in the given circumstances?

(x) What are the areas where **control is weak** and where it is excessive; and

(xi) Whether some **worthwhile suggestions** can be given to improve the control system.

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation.

Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.

A review of the internal control can be done by a process of study, examination and evaluation of the control system installed by the management. The first step involves determination of the control and procedures laid down by the management. By reading company manuals, studying organisation charts and flow charts and by making suitable enquiries from the officers and employees, the auditor may ascertain the character, scope and efficacy of the control system.

To acquaint himself about how all the accounting information is collected and processed and to learn the nature of controls that makes the information reliable and protect the company's assets, calls for considerable skill and knowledge. In many cases, very little of this information is available in writing; the auditor must ask the right people the right questions if he is to get the information he wants. It would be better if he makes written notes of the relevant information and procedures contained in the manual or ascertained on enquiry.

To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, the auditor can use one of the following to help him to know and assimilate the system and evaluate the same:
(i) Narrative record;
(ii) Check List;
(iii) Questionnaire; and
(iv) Flow chart

THE NARRATIVE RECORD	❖ This is a complete and exhaustive description of the system as found in operation by the auditor.

	❖ Actual testing and observation are necessary before such a record can be developed. It may be recommended in cases where no formal control system is in operation and would be more suited to small business. ❖ The basic disadvantages of narrative records are: (i) To comprehend the system in operation is quite difficult. (ii) To identify weaknesses or gaps in the system (iii) To incorporate changes arising on account of reshuffling of manpower, etc.
A CHECK LIST	❖ This is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. ❖ When he completes instruction, he initials the space against the instruction. ❖ Answers to the check list instructions are usually Yes, No or Not Applicable. ❖ This is again an on the job requirement and instructions are framed having regard to the desirable elements of control. ❖ A few examples of check list instructions are given hereunder: 1. Are tenders called before placing orders? 2. Are the purchases made on the basis of a written order? 3. Is the purchase order form standardised? 4. Are purchase order forms pre-numbered? 5. Are the inventory control accounts maintained by persons who have nothing to do with: (i) custody of work; (ii) receipt of inventory; (iii) inspection of inventory; and (iv) purchase of inventory? ❖ The complete check list is studied by the Principal/Manager/Senior to ascertain existence of internal control and evaluate its implementation and efficiency.
INTERNAL CONTROL QUESTIONNAIRE	❖ This is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation. ❖ An important advantage of the questionnaire approach is that oversight or omission of significant internal control review procedures is less likely to occur with this method. ❖ With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an interim basis. The questionnaire form also provides an orderly means of disclosing control defects.

	❖ It is the general practice to review the internal control system annually and record the review in detail. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. ❖ Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given. ❖ The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.
A FLOW CHART	❖ It is a graphic presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. ❖ It minimizes the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form. ❖ It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested. ❖ It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels of goods and materials as well as cash, both inward and outward; and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

NEED FOR AUDIT SAMPLING

Formalized audit sampling procedures offer innumerable benefits to all auditors. These include:
1. Developing a consistent approach to audit areas;
2. Providing a framework within which sufficient audit evidence is obtained;
3. Forcing clarification of audit thinking in determining how the audit objectives will be met;
4. Minimising the risk of over-auditing; and
5. Facilitating more expeditious review of working papers

Advantages of statistical sampling in Auditing:

The advantages of using statistical sampling technique in auditing are:

(i) Sample size does not increase in proportion to the increase in the size of population.

(ii) Sample selection is more objective and based on law of probability.

(iii) This provides a means of estimating the minimum sample size associated with a specified risk and precision level.
(iv) It also provides a means for deriving a calculated risk and corresponding precision.
(v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistake are not large.

INTER-FIRM COMPARISON

1. It is technique of evaluating the performance, efficiency, costs and profits of firms in an industry. It consists of voluntary exchange of information/data concerning costs, prices, profits, productivity and overall efficiency among firms engaged in similar type of operations for the purpose of bringing improvement in efficiency and indicating the weaknesses. Such a comparison will be possible where uniform costing is in operation.

