AUDITING AND CORPORATE GOVERNANCE

UNIT-2
INTRODUCTION

INTRODUCTION

An audit is an independent examination of financial information of any entity, whether profit oriented or not, irrespective of its size or legal form. When such an examination is conducted with a view to express an opinion thereon" It also attempts to ensure that the books of accounts are properly maintained by the concern as required by law. Auditing has become such a ubiquitous phenomenon in the corporate and the public sector that academics have started identifying an "Audit Society". Auditors perceive and recognize the propositions before them for examination, obtain evidence, evaluate the same and formulate an opinion on the basis of their judgement which is communicated through their auditing report.

Any subject matter may be audited. Audit is a safeguard measure since ancient times Audits provides third-party assurance to various stakeholders that the subject matter is free from material misstatement. The term is most frequently applied to audits of the financial information relating to a legal person. Other commonly audited areas include: secretarial and compliance, internal controls, quality management, project management, water management, and energy conservation.

MEANING

The term audit is derived from a Latin word **"audire"** which means to hear authenticity of accounts is assured with the help of the independent review.

Audit is performed to ascertain the validity and reliability of information. Examination of books and accounts with supporting vouchers and documents to detect and prevent error, fraud is the primary function of auditing.

Auditor has to check the effectiveness of internal control systems for determining the extent of checking out the audit.

Initially its meaning and use were confined merely to cash audit, and the auditor has to ascertain whether the persons are responsible for the maintenance of accounts had adequately accounted for all the cash receipts and the payment on behalf of this principle.

DEFINITION

"Auditing is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the Auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis, formulates his judgment which is communicated through his audit report."

- The Institute of Chartered Accountant of India

"Auditing is an intelligent and critical scrutiny of books of accounts of a business with the documents and vouchers from which they have been written up, for the purpose of ascertaining whether the working results of a particular period as shown by Profit and Loss Account and also the financial position as reflected in the Balance-sheet are truly and fairly determined and presented by those responsible for their compilation."

- J. R. Batliboi

The International Federation of Accountants has given the following definition of an audit, "audit is an independent inspection of the financial information of any organization, whether profit-oriented or not profit-oriented, irrespective of its legal form, status or size when such examination is conducted with a view to express an opinion thereof".

According to the American Accounting Association (AAA); "Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users".

"Auditing is a systematic examination of the books of records of business or other organization in order to ascertain or to verify and to report upon the facts regarding its financial operations and the result thereof." –**Prof. Montgomery**

OBJECTIVES OF AUDITING

The main objectives of auditing are discussed as follow;-

A) PRIMARY OBJECTIVES

The Primary objectives of auditing are as below;-

1. FAIRNESS OF STATEMENTS: The purpose of auditing is to determine the fairness of statements. The financial statements can show true and fair view after auditing. Due to limitations of financial statements it is not possible to provide cent percent accuracy, so an attempt is made to show the fair view of financial statements.

2. PRESCRIBED LAWS: The purpose of the audit is to check that prescribed laws have been followed in the preparation of financial statements. There are various laws that govern the working of many businesses. The auditor can indicate whether the prescribed laws were followed in the preparation of final accounts.

3. ACCOUNTING POLICIES: The purpose of auditing is to examine the accounting policies. There is need to follow the accounting policies for preparing accounting records. The effective accounting system can provide better results. The auditor can express an opinion on the accounting policies in the best interest of business.

4. INDEPENDENT OPINION: The purpose of the audit is to express an independent opinion. The auditor must be honest in his work. Management and other persons must not influence him there must be high ethical standard for independent reporting.

B) SECONDARY OBJECTIVES

The Secondary objectives of auditing are as below;-

1. DETECTION OF ERRORS: The purpose of auditing is to detect the errors. The auditor can use ways and means to find out errors in the accounting records. It is the duty of management to avoid errors. The independent audit work is helpful for discovery and correction of errors.

2. DETECTION OF FRAUDS: The purpose of auditing is to detect frauds. The management is responsible for the detection of frauds. The various types of fraud may be detected by an audit. The management can take steps to correct the wrong effects of frauds for the benefit of owners.

