

# PRINCIPLES AND PRACTICES OF AUDITING

MAY/JUNE 2019

## SECTION-A

Answer the following. Each question carries two marks :-

1. a) Define Auditing.

Ans. According to Spicer and Pegler “An audit may be said to be such an examination of the books, accounts and vouchers of a business, as shall enable the auditor to satisfy himself whether the Balance Sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business, and that the Profit and Loss account gives a true and fair view of the profit or loss for the financial period, according to the best of his information and the explanations given to him as shown by the books; and if not, in what respect he is not satisfied”.

b) What is internal check?

Ans. The internal check is an arrangement of the duties of the staff members of the accounting function in such a way that the work performed by one person is automatically checked by another. In other words, it is an such arrangement of duties among the accounting staff that the work performed by one individual is independently checked by another in the routine course, such that errors and frauds are prevented, or discovered without delay.

c) What do you mean by primary voucher?

Ans. When written evidence is available in original, it is known as primary vouchers. For example: - cash memo, purchase invoice, goods received notes, counterfoil of cash receipts, purchase order, etc.

d) What is meant by valuation of Assets?

Ans. Valuation means ascertaining the monetary or financial worth of an asset on the date of the balance sheet. This involves the critical examination and the testing of determined values on the basis of generally accepted accounting principles and conventions. Further, valuation of assets is an important bearing on the capital worth of the business. The auditor, therefore, is required to find out the correct value of assets.

e) What is 'Professional Ethics'?

Ans. Professional ethics refers to the professionally accepted standards of personal and business behaviour, values, and guiding principles. It encompasses the personal, organizational, and corporate standards of behaviour expected of professionals.

f) What do you mean by Audit working papers?

Ans. Audit working papers are used to document the information gathered during an audit. They provide evidence that sufficient information was obtained by an auditor to support his or her opinion regarding the underlying statements. In simple words, audit working papers contain essential facts about accounts that are under audit. These audit working papers are kept or prepared by the independent auditor.

g) Mention the important categories of assets for the purpose of valuation.

Ans. They are:-

- a. Fixed Assets
- b. Floating Assets
- c. Wasting Assets
- d. Intangible Assets
- e. Fictitious Assets

## SECTION –B

Answer the following questions. Each question carries six marks:-

2. What is Tax Audit? Who can appoint a Tax Auditor?

Ans. Tax audit refers to audit of incomes or expenses or specific claims of deductions or exemptions for the purpose of assessment of income tax. Tax audit in addition to financial audit, which does not fulfil the specific requirement of the tax authority.

Tax audit came into force on 1/4/1985 u/s 44AB of the Income Tax Act, 1961. The scope of tax audit extends to verification of accounts of the previous year or years relevant to any assessment year.

Any practicing Chartered Accountant or firm of Chartered Accountants can conduct Tax Audit. **The Board of Directors in case of Company, Partner of a firm and proprietor of the business can appoint Tax Auditor.**

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3. What are the advantages and disadvantages of Internal Audit?

Ans. Advantages of Internal Audit:-

1. The biggest advantage of internal audit is that it will lead to discovery of errors and therefore when external audit is done these errors which were discovered during internal audit would have been rectified by then.
2. Since audit is done by the employees of the company there is no additional cost involved which again is a big advantage for a company which is doing internal audit.
3. As internal audit is a constant procedure where records are checked regularly it ensures that accounting staff of a company keep the records up to date.
4. Internal audit helps to detect errors and frauds and provides suggestions to improve them which help the management to take corrective action.
5. Internal audit detects the misuse of resources in time which helps to reduce unnecessary expenses.

Disadvantages:-

1. Internal audits report is not accepted by either the shareholders or tax authorities, it is the external auditor report which is required to be submitted to these parties.
2. Since internal audit is done by the employees of the company chances are that it may be biased and therefore company cannot depend on such reports.
3. Since an internal audit is not done by the professional auditor chances of internal auditor not detecting the errors are high.

4. Internal auditing can sometimes fail to check planned frauds.

5. Another disadvantage to audits is that they don't always show the true picture. An auditor's purpose fails when they don't see the real business affairs; the view of the audit is altered.

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4. What is Vouching and mention its objectives.

Ans. Vouching means a careful examination of all original evidences that is invoices, statements, receipts, correspondence, minutes, contracts etc. with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible that no entries have been omitted in the books of accounts.