2. An inter-firm comparison indicates the efficiency of production and selling, adequacy of profits, weak spots in the organisation, etc. and thus demands from the firm's management an immediate suitable action. Inter-firm comparison may enable the management to challenge the standards which it has set for itself and to improve upon them in the light of the current information gathered from more efficient units. Such a comparison may be carried out in electrical industry, printing firms, cotton spinning firms, pharmaceuticals, cycle manufacturing, etc

3. The **main advantages** of inter-firm comparison are:–
i. Such a comparison gives an overall view of the industry as a whole to its members– the present position of the industry, progress made during the past and the future of the industry.

ii. It helps a concern in knowing its strengths or weaknesses in relation to others so that remedial measures may be taken.

iii. It ensures an unbiased specialized reporting on particular problems of the concern.
iv. It develops cost consciousness among members of the industry.
v. It helps Government in effecting price regulation.
vi. It helps to improve the quality of products manufactured and to reduce the cost of production. It is thus advantageous to the industry as well as to the society.

4. **Limitations of inter-firm comparison**
The following are the limitations in the implementation of a scheme of inter-firm comparison :
i. Top management feels that secrecy will be lost.
ii. Middle management is usually not convinced with the utility of such a comparison.
iii. In the absence of a suitable Cost Accounting System, the figures supplied may not be reliable for the
purpose of comparison.

INTRA-FIRM COMPARISON

1. Intra-firm comparison means comparison among different units/products/strategic business unit (SBU) of a firm. This comparison is possible only when uniform costing methods and practices are being adopted by all units and SBUs.

2. Intra firm comparison helps the management in identifying the units/Strategic SBUs which have not been performing as per the internal benchmark or standards achieved by other units SBUs. This comparison is difficult sometime when the firm is dealing in different product/sectors and their working conditions are significantly different.

3. **Advantages of Intra-firm comparison**:
1. Such a comparison gives an overall view of the firm as a whole to the owner or stakeholders and gives a comparative view of different product/different business of the firm.
2. It helps a SBU in knowing its strengths or weaknesses in relation to others SBUs.
3. It develops cost consciousness among units of the firm.

AUDIT IN DEPTH:

1. **Authorization of Purchase requisition**: Check whether the requisitions are pre-printed, pre-numbered and authorized. See whether the purchase requisition have been authorized by competent official.

2. **Issue of Request for quotation**: Check whether request for quotatio0n have been issued or not. If not find the reasons of not issuing request for quotation. Check whether the requests for quotation have been issued to approved vendors.

3. **Issue of Purchase order**: Check whether purchase order have been issued or not. If purchase order have been issued check whether it has been issued from the competent authority. Check whether the purchase order have been issued to the approved vendor who has given lowest quote. If not check the reasons. Check whether the reasons of issuing the purchase order to a vendor other than the lowest bidder have been approved by the competent authority.

4. **Receipt of goods and entry of goods in store ledger**: check whether the goods receipt is as per specification given in the purchase order. If not check whether the deviations have been recorded and the communication has been made to the supplier or not. Check whether the goods receipt have been properly recorded in store ledger or not.

5. **Approval of payment of Supplier Invoice**: Check whether the amount has been approved by the competent authority.

6. **Payment of supplier invoice**: Check whether the supplier bill have ben paid correctly. Check whether all deduction for short receipt of goods, late delivery of goods, inferior quality of goods, advance payment for the goods have been done or not.

7. **Accounting of Transaction**: Check whether accounting made is correct or not. Check whether correct expenses code have been debited or not. Check whether the applicable accounting standard have been complied with or not.

UNIT 5: REVIEW OF INTERNAL CONTROL

Segregation of duties in purchase operations

To ensure proper separation of duties, assign related buying functions to different people. Ensure proper segregation, no single person has complete control over all buying activities.