3. PREVENTION OF ERRORS: The purpose of auditing to errors. The errors can be prevented through effective internal check- The mistake can occur due to heavy load work or carelessness on the part of employees. There should be no extra burden of work on each employee. The senior person should check the work of a junior person.

4. PREVENTION OF FRAUDS: The purpose of auditing is to prevent frauds. In accounting, it includes manipulation or alteration of records and misappropriation of assets, an omission of the effects of the transaction from records or documents, recording of the transaction without substance and misapplication of accounting policies. The effective internal check is a useful tool to prevent frauds.

C SPECIAL OBJECTIVES

The Special objectives of auditing are as below;-

1. MANAGEMENT AUDIT: The purpose of management audit is to assess the performing, review the organizational structure and suggest the best course of action. It is a voluntary audit and an audit

2. TAX AUDIT: The purpose of auditing is to satisfy the taxation officers. The can be conducted to determine the income. The sole proprietors and partnership firms can settle their tax matters through tax audit

3. SOCIAL AUDIT: The purpose of the social audit is to measure social performance of the business. The society is concerned with the Protection of natural environment the social audit can examine the business performance of the society.

4. PROPRIETY AUDIT. The purpose of propriety audit is to examine the proper use of money. There is a requirement of economic use of resources in the best interest of business. There must be a justification for spending every rupee for the benefit of business. The audit can determine the wise use of money.

5. COST AUDIT: The purpose of cost audit is to verify the correctness of cost accounts. The management must have followed the cost objectives in maintaining books and other records. The cost audit can help the management to improve the efficiency in doing business.

6. OPERATIONS; The purpose of operations audit is to prevent misuse of resources It is a part of social audit The management must use prudence in spending money. There is need of intelligent use of resources for optimum output with lowest possible cost.

7. BID OFFER: The purpose of the audit is to determine the real value of the business forbid offer. The value of net tangible assets becomes the basis of Sales. The bidders can offer bid price on the basis of such price. The audited accounts serve as a guideline to arrive at a certain decision.

8. PURCHASE CONSIDERATION: The purpose of the audit is to determine the purchase price of a business. The audited accounts determine value of assets and liabilities. The buyers and sellers come to know the real value of a business. They can make a deal to amalgamate or merge business.

9. LOAN: The purpose of the audit may be a loan. The management can approach banks and other lenders. The bankers rely on audited accounts for the supply of money. The audited accounts are legal requirements of the loan facility.

10. ADMISSION: The purpose of the audit may be an admission of a partner. The audited accounts can provide information to new as well as old partners. They can decide terms and conditions for admission. The value of assets and liabilities is agreed upon.

11. PROFITS: The purpose of audit may be checking variations in profits. The fluctuation in profits can be analyzed by an expert auditor. The file of business depends on reasonable profits.

PRINCIPLES OF AUDITING:-

Fundamental principles are those according to which the books of business accounts are audited. These principles can be changed according the desire of the auditor.

We discuss the main principles of auditing under these headings:

1. Planning:-

It is the basic principle of auditing. The auditor should plan before starting the work. In planning auditor decides accounting about the system and internal control procedure.

2. Honesty:-

Honesty and sincerity is the second important principle of auditing. The loyalty of auditor to work and profession must be beyond the doubts.

3. Impartiality:-
In case of audit the attitude of the auditor must be impartial. Keeping in view this principle his personal views may not be included in the audit report.

4. Secrecy:-
Secrecy must be maintained by the auditor during the process of audit. He cannot disclose any information to the third party.

5. Evidence:-
During the audit the auditor can collect the evidence through the working papers. He can frame his opinion on the audit evidence. The nature and source of evidence must be kept in view by the auditor.

6. Consistency:-
It is an important principle of auditing. In case of selecting the rates of depreciation and valuation of stock the accountant must follow the rates of the coming years. In this regard there should be consistency and changes are not acceptable.

7. Legal Frame Work:-
The business activities may run within the rules and legal formalities. To protect the rights of the interested parties' rules must be applied.

8. Working Paper Preparation:-
The auditor collects documents providing evidence that audit was carried out according the principles. The auditor prepares the working paper and kept in this custody as a proof.

9. Internal Control:-
The auditor will examine the accounting system and inter control. To frame his opinion, he keeps in view the evidence obtained from the books.