The act of examining documentary evidence in order to ascertain the accuracy and authenticity of entries in the books of account is called Vouching.

Vouching is an act of comparing entries in the books of accounts with documentary in support thereof.

### **Objective of Vouching**

- To check whether all the business transactions are properly recorded in the books of accounts or not.
  - To see whether recorded transactions are duly supported by documentary evidence or not.
  - To verify that all the documentary evidence is authenticated and related to business transactions only.
  - To verify that transactions are free from errors or frauds.
  - To verify whether voucher is processed through all the stages of Internal Check system properly.
  - To verify and confirm that the entries are recorded according to the capital and the revenue nature or not.
  - To check the accuracy of accounting transactions.
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5. State the objectives of verification.

Ans. Verification is a process carried out to confirm the ownership, valuation and existence of items at the balance sheet date.

Verification refers to a process of confirming the truth or accuracy and to substantiate.

Definition: The Verification of assets implies an inquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets.

Objectives of Verification:

a.Existence: auditor has to ensure himself that the assets are in existence at the date of the balance sheet and they belong to the client.

b. Ownership: confirmation need to be obtained from the client showing that assets have been acquired for the business and are clearly stated in the balance sheet.

c. Valuation: to satisfy himself that the assets are properly valued for the purpose of the balance sheet.

d.Encumbrance: to verify that the assets which exist in financial statement are free from any change or encumbrances means it is not given as security for any debt/loans.

e. Possession: To satisfy himself that the assets are in the possession or control of the client or in the custody of the persons authorized by him.

f.Recording: The assets recorded has been properly valued and authorized before recording in the books of accounts. The authorization of recording need to be checked.

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6. What are the services the company auditor cannot perform directly or indirectly to the company?

Ans.As per section 144 of companies act 2013, a company auditor shall provide those services that are approved by the board of directors or the audit committee of the company. However, this section 144 also prohibits certain non-audit services which a company auditor cannot perform after being appointed as company auditor.

Here are the non-audit services which a company auditor cannot perform;

1. accounting and book keeping services
2. internal audit
3. design and implementation of any financial information system

4. actuarial services
  5. investment advisory services
  6. investment banking services
  7. rendering of outsourced financial services
  8. management services and
  9. any other kind of services as may be prescribed
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### SECTION C

Answer the following questions. Each question carries fourteen marks:-

7. What are the qualities and qualifications of a Company Auditor?

**Ans. Qualification of Company Auditor**:- As per section 226 of companies act, a person should not be qualified for appointment as an auditor of a public or private company unless he is a chartered accountant within the meaning of the Chartered Accountant Act, 1949.

According to section 226(2), a person holding a certificate under Restricted Auditors Certificate (Part – B states) Rules, 1956, is also qualified to act as an auditor of a company.

However, the Central Government may grant, renew, suspend or cancel and make other rules for such certificates by notification in the official Gazette.

#### Professional Qualities

1. Knowledge of accounting :- Audit, being primarily an examination of accounting statements and records, cannot exist independent of accounting. An auditor, therefore, must possess the thorough knowledge of accounting to carry out an audit effectively and efficiently. Thus, the auditor should know the conceptual framework of accounting, various systems of accounting, and its functions in the business.
2. Knowledge of theory and practice of auditing :- Auditor must be professional and master of various techniques of auditing. He should possess thorough knowledge of theory and practice of auditing.

3. Knowledge of relevant laws:- Auditor must be familiar with various relevant laws of the country governing a business and that laws may affect his profession, such as tax laws, business laws, corporate laws, economic laws, etc.
4. Knowledge of the organization and operational methods:- The auditor must have considerable knowledge about the organization and operational methods of various types of business concerns.
5. Knowledge of cost and management accounting :- Auditor should be fairly acquainted with the concepts of cost and management accounting such as direct and indirect costs, cost allocation, allocation of overheads, methods of costing, techniques of costing such as standard costing, marginal costing, fund flow and cash statements, budgetary control, ratio analysis etc.
6. Knowledge of production systems:- Auditor should possess adequate knowledge about the nature of production, production planning and processes and how cost accounting is related to them in the business under audit.
7. Knowledge of economics:- Auditor should possess knowledge with the principles of economics- effects of economic factors on business units and their interactions, relationship between demand and price, supply and price, elasticity, competition, etc.
8. Knowledge of mathematics and Statistics: - Auditor should have a sufficient knowledge of mathematical and statistical tools and methods of solving business problems by quantification techniques.
9. Knowledge of functional management: - Auditor should have sufficient knowledge of functional management such as financial management, marketing management, production management, cost management etc.
10. Knowledge of general management:-Auditor should possess fair knowledge of general management theory and practice – planning, decision-making process, authority-responsibility relationships, span of management, motivational techniques, leadership styles etc.