It is always preferable to have different people who –

I. Approve purchases
II. Receive ordered materials
III. Approve invoices for payment
IV. Review and reconcile financial records
V. Perform inventory counts

If segregation of duties does not exist in purchases operations, this may result into unauthorized or unnecessary purchases, improper charges to department budgets, purchase of goods at excessive costs, use of goods for personal purposes.

Physical control over of assets

Once the purchases are done, it is necessary to secure the materials in a safe location. To ensure that the resources are accounted for, it is necessary to periodically verify the inventory and compare the results with the books.

To ensure security of assets, it is advisable to –

(i) Secure goods received in a restricted area.
(ii) Restrict inventory access to appropriate staff.
(iii) Lock goods and materials, and provide key or combination to as few people as possible.
(iv) Keep inventory records and periodically calculate beginning and ending inventory amounts.

If physical control over assets does not exists, it may result into theft of goods, inventory shortages, additional costs incurred for replacement of goods

Objectives of Management Information Systems Review

1. To determine whether review procedures are necessary to achieve stated objectives.

2. To determine whether MIS policies or practices, processes, objectives, and internal controls are adequate.

3. To evaluate whether MIS applications provide users with timely, accurate, consistent, complete, and relevant information.

4. To assess the types and level of risk associated with MIS and the quality of controls over those risks.

5. To determine whether MIS applications and enhancements to existing systems adequately support corporate goals.

6. To determine whether MIS is being developed in compliance with an approved corporate MIS policy or practice statement.

7. To determine whether management is committed to providing the resources needed to develop the required MIS.

8. To determine if officers are operating according to established guidelines.

9. To evaluate the scope and adequacy of audit activities.

10. To initiate corrective action when policies or practices, processes, objectives, or internal controls are deficient.

11. To determine if any additional work is needed to fulfill the examination strategy of the institution.

UNIT 6: AUDIT ENGAGEMENT & DOCUMENTATION

AUDIT PROGRAMME:

<table>
<tr><td>MEANING</td><td colspan="2">
➢ An audit programme is a predetermined detailed plan of auditing work to be performed, specifiying the procedure to be followed in verification of each item in the financial statement, allocation of the audit staff and the time framed to be followed in conducting the audit.
➢ Thus an audit programme is written plan for the conduct of an audit specifying what work to be done, when to be done and by whom to be done.
➢ It consist of series of verification procedure to be followed to the financial statements and accounts of a given company for the purpose of obtaining sufficient & appropriate evidence to enable the auditor to express an informed opinion on such statements.
</td></tr>
<tr><td rowspan="11">ADVANTAGES OF AUDIT PROGRAMME</td><td>1. Selection of team members</td><td>The programme helps in selection of assistants for jobs on the basis of their capability.</td></tr>
<tr><td>2. Instructions for staff</td><td>The audit programme specifies the extent and manner of checking and verification to be carried out in respect of different aspects of accounting records.
These instructions helps assistants and the staff in knowing how much to be checked and in what manner.</td></tr>
<tr><td>3. Ready checklist</td><td>It provides ready checklist of all the procedures and techniques to be adopted. Therefore minimizes the possibility of overlooking any of important audit steps.</td></tr>
<tr><td>4. No ignorance or overlooking</td><td>Due to properly written programme, there is no chance of forgetting / overlooking some important manner.</td></tr>
<tr><td>5. Responsibility fixation</td><td>Programme clearly sets out as to who is required to do a particular work. Thus responsibility can be fixed.</td></tr>
<tr><td>6. Progress of work done</td><td>The progress of work can be determined on the basis of entries on the programme.</td></tr>
<tr><td>7. Supervision</td><td>Work by assistants can be easily supervised by referring the programme.</td></tr>
<tr><td>8. Timely completion</td><td>Time to time, compliance with program is checked as to complete the work on timely basis.</td></tr>
<tr><td>9. Basis for reporting</td><td>Program easily sets out procedure – evidence- conclusions chain, to enable the auditor to express an opinion.</td></tr>
<tr><td>10. Future audits</td><td>It serves as a guide for audits to be carried out in succeeding years.</td></tr>
<tr><td>11. Safeguard for auditor</td><td>Audit programme is a record of work done, particularly in defending a suit brought against the auditor for negligent performance of work.
It is sufficient proof that work was carried out with reasonable skill and care that is expected to be professional.</td></tr>
<tr><td rowspan="2">DISADVANTAGES OF AUDIT PROGRAME</td><td>1. Mechanical work</td><td>The audit may be performed mechanically without reference to the special circumstances of the client or to the development of any new or unusual features in the client's business.</td></tr>
<tr><td>2. Inflexibility</td><td>The programme often become rigid & inflexible. Assistants are</td></tr>
</table>