10. Report:-
According the principle of auditing a report will be prepared by the auditor at the end. It may be conditional or unconditional. The auditor can draw conclusion and disclose the facts and figures about the business for general information.

TECHNIQUES OF AUDITING or AUDIT TECHNIQUES:-

Techniques of auditing mean the procedure and method which is adopted by the auditor in checking the accounts.

Following are the important techniques of audit:

1. Examination of Record:-
This technique is commonly used by the auditors; the inspection of books and documents is made to verity the validity of data.

2. Inquiry:-
The auditor can also use the technique of inquiry. He can get the information from resource persons inside or outside the enterprise.

3. Sampling:-
Auditor can select few items from whole accounting information. This technique enables the auditor to obtain and evaluate the evidence of some characteristics of the whole class. It is helpful in forming the conclusion.

4. Confirmation:-
To ensure the accuracy of the data auditor can collect the information from the debtor. Confirmation is response to an inquiry to prove certain data recorded in the books.

5. Compliance:-
To check the arithmetical accuracy of accounting record, the balancing accounts can be compared with the vouchers to test the reliability of data.

6. Compliance Test:-
These tests are designed to check the effectiveness and compliance of internal control. In obtaining the audit evidence, auditor is concerned with the existence of effective internal control.

7. Use of Computer Techniques:-
There is large number of audit techniques like audit software, test packs and mapping which can be used by the auditor to test the accuracy of the data.

8. Substantive Test:-
There are designed to obtain evidence that data produced by accounting system is accurate or not. It has two kinds :
a) Test of detail transaction.
b) Test of significant ratios and trends.

9. Dependence on Experts and Auditors:-
The auditor has to rely on the internal and other auditors to complete his work.

He has also to rely on other experts like lawyers, engineers and doctors for their expert opinion about the business.

10. Analytical Review:-
It consists of studying significant ratios, trends and investigating different changes. This review procedure is based on the expectations of relationship among the past and present data.

CLASSIFICATION OF AUDITING:

On the basis of organizational or organizational structure:

1. Statutory Audit

2. Government Audit

3. Private Audit

1. Statutory Audit:

A statutory audit is an audit, which is made mandatory by law. The purpose is to check the truthfulness and fairness of accounting records. The appointment of Auditors, his removal, rights and duties, remuneration, are set according to the Provisions of the law, as applicable to the organization. In the case of companies, the auditor is appointed by the shareholders at the annual General meeting (AGM) and the remuneration is also fixed by them. Companies Registered under The Companies Act, 1956 need to get their accounts audited by a qualified chartered accountant, only after the preparation of the financial Statements. The statutory auditor presents his report, in which he expresses his Opinion on the true and fair view of the final accounts. In addition to this, he ensures the compliance of the financial statements as per the provisions of the act.

2. Government Audit:

Government audit is applicable to Government departments and departmental Undertakings. Government of India maintains a separate department known as Accounts and Audit Department. Comptroller and Auditor General of India head this department. In India the President appoints the Comptroller and Auditor General of India under Article 149 of the Constitution, which gives the powers and rights and fixes his Responsibility for the audit of Government departments and institutions. Government audit is divided into several branches like Defence, Railways, and Posts and Telegraphs audit. It works only for government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

3. Private Audit:

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

On the basis of Degree of Independence of auditor:

1. Internal Audit

2. External audit

External Audit

External audit, also known as financial audit and statutory audit, involves the examination of the truth and fairness of the financial statements of an entity by an external auditor who is independent of the organization in accordance with a reporting framework such as the IFRS. Company law in most jurisdictions requires external audit on annual basis for companies above a certain size. The need for an external audit primarily stems from the separation of ownership and control in large companies in which shareholders nominate directors to run the affairs of the company on their behalf. As the directors report on the financial performance and position of the company, shareholders need assurance over the accuracy of the financial statements before placing any reliance on them.

External audit provides reasonable assurance to the owners of the company that the financial statements, as reported by the directors, are free from material misstatements. External auditors are required to comply with professional auditing standards such as the International Standards on Auditing and ethical guidelines such as those issued by IFAC in order to maintain a level of quality and trust of all stakeholders in the auditing exercise.