Personal Qualities:-

1. Intelligent and tactfial
2. Honest and integrity
3. Sincere
4. Vigilance
5. Confidentiality and loyalty

6. Judgment
  7. Responsibility
  8. Objectivity and transparency
  9. Independency
  10. Prudent and Practical.
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8. Explain:

a. Internal check as regards to wages:-

Internal check

A system of internal check is an arrangement of staff duties whereby no one person is allowed to carry through and to record every aspect of a transaction so that, without collusion between two or more persons, fraud is prevented and at the same time the possibilities of errors are reduced to a minimum.

Internal check means practically a continuous internal audit carried on by own staff itself, by means of which the work of each individual is independently checked by other members of the staff.”

Internal check means that checks imposed in such a way on day to day transactions that work of one person is checked by other person automatically. In this way the chances of fraud and errors minimizes. Because the mistake made by one person is checked by the other.

### **Internal check with regards to wages**

The system of internal check of wages should be devised in a careful and planned way, especially in manufacturing concerns. This is because particularly in large manufacturing concerns, employing large number of workers, Possibilities of frauds are always more. Thus efforts should be made to prevent such frauds with the help of some suitable arrangements of internal check which should be revised from time to time in the light of experience gained. Internal check should be actively enforced and supervised by some responsible official.

### Objectives of internal check with regards to wages

1. To avoid inclusion of dummy workers in the list workers.
2. To avoid incorrect time or piece work records.
3. To avoid fraudulent manipulation of wage sheets of misappropriation of money etc.,



The following system of internal check for wages is suggested:

1. Time records: workers are paid their wages normally on basis of the time. Thus the time spent by each worker should be correctly recorded in that time record-book and for this purpose the following methods are in practice.

a. Time recording clock: the time recording clock is placed at the gate under the in charge of the timekeeper. As soon as worker enters the gate, the time keeper inserts his timecard into the clock which records the time. It is again recorded when the worker leaves the factory.

b. Brass token: the workers are given brass token being the numbers. At the gate, the time board is maintained on which each workers hangs his token as soon as he enters the factory. He should be vigilant enough to see that no workers hang the token of others who are late or absent.

c. Attendance cards: each worker is provided with a timecard with his name, number, department and wages rate mentioned on it. Each one should punch his card at the time of his arrival and departure.

The punching of card must be supervised by the time keeper.

2. Piece work records: where the workers are paid on the basis of piece wages system, proper books for actual work done by workers should be maintained. Each worker should be provided with a jobcard, piece work return form bearing his name, job number, nature of work and the rate at which the wages will be paid. It should be finally checked by piecework reliever along with quantity of goods.

3. Over time records: ordinarily one time work should not be encouraged. No workers should be allowed to work overtime unless is authorized to do so by the authorized official of the organisation.

Strict check must be kept on loiterers at the place of the work. Over time slips should be sanctioned in advance. Such slips should bear the name and number of workers, overtime put in and the job or the department in which is engaged. At the weekend such slips should be sent to the timekeeper who will forward them to the wage office.

4. Pass out records: the workers should not be allowed to leave the factory before the scheduled time.

But if sometimes, a worker wants to go out of the factory on his personal work during working hours he should not be allowed to go out of the factory premises without obtaining permission from authorized official, who should issue pass-out slips. Such slips are handed over to gatekeeper. The wage office should also be given a copy of such slips. In case of workers leaves the factory before time on his own account, it should be properly accounted.

5. Preparation of wage sheets: the preparation of wage sheets should be done by a separate department. This work should be done five clerks to minimize the irregularities. Information regarding attendance can be had from the attendance register, job cards, piece work register, overtime slips. Pass-out slips etc. for time workers and piece rate workers, a separate page sheet should be used. In big factories loose wage sheets should be used so that the work may be distributed amongst various clerks easily.

All essential particulars should be entered in the wage slips which should have columns for: Name, Code number allotted to him and his address, total time worked, details of work, rate, total amount of wages, bonus, overtime if any, deductions, net amount payable.