		not able to change it as per requirements of specific case.
	3. **Lack of initiative**	Independent judgment and initiative of the staff may be restricted. It may frustrate talented and efficient audit staff.
	4. **False sence of security**	Members of the audit team may feel that everything is being taken care of by the audit programme. They may fail to apply their mind in circumstances that arise during the course of work.
	5. **Lack of suitability**	Wrong and redudant procedures may be undertaken which may be inappropriate to the circumstances of the client's business.
	6. **Inefficient staff**	Inefficient staff may take shelter behind the programme saying that matter does not contain any instructions.

VOUCHING: (Nov 05) The act of examining vouchers is referred to as vouching. It is the practice followed in an Audit with the objective of establishing the authenticity of the transactions recorded in the primary books of account. It essentially consists of verifying a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mentioned in the voucher has been posted to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account.

OBJECTIVES OF VOUCHING

The basic objectives of vouching are as under:
1. To ensure that all the transactions are properly recorded in the books of accounts.
2. To see the proper evidence supports all the entries of the transactions.
3. To make sure that fraudulent transactions are not recorded in the books of accounts.
4. To see that all transactions relating to business are recorded in the books of accounts.
5. To see that all transactions are properly authenticated by a responsible person.

On these considerations, the **essential points to be borne in mind** while examining a voucher are:
(i) That the date of the voucher falls within the accounting period;
(ii) That the voucher is made out in the client's name;
(iii) That the voucher is duly authorised;
(iv) That the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into,
i.e., the voucher is complete in all respects; and
(v) That the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

VERIFICATION: verification includes verifying:-
1. The existence of the assets
2. Legal ownership and possession of the assets
3. Ascertaining that the asset is free from any charge, and
4. Correct valuation

POINTS TO BE CONSIDERED IN VERIFICATION

While conducting verification following points should be considered by the auditor:-

1. Existence: The auditor should confirm that all the assets of the company physically exist on the date of balance sheet.
2. Possession: The auditor has to verify that the assets are in the possession of the company on the date of balance sheet.

3. Ownership: The auditor should confirm that the asset is legally owned by the company.

4. Charge or lien: The auditor has to verify whether the asset is subject to any charge or lien.

5. Record: The auditor should confirm that all the assets and liabilities are recorded in the books of account and there is no omission of asset or liability.

6. Audit report: Under CARO the auditor has to report whether the management has conducted physical verification of fixed assets and stock and the difference, if any, between the physical inventory and the inventory as per the book.

7. Event after balance sheet date: The auditor should find out whether any event after the date of balance sheet has affected any items of assets and liabilities.

ADVANTAGES OF VERIFICATION

Advantages of verification are as under:-
1. It avoids manipulation of accounts.
2. It guards against improper use of assets.
3. It ensures proper recording and valuation of assets.
4. It exhibits true and fair view of the state of affairs of the company.

VOUCHING VS. VERIFICATION:

Verification is made on the basis of vouching. So, verification is a part of vouching. Even though they have some differences which are as follows:

1. Meaning

Verification is the act of checking title, possession and valuation of assets but vouching is the act of checking the records with the help of evidential documents.