Internal audit

Internal audit, also referred as operational audit, is a voluntary appraisal activity undertaken by an organization to provide assurance over the effectiveness of internal controls, risk management and governance to facilitate the achievement of organizational objectives. Internal audit is performed by employees of the organization who report to the audit committee of the board of directors as opposed to external audit which is carried out by professionals independent of the organization and who report to the shareholders via audit report. Unlike external audit, whose scope is primarily restricted to matters that concern the financial statements, the scope of work of an internal audit is very broad and can encompass any matters which can affect the achievement of organizational

OBJECTIVES.

Internal audit is typically centered around certain key activities which

Include:

 monitoring the effectiveness of internal controls and proposing

Improvements

 Investigating instances of fraud and theft

 Monitoring compliance with laws and regulations

 Reviewing and verifying where necessary the financial and operating

Information

 Evaluating risk management policies and procedures of the company

 Examining the effectiveness, efficiency and economy of operations and

Processes

On the basis of method or approach to audit work:

1. Continuous audit

When the accounts are audited throughout the year by the audit staff under the guidance of the auditor, it is called continuous audit. The work involved in Continuous audit is considerably high and the management requires the auditor to report at regular intervals. If the numbers of financial transactions are very large and/or if the internal control system is found to be weak in certain areas, continuous audit is desired. Banks conduct continuous audit which is otherwise known as concurrent audit in big branches.

2. Annual audit:

A final or completed audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed. The final audit takes place only after the end of the trading period when all the transactions for the whole year are completely recorded and balanced; trading and Profit & Loss Account, and Balance Sheet have been prepared. The auditor carries on his audit work continuously till it is completed.

3. Balance sheet audit:

A balance sheet audit is an evaluation of the accuracy of\information found in a company& balance sheet. It involves a number of checks as auditors conduct this evaluation based on supporting documents. After a balance sheet audit, you can use the analyses to detect irregularities or weaknesses in your company accounting system.

4. Interim audit:

Interim audit means the examination of financial records during the course of a fiscal year, generally to reduce the amount of work required for the end-of-year Audit. An audit is which conducted in between the two annual audits with a view to find out interim (short – term) profits to enable the company to declare an interim dividend is known as Interim Audit. It is a kind of audit which is conducted between the two periodical or balance sheet audits. It may be quarterly or half yearly

5. Occasional audit:

Occasional Audit; is done when there is a requirement, like there is a new addition of partner or the company wants a bank loan when audit becomes necessary to submit it to the authorities. There is no time frame for the occasional audit.

6. Complete audit:

Thorough examination and verification of a company financial and accounting records, and internal controls that are deemed to be comprehensive or relatively comprehensive depending on the size of the company being audited.
Complete audits are more reliable for the portions audited because complete audits will include the audit of subsidiary documents and records as well as supporting documents. Other audits may not be as comprehensive as a complete audit, and while not completely unreliable, they may still leave room for misstatements.

7. Partial audit:

An audit which is conducted considering the particular area of accounting is known as partial audit. Under partial audit, audit of whole account is not conducted. Audit of particular area where the owner thinks essential to conduct audit will be conducted. Generally, transaction of business is related to cash, debtor, creditor, stock etc. A business may conduct an audit of any of these transactions. An auditor should conduct audit of that transaction as per the scope determined by the agreement. Method of conducting such audit is similar to other audit but an auditor should sign the report clearing stating the partial audit if it is not done so, an auditor will be liable for the loss which is caused due to using the report as complete audit.

AUDIT PLANNING

The whole auditing process can generally be divided into three different phases. The audit planning phase includes procedures such as gaining an understanding of the client and its business, making risk and materiality assessments, determining an audit strategy, and determining the type of evidence to collect, based on the risk levels.

Performing the audit refers to the process of collecting evidence. Finally, the reporting phase deals with making conclusions, reporting any necessary adjustments to management, and issuing the independent auditor's report.

Audit planning is important because auditors should plan the audit so as to reduce audit risk to an acceptably low level that is consistent with the objective of the process. The auditor should plan the nature, timing, the extent of direction and supervision of the engagement team members, and review of the work.