The whole work is to be divided in various parts to be headed by separate clerks in the wage department:

- a. Two clerks should examine the time and piece wage records, overtime records and other statements received from the foreman.
- b. The third clerk is to prepare individual employee statement that his name of the worker. Codenumber allotted to him total time worked and rate of wages.
- c. The fourth clerk is to check the calculations and detect the permissible amount i.e. rent, PF, Income tax, installment of loans etc deductions under the payment of wages act, 1936, from the gross wages to arrive at the net amount to be paid to the workers.
- d. The fifth clerk is to check whole work thoroughly.
- e. Clerk should verify all this wage slips before these are signed by some responsible officer, such as director or work manager.

b. Internal check as regards purchases :-

The following points should be considered when purchasing activities are taken place.

- Requisition: the procedure for issuing purchase requisitions should be specified. The head of the department, who is in the need of goods, should fill in a requisition slip duly signed and then should send it to the purchase department the details about the quality, quantity, and the time by which the goods must be supplied to be clearly mentioned in the requisitions slip.
- Enquiry: purchases department makes an enquiry about the terms and conditions of purchase from different suppliers. For this purpose tenders are generally invited. But, who shall open and accept the tenders, should clearly specified. As a rule, the lowest tender should be accepted and accordingly the decision be taken.

- Purchase order: the purchase department places orders which should be recorded in the purchases order book. For copies of purchases order should be prepared. One copy will be sent to the vendor, second to the store department, third to the accounting department. Fourth one will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.
- Receipt of goods: on receipt of goods, the purchase department should properly inspect them, and after an enquiry in the goods inward (receipt) book, the same should be sent to the stores. Concerned department should be informed about the receipt of the goods.
- Making the payments: the purchase department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with a purchase order and incoming inspection report and should also verify the calculations. Only responsible officer should draw check for the payment of invoice. If some portion of the goods is returned to the supplier, a proper entry must be made in the purchase return book.

Check on irregularities, errors and frauds:

- a. Fictitious purchase: fictitious purchase may be recorded in the purchase book and the payments are withdrawn may be misappropriated.
- b. Double payment: some invoices may be recorded twice and double payment made may be misappropriated.
- c. Artificial inflation in profits: goods purchased may not be entered in that period so as to inflate profits.
- d. Artificial reduction in profit: goods not received in one period may be entered as purchases so as to show profits less than the actual.

10. Briefly explain vouching of payments or credit side of cash book.

Ans. The auditor vouches cash payments with an objective to ensure that all cash payments pertaining to business activities are genuine and properly authorized. The auditor in vouching cash payments or credit side of Cash Book should ensure that payments are made for the purpose of business, payment relates to the period under audit, payment is properly sanctioned

and recorded, payment has been made to the right person, and payment is properly supported by a voucher and same as entered in Cash Book.

### **Auditors Duty in Vouching Cash Payments**

The auditor should pay special attention to the following points while vouching cash payments.

1. The auditor should evaluate the effectiveness of Internal check and control system for cash payments.
2. He should ensure that all the vouchers are made in the name of the business concern and payments are made pertaining to business.
3. He should ensure that vouchers have been correctly posted to the appropriate accounts and properly distinguished between capital and revenue expenditure.
4. He should ensure that all cash payments are within the period under audit.
5. When cash payments are made in excess of Rs.10,000 the auditor should enquire the circumstances for making such a payment.
6. He should also compare the rough cash book with the cash book to identify the fictitious payments.

**Documents to be Vouched:** Receipts issued by creditors, Invoices, Statement of accounts of creditors, Bank statement.

### **Cash Paid To Creditors**

While vouching cash payment to creditors, the auditor should examine the system of Internal control in existence. He should check the entries in the cash book with the receipts issued by creditors or counterfoils of cheque book and bank statement. He should compare the ledger balances of creditors with statement of accounts sent by them. Further, the auditor should ensure that all payments made to creditors are properly authorized by a responsible official. When payment was made as full and final settlement, auditor should verify whether the company has been availed any discount and is accounted as discount received.

**Documents to be Vouched:** Receipts issued by creditors, Invoices, Statement of accounts of creditors, Bank statement.

## **Wages**

Vouching of payment of wages is an important duty of an auditor as there are many chances of misappropriation of cash. The following are some of the duties of an auditor in vouching wage payments.

1.The auditor should verify the effectiveness of the system of Internal check in operation with regard to the preparation of wage sheet, maintenance of records and payment of wages.

2.He should verify the arithmetical accuracy in calculation of wages.