2. Nature

Verification is specially related to the assets and liabilities but vouching is related to all the accounting documents.

3. Person

Generally, assistant staff or auditor performs the work of vouching but auditor himself performs the work of verification.

4. Time

Vouching is made at the beginning of auditing but verification is made at the end of auditing or at the time of checking balance sheet.

AUDIT DOCUMENTATION

MEANING	Audit documentation refers to record of - audit procedures performed; • relevant audit evidence obtained; • conclusions the auditor reached
NATURE & PURPOSE OF AUDIT DOCUMENTATION	**Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SA's provides:** a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and b) Evidence that audit was planned and performed in accordance with SA's and applicable legal and regulatory requirements. **Audit documentation serves a number of additional purposes, including the following:** a) Assisting the engagement team to plan and perform the audit. b) Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220. c) Enabling the engagement team to be accountable for its work. d) Retaining a record of matters of continuing significance of future audits. e) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1. f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.
EXPERIENCED AUDITOR	An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of: ➢ Audit processes; ➢ SA's and applicable legal and regulatory requirements; ➢ The business environment in which the entity operates; and ➢ Auditing and financial reporting issues relevant to the entity's industry.

FORM CONTENT & EXTENT OF AUDIT DOCUMENTATION	The auditor shall prepare audit documentation that is sufficient to enable an **experienced auditor**, having no previous connection with the audit, to understand: ➢ The nature, timing and extent of the audit procedures performed to comply with SA's and applicable legal and regulatory requirements; **In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:** ✓ The identifying characteristics of the specific items or matters tested; ✓ Who performed the audit work and the date such work was completed; and ✓ Who reviewed the audit work performed and the date and extent of such review. ➢ The results of the audit procedures performed, and the audit evidence obtained; and ➢ Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions. **SOME OTHER IMPORTANT MATTERS AN AUDITOR SHOULD DOCUMENT ARE AS FOLLOWS:** a) **DISCUSSIONS**:- Discussions of significant matters with management, those charge with governance and others, including the nature of the significant matters discussed and when and with whom the discussion took place. b) **INCONSISTENT INFORMATION**:-If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency. **c)** **DEPARTURE FROM A RELEVANT REQUIREMENT:** If in exceptional circumstances, he departs from SA's, the auditor shall document the reasons for the departure and alternative procedures performed. **d)** **MATTERS ARISING AFTER THE DATE OF THE AUDITOR'S REPORT:** If in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document the same.
WORKING PAPERS	Working papers refers to documents kept by the auditor in connection with the performance of his audit work. It is the record of: ➢ Planning ➢ Procedure applied ➢ Tests performed ➢ Evidence obtained; & ➢ Conclusions reached Examples of working papers are audit programme, analysis, memoranda, letters of confirmation, representation letter abstracts, schedules or commentaries, electronic media containing data, etc.

<table>
<tr><td></td><td colspan="3">IMPORTANCE OF AUDIT WORKING PAPERS:
(i) It provides guidance to the audit staff .
(ii) The auditor is able to fix responsibility on the staff member who signs each schedule checked by him.
(iii) It acts as evidence in the court of law when a charge of negligence is brought against the auditor.
(iv) Important for future planning.
(v) Contains basis for forming an opinion.
(vi) Helps the senior to review work done by assistants.</td></tr>
<tr><td>ASSEMBLY OF THE FINAL AUDIT FILE</td><td colspan="3">SQC- 1 requires firm to establish policies and procedures for the timely completion of assembly of the audit files.
An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.</td></tr>
<tr><td rowspan="4">GUIDANCE NOTE ON AUDITORS RIGHT IF CLIENT & OTHERS SEEK ACCESS TO HIS DOCUMENT</td><td>Auditors property</td><td colspan="2">Working papers are the property of the auditor. He may at his discretion, make any portions or extracts from his working papers to client.
The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.</td></tr>
<tr><td>Rule of confidentiality</td><td colspan="2">As per SA-200, auditor should not disclose any confidential matter relating to client to any 3rd party unless it is
Permitted by client OR his legal/ professional duty to disclose</td></tr>
<tr><td rowspan="2">Can he show working papers to</td><td>3rd parties including other auditors</td><td>No, otherwise it will violate rule of confidentiality as above.</td></tr>
<tr><td>client</td><td>➢ Client doesn't have any right to access audit W.P. kept by auditor.
➢ But auditor may, at his discretion, show some/ complete W.P. to client.</td></tr>
<tr><td>TIME OF RETENTION OF WORKING PAPERS/ AUDIT DOCUMENTATION</td><td colspan="3">SQC-1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is not shorter than seven years from the date of the auditor's report, or, if later the date of group auditor's report.</td></tr>
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PERMANENT & CURRENT AUDIT FILES