The four main reasons for audit planning include:

- To identify areas of risk of material misstatements
- To design audit procedures to address those risks and to obtain sufficient appropriate evidence
- To help keep audit costs reasonable
- To avoid misunderstandings with the client

BENEFITS OF AUDIT PLANNING

- It helps the auditor obtain sufficient appropriate evidence for the circumstances
- It helps to keep audit costs at a reasonable level.
- It helps to avoid misunderstandings with the client.
- It helps to ensure that potential problems are promptly identified
- It helps to know the scope of audit program by an Auditor.

- it helps to carry out the audit work smoothly and in a well defined manner

STEPS IN PLANNING

The **steps in planning** an audit include *(*Planning Procedures):

1. **Basic discussions with the client** about the nature of the engagement and the client's business and industry are performed first, and the auditor meets the key employees, or new employees of a continuing client. The overall audit strategy or the timing of the audit may be discussed, but don't discuss specific audit procedures.

2. **Review of audit documentation** from previous audits performed by the accounting firm or a predecessor auditor (if the latter makes these audit documentation available) will assist in developing an outline of the audit program.
3. **Ask about recent developments** in the company such as mergers and new product lines which will cause the audit to differ from earlier years.
4. **Interim financial statements** are analyzed to identify accounts and transactions that differ from expectations (based on factors such as budgets or prior periods). The performance of such **analytical procedures** is **mandatory** in the planning of an audit to identify accounts that may be misstated and that deserve special emphasis in the audit program.
5. **Non-audit personnel** of the accounting firm who have provided services (such as tax preparation) to the client should be identified and consulted to learn more about the client.
6. **Staffing** for the audit should be determined and a meeting held to discuss the engagement.
7. **Timing** of the various audit procedures should be determined. For example, internal control testing needs to be performed early in the engagement, inventory counts need to be performed at or near the balance sheet date and the client representation letter cannot be obtained until the end of the audit fieldwork.
8. **Outside assistance** needs should be determined, including the use of a **specialist** as required (a tax practitioner or an information technology (IT) professional) and the determination of the extent of involvement of the internal auditors of the client.
9. **Pronouncements** on accounting principles and audit guides should be read or reviewed to assist in the development of complete audit programs fitting the unique needs of client's business and industry.

10. **Scheduling with the client** is needed to coordinate activities. For example, client-prepared schedules need to be ready when the auditor is expected to examine them, and the client needs to be informed of dates when they will be prohibited from accessing bank safe deposit boxes to ensure the integrity of counts of securities held at banks

INTERNAL CONTROL

DEFINITION:

Internal Control can be defined as a system designed, introduced and maintained by the company's management and top-level executives, to provide a substantial degree of assurance in achieving business objective, while complying with the policies and laws, safeguarding the assets, maintaining efficiency and effectiveness in regular operations and reliability of financial statements.

OBJECTIVES OF INTERNAL CONTROL SYSTEM

1. To ensure that the business transactions take place as per the general **and** specific authorisation of the management.
2. To make sure that there is a sequential and systematic recording of every transaction, with the accurate amount in their respective account and in the accounting period in which they take place. It confirms that the financial statement fulfils the relevant statutory requirements.
3. To provide security to the company's assets from unauthorised use**.** For this purpose, physical security systems are used to provide protection such as security guards, anti-theft devices, surveillance cameras, etc.
4. To compare the assets in the record with that of the existing ones at regular intervals and report to the charged with governance (TCWG), in case any difference is found.
5. To evaluate the system of accounting for complete authorisation of the transactions.
6. To review the working of the organization and the loopholes in the operations and take necessary steps for its correction.
7. To ensure there is the optimum utilization of the firm's resources, i.e. men, material, machine and money.

8. To find out whether the financial statements are in alignment with the accounting concepts and principles**.**

An ideal internal control system of an organization is one that ensures best possible utilization of the resources, and that too for the intended use and helps to mitigate the risk involved in it concerning the wastage of organization's funds and other resources.

TYPES OF INTERNAL CONTROL SYSTEM

1. Organization: Organization is concerned with placement of workers on their jobs. Authority and responsibility go together. The workers are responsible for their activities. The head of department is responsible for looking after the worker of his own department.

2. Segregation of Duties: The segregation of duties is necessary. There are many employees. All aspects of a transaction are not complete by one person. The recording of transaction by many persons can reduce the risk of errors and frauds. The division of duties can improve the working of workers.