3.He should verify the attendance register of the employees and vouch it with the wage sheet to ensure that the wages has been correctly calculated only for the days worked by the employee.

4.Auditor should carefully scrutinize the wage sheet to identify that no dummy workers or ex-employees are included in the wage sheet.

5. Auditor should vouch the entries in the cash book with the wage sheet. He should also vouch the entries in the cash book with the bank statement to ensure that correct amount is withdrawn for payment of wages.

6.The auditor should compare the signature or thumb impression of the workers with previous months to check the genuineness of the person receiving the payment.

7.He should ensure that unclaimed or unpaid wages has been deposited in the bank. He should vouch the unpaid amount in the wage sheet with the entry in the bank statement. Payment for unpaid wages should be made only against authorization signed by a responsible official.

8. Auditor should verify that there is a proper system of wage payment to casual labourers.

**Documents to be Vouched:** Attendance register, Time or piece records, Leave register, Overtime register, Wage sheet, Bank statement, Register of casual labourers.

### **Capital Expenditure**

Capital expenditure is the amount spent on acquisition of fixed assets which include purchase of (1) Land and Buildings, (2) Plant and Machinery, (3) Motor Vehicles, (4) Investments and (5) Patents and copyrights. The procedures in vouching various items of capital expenditure are as follows:

#### **Purchase of Land and Buildings**

Auditor should examine the title deeds and sale agreements of the property purchased.

When assets are purchased on leasehold basis, lease agreement should be verified with regard to lease rent, period, terms etc. In case of purchase of freehold asset, auditor should examine the correspondence directly from the seller. He should ensure that all expenses incurred in connection with purchase of a asset like auctioneers commission, brokerage, architects fees, registration fees and legal charges, are capitalized. He should also vouch all such payments with reference to receipts. When asset is purchased through broker, the auditor should verify the brokers note. When asset is purchased in auction, the account submitted by the auctioneer should be examined. Similarly, auditor should ensure that all expenses incurred in connection with construction of a building like materials purchased, wages paid, cartage has been capitalized. In case of construction of a building, auditor should examine the construction contracts and architects certificate.

Documents to be Vouched: (1) Title Deeds, Sale Agreements, (2) Lease Agreement, (3) Correspondences with Seller, (4) Auctioneers Statement, (5) Architects Certificate, (6) Contractors Agreement, (7) Receipts.

#### **Vouching of Purchase of Land and Buildings**

Auditor should vouch the transaction in the following manner:

1. Verify entry in Cash Book with respect to date of purchase, cost, and nature of asset purchased.
2. Verify entry in Land and Buildings Account with regard to date and amount of purchase.

### **Purchase of Plant and Machinery / Furniture And Fixtures**

When plant and machinery are purchased, auditor should vouch the invoices and receipts received from the vendors. He should ensure that all incidental charges connected with the asset are capitalized and added with the cost of asset. He should also carefully scrutinize that expenses in connection with repairs and maintenance are not capitalized. When the asset is purchased on Hire purchase, he should verify the Hire purchase agreement and related vouchers. When the asset is purchased on Auction, Auctioneers statement of account should be verified. In case of purchase of imported machinery, any import duty and clearing charges should be debited to asset account.

#### **Documents to be Vouched:**

(1) Invoice from Vendors, (2) Receipts, Auctioneers Statement of Account, Hire Purchase Agreement.

### **Purchase of Motor Vehicles**

Contract of purchase, invoice, broker's note, payee's acknowledgement, asset receiving report and the registration book showing the ownership in the name of the client should be examined.

#### **Documents to be Vouched:**

(1) Invoice, (2) Contract of purchase, Registration book, (4) Brokers note and (5) Payees acknowledgement.

### **Purchase of Investments**

Auditor should vouch payments made for purchase of Investments with the Brokers Bought Note. He should verify that investments purchased are properly authorized and registered in the name of the company. He should physically examine the actual investment held by the company. In case of new issue of securities, auditor should examine letters of allotment, bank receipt for installments paid, share certificates etc. If investments are purchased cum-dividend, auditor should verify that the expenditure has been properly apportioned between capital and revenue. In case of inscribed stock, certificate from the bank in whose books the stock is inscribed should be obtained.

**Documents to be Vouched:**

(1) Brokers Bought Note, (2) Schedule of Investments, (3) Share certificate, (4) Letters of Allotment and Bank Receipt, Bank Certificate for Inscribed Stock.