In case of recurring audit, two type of files are maintained to avoid duplicity of documentation. These are as follows:

PERMANENT AUDIT FILES	It contains matters which are updated currently with information of continuing importance to succeeding audit.
PERMANENT AUDIT FILE NORMALLY INCLUDES:	The **PERMANENT AUDIT** file normally includes: • Information concerning the legal and organizational **s**tructure of the entity. In the case of a company, this includes the MOA and AOA. In case of statutory corporation, it includes Act and Regulations which the corporation functions. • Extract or copies of important **l**egal documents, **a**greements and minutes relevant to the audit. • A record of the study and the evaluation of the internal **c**ontrols related to

	the accounting system. • Copies of audited **f**inancial statement for previous years. • Analysis of significant **r**atios and trends. • Copies of management letters issued by the auditor; if any • Record of communication with the retiring auditor, if any, before the acceptance of the appointment as auditor. • Notes regarding significant accounting **p**olicies. • Significant audit **o**bservations of earlier years.
CURRENT AUDIT FILE	Current audit files which contain information relating primarily to the audit of a single period. The **CURRENT FILE** normally includes: • Correspondence relating to acceptance of annual reappointment. • Extracts of important matters in the minutes of Board Meetings and General Meetings as relevant to audit. • Evidence of the planning process of the audit and audit programmes. • Analysis of transactions and balances. • A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures. • Evidence that the work performed by assistants was supervised and reviewed. • Copies of communication with other auditors, experts and other third parties. • Letters of representation or confirmation received from the client. • Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated. • Copies of the financial information being reported on and related audit reports.

GENERAL CONSIDERATIONS IN FRAMING A SYSTEM OF INTERNAL CHECK:

(1) No single person should have an **independent control** over any important aspect of the business. All dealings and acts of every employee should, in the ordinary course, come under the review of another.

(2) The **duties of members of the staff should be changed** from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.

(3) Every member of the staff should be **encouraged to go on leave at least once in a year**. Experience has shown that frauds successfully concealed by employees are often unearthed when they are on leave.

(4) Persons having physical custody of assets must not be permitted to have access to the books of account.

(5) There should exist an accounting control in respect of each important class of assets; in addition, these should be **periodically inspected** so as to establish their physical condition.

(6) To prevent loss or misappropriation of cash, mechanical devices, such as the **automatic cash register**, should be employed.

(7) A majority of business concerns now-a-days work according to some kind of **budgetary control**. It enables them to review from time to time the progress of their trading activities. Such business houses should have a separate staff for the collection of statistical figures which later on should be checked with the corresponding figures from the financial books. If wide discrepancies are observed, these should be reconciled.

(8) For inventory-taking, at the close of the year, trading activities should, if possible, be suspended. The task of inventory-taking, and **evaluation should be done by staff belonging to several sections of the organisation**. It may prove dangerous to depend exclusively on the inventory section staff for these tasks, since they may be tempted to under or over-state the inventory.

(9) The financial and administrative **powers should be distributed very judiciously** among different officers and the manner in which these are actually exercised should be reviewed periodically.

(10) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.