3. Physical: The physical internal control is desirable to safeguard assets. The access to assets must be limited. The authorized persons can be allowed to examine the assets. The persons may visit the warehouse or they may release the assets through requisition slips. The assets require lockers, iron safe possession of keys and use of passes of warehouse.

4. Approval: All transaction in any business requires proper approval of responsible person. The limit for approval may be fixed. The creditor recovery officer can approve credit sales. The foreman can approve overtime wages. Purchase officer can approve the purchase of goods.

5. Accounting: The accounting control is concerned with approval of transactions, accurately processing and correctly recording. The control of total, preparation of trail balance reconciliation's and control accounts is necessary. There is examination of vouchers that every aspect is not over looked so far this type of control is concerned.

6. Management: The top-level management can apply certain controls beyond the routine working of business. The management control, include internal audit review of management accounts comparing actual result with budgets, supervisory control and many other review procedure of business functions

PRINCIPLES OF INTERNAL CONTROL

1. Simple Record and Books: The principal of the internal control is also the simple records such as the record of employees, plant register list of shareholders etc are kept in usual simple manner books should be kept up to date and at regular internals these should be balanced. He different persons should make handling of cash transactions. For instance the cashier should not be allowed to record the cash in the accounts book. He should have no concern with written ledgers.

2. Independent Checking: Another person should independently and automatically check work performed by one person.

3. Principle Relating to Staff: It is also the part of the internal control. The employees are placed on the business according to their ability. The employees are bound for the duties for which they are assigned. Duties of each staff member should be clear and there should be no confusion and doubt in this regard. In case of any staff member absence duties arrangements should be made in advance.

4. Changing: It is also an important principle that no one should handle the transaction from beginning to end, because in this situation there is a chance of fraud. Generally most of the frauds are committed due to this reason.

5. Proper Supervision: It is also a principal of the internal control. All the senior officers have a right to supervise the activities of their juniors. It is necessary for the benefit of the business.

6. Clear Rules: All those rules relating to cash stock receipts and issuance of goods should be very clear and well defined. It should be also checked that the employees should follow their rules properly.

7. Instructions in Writing: All the instructions should be in written form according to the best internal control system.

8. Qualified and Competent Staff: For the better internal control system the qualified staff is necessary. And it should also necessary that the stuff is placed at a proper place.

9. Double System of Accounting: For the internal control the double accounting system is very helpful. No doubt, it is an expensive system but it helps lot for the internal control.

10. Incentive for Honest Worker: Honest and hardworking person must be encouraged. He should be given some reward in the shape of promotion and cash. This principle is also very effective in improving the internal control.

11. Use of Machines: It is also the principal of the internal control how to use the machines. He has to check either the proper machines have been installed or if it does so the work can be completed in time.

12. Performance of Duties Record: For the best internal control it is necessary that the performance of all the employees must be recorded.

13. Record of Goods and Assets: All the companies' assets and property record should be maintained properly. There should be also the security measures for the property.

14. Surety Bonds: To protect the company from fraud and to make the internal control more effective surety bonds can be taken from the employees.

15. Division of Duties: Division of duties is a part of internal control. The employees can be placed on jobs according to their abilities. The duties are assigned to which they are accountable.

16. Rotation of Duties: Rotation of duties is a principle of internal control. An employee must be from one seat another. It is necessary for increasing the efficiency and avoiding the chances of errors and fraud.

17. Division of Work: Division of work is a principle of internal control. The total amount of work is determined. It is divided among the department's branches and sections. It has become possible due to specialization and division of labour.

18. Subsidiary Record: Subsidiary record is a principle of internal control. The detail every account is maintained. Stock of goods may consist of many items. As a whole it is called stock account or stock control account and every group of items can be stated in subsidiary record.

19. Confirmation from Outsiders: The confirmation from outsiders from outsiders is a principle of internal control. The letters may be written to debtors to confirm their accounts balances. There may be positive or negative approach in collecting information from sundry debtors.

20. Dependent Work: Dependent work is a principle of internal control. One person cannot be allowed to do every aspects of a transaction. The work depends upon many persons. Every person is dependent upon others to perform his duties.

21. Supervision: Supervision is a principle of internal control. The officer, foreman or supervision has the right to look after activities of junior workers. The supervisory control is essential to make the business effective.