**Purchase of Patents and Copyrights**

Patent is an exclusive right or privilege to make or produce something and copyright is a right to produce an item of a particular design. In case of purchase of patents and copyrights, auditor should obtain the patents and copyrights list from the client and examine it with reference to registration number, date, name of the seller, consideration paid etc. He should verify the registration certificates, certificates for grant of patent, documents of assignment, copyright agreements and receipt for renewal fees. When patent is purchased through broker, brokers commission should be accounted as capital expenditure and should be included in the cost of patent. Similarly, when patents are received through research, research expenses should also be capitalised. On the other hand, he should ensure that renewal fees paid should be not be capitalized but instead should be treated as revenue expenditure. He should also ensure that lapsed patents have been written off from the books of accounts.

**Documents to be Vouched:**

(1) List of Patents and Copyrights, (2) Patent and Copyright Agreement, (3) Registration Certificates, (4) Document of Assignment, (5) Receipts.



## **Bills Payable**

The auditor should vouch the entries in the Bills Payable Book and the Bank Pass Book if payment is made by bank. He should ensure that bills when honoured on the date of maturity and returned by the payee after receiving the payment should be properly cancelled after payment.

### **Documents to be Vouched:**

Bills payable book, (2) Pass book and (3) Receipts.

## **Bills Receivable Discounted and Dishonoured**

Sometimes the bills receivable discounted with the bank is dishonoured by the drawee. In such a case, the amount of bill has to be paid to the bank. If the account is maintained with the same bank, bank may debit the account of customer instead of receiving payment. Auditor should obtain a schedule of bills discounted dishonoured and examine the same. He should verify dishonor of bills discounted from bank's advice. The bank also returns the bill. The payment side of the cash book can be checked for the dishonor of such bill with bank's advice and amount of bill plus any charges incurred thereon. The auditor should verify entries for dishonour passed in the parties account. He should confirm whether bank charges, noting charges etc. have been debited to concerned customers account.

### **Documents to be Vouched:**

(1) Bank advice, (2) Dishonoured bill, and (3) Pass book.

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10. Explain the procedure adopted for verification of liabilities.

Ans. Verification of liabilities is equally important as that of verification of assets. The Balance Sheet will reveal the true and fair view of the state of affairs of the business concerns only when the liabilities as well as assets are properly valued and verified.

Verification of liabilities aims at ascertaining whether all the liabilities of the business are properly disclosed, valued, classified, and shown in the Balance Sheet. The auditor should see that they are correctly stated in the Balance Sheet. He should obtain a certificate from the responsible official as to the correctness of liabilities.

This was held in the case of Westminster Road Construction and Engineering Co. Ltd.

In short, the auditor should have to examine and see that,

- i. all the liabilities have been clearly stated in the liability side of the Balance Sheet.
- ii. they are all relate to the business itself.
- iii. they are all correct and authorized by the responsible official.
- iv. they are shown in the Balance Sheet at their actual figures.

#### 1. Verification and Valuation of Trade Creditors

1. The correctness of liabilities depends upon the correctness of purchases. Hence, the auditor should compare the percentage of gross profits to purchase with that of the previous years to verify the correctness of purchases.

2. The auditor should obtain a Schedule of creditors and verify them with the balances of ledger accounts and statements of account received from creditors.

3. He should check the Purchases Book and Purchases Returns Book with the help of invoices, credit notes, etc. He should also check the postings into the Ledger.

4. He should examine the Goods Inward Book to ensure that the goods purchased have been actually received.

5. He should see that all the purchases made during the year have been accounted for especially at the end of the year.

6. He should examine the discount allowed to creditors during the period and see that these substantiate the credit balances.

7. In case of hire purchases, the auditor should see that the conditions of Hire Purchase Agreement are properly complied with.

8. He should examine the entries made at the beginning as well as at the end of year to check the employees have passed any fictitious entries in this regard.

9. If any debt is found unpaid for a long time, an enquiry should be made since it is possible that instead of paying to the creditor, the amount might have been misappropriated.

## 2. Verification and Valuation of Bills Payable

In case of bills payable, the auditor should follow the following verification procedure:

1. The auditor should obtain a Schedule of bills payable and its totals should be compared with the Bills Payable Book and Bills Payable Account.

2. The bills paid after the Balance Sheet date should be examined with the entries passed in the Cashbook.

3. The auditor should obtain confirmatory statements from the drawers directly with the permission of his client.

4. He should pay special attention to the bills that have been paid between the date of the Balance Sheet and the date of his audit have been duly written in the books.

## 3. Verification and Valuation of Loans

1. The auditor should verify the existence of loans, if any. In case of a company he should examine the correspondence, contracts, and Directors' Minute Book.

2. The auditor should ascertain the terms of loan, amount of loan, period and nature of loan, etc. by referring to the loan agreement.

3. He should confirm the balances of the unpaid loans directly from the creditors of the company with the permission of his client.

4. In case of loans or overdrafts taken from a bank, an agreement with the bank and a certificate to that effect should be obtained and examined.

5. The auditor should see whether the interest due has been paid or not. If the interest is due but not paid till the date of the Balance Sheet, he should see whether the same has been clearly shown as liability therein.

6. In case of a Joint Stock Company, the auditor should examine the borrowing powers of the company. He should also examine the Register of Charges, and should see that a charge created has been registered with the Registrar.

7. It should be seen that the interest on loans has been paid up to date. If not he should see whether the amount due is recorded as unpaid in the books of accounts.

#### 4. Verification and Valuation of Outstanding Liabilities for Expenses

1. In case of outstanding liabilities, the auditor should obtain a certificate from a responsible officer of the company stating that all expenses become payable have been brought into account.

2. He should see whether necessary provision for all the outstanding expenses have been made by checking receipts and other vouchers.

3. He should compare the expenses shown as unpaid during the current year with those of the last year and if he finds any difference, the same should be enquired into.

#### 5. Verification and Valuation of Capital

Capital is not the liability of an entity but still the auditor is required to verify it in order to report the genuineness and correctness of the Balance Sheet. In case of a firm, the auditor should verify capital with the help of Partnership Deed, Cashbook and the Passbook. He should see that it has been properly recorded in the books of account. In the case of a company, verification of capital can be discussed under the two heads:

##### 1. First Audit

In case of first audit, the auditor should examine the Memorandum of Association to see what is the maximum capital, which the company is authorized to raise. He should also check the Articles of Association.

The Cashbook, Passbook, and Minute book of the Board of directors should be examined by the auditor in order to find the amount of shares and different classes issued, the amount collected on each shares, and the balance due from the shareholders in respect of calls, etc.

The shares allotted to vendors, should be examined with the contract between the vendors and the company.

## 2. Subsequent Audit

Normally, in case of subsequent years, the share capital would be the same as in the previous year unless the company has made any alteration or addition by fresh issue or otherwise. If he come across any change, he should see that the relevant provisions of Secs. 94, 95 and 100 to 105 of the Companies Act have been duly complied with.

## 6. Verification and Valuation of Reserves and Fund

Reserves and funds are appropriations out of profits. The directors of a company determine the amount of reserves and funds to be created taking into account the circumstances of the business. The reserve and funds are to be shown on the liability side of the Balance Sheet with footnotes.

## 7. Verification and Valuation of Debentures

1. In case of debentures, the auditor should verify the Memorandum of Association and the Articles of Association of the company and ascertain the power of the company to issue debentures. He should find out what is the borrowing limit and ensure that the company has not exceeded the same.

2. He should verify the Debenture Trust Deed to verify the amount of debentures issued and securities offered. If necessary, he can obtain a certificate from the debenture holders to verify the amount of debentures issued.

3. He should enquire as to what arrangement has been made for the redemption of debentures. In case debenture redemption fund has been created, he should verify the Articles of Association.

4. If the debentures are issued at premium or at discount, the auditor should see that the debenture premium and discount on issue of debenture are properly dealt with in the books of account.

5. He should verify Register of Charges and Register of Debenture Holders to see that the debentures shown in the Balance Sheet agree with the debentures recorded in the books of account.

## 8. Verification and Valuation of Income Received in Advance

Sometimes the firm receives some amount in advance, which is to be actually received in the next year. It is treated as a liability and should be shown in the liability side of the Balance Sheet. The auditor should verify whether the items of incomes received in advance are recorded in books. The auditor should obtain a Certified Schedule of income received in advance and verify the same. He should ensure that income received in advance is fully shown in the liability side of the Balance Sheet.

## 9. Verification and Valuation of Employees Deposits

In commercial and industrial establishments, it is usual to require the employees, who deal with cash or stores to give security deposit. It acts as a safeguard against some possible misappropriation or pilferage on the part of such employees. Sometimes, the employees instead of paying cash as security deposit endorse trustee securities in favor of the employers. In such cases, the auditor should see whether such a security in cash or in securities deposited separately in the bank. He should see whether they are shown distinctly in the liabilities side of the Balance Sheet. He should verify the amount of deposits by reference to the Certified Schedule received from the client.

## 10. Verification and Valuation of Taxation Liability

Now-a-days, taxation has become an important liability and so the companies are required to make full provision in the accounts in this regard. The auditor should see whether the provision made therefore is sufficient to meet the estimated liability. Usually, auditors are required to advise on the adequacy of the liability and in such a case, they work as tax consultant.

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11. What are the duties of Company Auditors?

**Ans.**

1. Provide an Audit Report

The fundamental duty of a company's auditor is to make a report regarding accounts and financial statements examined by him and present the same to the members of the company.

Such an opinion of the auditor enhances the credibility of the financial statements. This is because it provides reasonable assurance from the auditor that the financial statements give a true and fair view of the company's state of affairs.

Furthermore, such an auditor's opinion assures that the report has been prepared taking into account the accounting and auditing standards.

2. Make Proper Enquiry

It is the duty of every auditor to seek access to books of accounts, vouchers and other information and explanation from the company. Furthermore, an auditor can also inquire information regarding the following matters from the company at any time:

- whether the loans and advances made by the company on the basis of security have been properly secured. Furthermore, he needs to inquire whether the terms and conditions on the basis of which such loans and advances have been made are not unfair.
- if the transactions of the company represented only by book entries have actually taken place and are not unjust to the company in any way
- whether loans and advances made by the company are shown as deposits if the personal expenses (expenses not associated with the company) are charged to the revenue amount
- whether cash has been received for the shares that were issued for cash. However, if no cash has actually been received, the auditor shall verify that the company's position as stated in the books of accounts is correct, regular and not misleading.

3. Assist in Branch Audit

The accounts of a branch office can be audited by:

- a company's auditor
- any individual appointed as the branch auditor as per the act

- company's auditor or accountant or any competent person appointed as per the laws of the foreign country in case of a foreign branch

Thus, a branch auditor needs to prepare a report with regards to the accounts of the branch examined by him. He needs to ensure that proper books are maintained and hence give reasons of qualification in the report.

After preparing the report, the branch auditor needs to submit this to the company's auditor. Furthermore, the company's auditor shall examine such a report in a manner as he deems fit.

#### 4. Compliance with Auditing Standards

The central government establishes the auditing standards in consultation with the ICAI and National Financial Reporting Authority (NFRA).

These standards help the auditors to examine the books of accounts effectively and with great accuracy. Thus, every auditor must comply with the established auditing standards while examining a company's books of accounts.

#### 5. Reporting of Frauds

A company's auditor while performing his duties might encounter fraudulent situations. In such circumstances, the auditor may believe that an offence equivalent to a fraud has been committed against the company.

And such a fraud has been committed by any of the officers or the company's employees. Thus, in such situations, it is the duty of the auditor to report such matters to the central government within 60 days of his knowledge.

#### 6. Provide Assistance in Investigation

Investigation refers to checking of specific records of a business systematically and critically.

Such an examination is conducted when a fault on the part of the company already exists and the intent of the investigation is to find out a reason and person involved in such an activity.

Thus, it is the duty of an auditor to assist the officers undertaking such an investigation.



### 7. Adhere Principles of Auditing

One of the basic principles that govern an audit is confidentiality. Thus, the auditor should maintain confidentiality of information acquired while performing his duties as an auditor.

He should not disclose the client information without his prior permission. Furthermore, the auditor must be honest, sincere, impartial and free from biasness. Thus, he should exercise a high degree of integrity and objectivity while examining the company's books of accounts.

### 8. Provide Negative Opinion

The auditor needs to give his opinion in the auditor's report. Such an opinion can be qualified or unqualified.

An unqualified opinion is the one that concludes that the company's financial statements present its affairs fairly in almost all the important aspects.

Furthermore, it states that the company complies with the necessary statutory requirements and Generally Accepted Accounting Principles (GAAP).

A qualified opinion, on the other hand, concludes that the company has dealt with most of the issues except for the few ones. Under this, it is the duty of the auditor to give even an adverse opinion regarding the company's financial statements.

Such an opinion must be given when the auditor disagrees with the management regarding application, acceptability or adequacy of accounting policies.