22. Control Accounts: Control accounts are proposed to check the accuracy of the accounting books and other record. The total debtors accounts and total creditors accounts or sales ledger adjustments and purchase ledger adjustments accounts are prepared.

LIMITATIONS OF INTERNAL CONTROL

1. Cost: The management thinks that cost of a control procedures must not be in excess of potential loss due to error or frauds.

2. Transactions: The internal control tends to be directed a anticipated types of transactions and not at unusual transactions.

3. Error: There is possibility of human error due to carelessness distraction, mistake of judgement or the misunderstanding of instructions.

4. Circumstances: There may be collusion with parties outside the entity employees of the entity. Due to such collusion there is possibility of circumvention of control.

5. Responsibility: There is chance that a person responsible for exercising control could abuse that responsibility, for example, a member of management overriding a control.

6. Conditions: There is possibility that procedure may become inadequate due to changes in conditional and compliance with procedure may deteriorate.

INTERNAL CHECK:

MEANING

Internal Check is a valuable part of internal control. It is an arrangement of duties of the staff is such a manner that the work performed by one individual is automatically checked by another person is a run time course.

DEFINITION OF INTERNAL CHECK

Ronald A. Irish says that It refers to the organization of office duties in such a way as to prevent or disclose both errors and frauds.
L.R. Dickness says that It is an arrangement of book that error and frauds are likely to be prevented by the operation of the bookkeeping itself.
De Paula says that It means practically a continues internal audit carried on by the staff itself by means of which the work of each individual is independently checked by other members of the staff.

OBJECTIVES OF INTERNAL CHECK

1. Fraud prevention: The purpose of the internal check is to frauds. The management can achieve this objective through the distribution of duties. One employee is allowed to perform one part of the others complete*the other parts. In this way, many hands complete the work

2. Assets protection: The purpose of the internal check is to protect the assets. The management can take steps to safeguard the resources One person maintains the record and the custody are given to another officer. Top-level management makes the purchase and disposal. The assets are used for business purpose the periodical inspection of resources is necessary to avoid misuse of the resource.

3. Error prevention: The purpose of the internal check is to prevent errors. The management can devise such a system of internal that mistakes are prevented altogether. If there is negligence on the pan of one employee, it is pointed out by another employee who can check the person of the first person.

4. Fixing responsibility: The purpose of the internal check is to fix the responsibility of employees. The division of duties helps the management to locate the inefficient employees.' The pending work provides chances of errors and frauds. The management can replace employees who are negligent in their duties,

5. Moral check: The purpose of the internal check is to develop high moral values. The work of one employee is supervised and checked by another employee. Alt employees feel the sense of responsibility, They complete their work on daily basis. Thus the efficiency of workers increases.

6. Recording facts: The purpose of the internal check is to record facts and figures in the books of accounts. The work of recording facts is divided among many employees, In this way, it is possible to prepare books of accounts, which can reflect the true and fair view of business work.

7. Accounting system: The purpose of the internal check is to devise proper accounting system, It consists of personnel, procedure, records, form and used by an organization in developing and communicating accounting information.

PRINCIPLES OF INTERNAL CHECK

1. Sufficient staff: The principle of internal check is sufficient staff, the employees can be appointed according to workload, the management can determine the amount of 'work, which distributed among the departments. The persons are hired to perform their duties the overloading can create trouble for management.

2. Division of work: Division of work is a principle of internal check. The management can determine the total amount of work. The whole work is divided among departments. The heads of such departments are responsible for completion of work according to a timetable.

3. Co-ordination: Co-ordination is a principle of internal check. All departmental managers are bound to coordinate with each other in order to achieve the objectives of the organization. When there is a fault in one department, the work other departments suffers and the objectives cannot be achieved. It determines the degree of coordination among the managers.

4. Rotation of duties: Rotation of duties is a principle of internal check/ the workers bored by doing the same work from year to year. There is a need for rotation of duties. It is in the interest of the concern as well as the employee. The efficiency improves due to change in duties.

5. Recreation leave: The recreation leave is a principle of internal check. The employee can enjoy the recreation leave, It is necessary for the mental health of the employee, He cannot commit frauds as the new employee in his place can disclose the matter. The internal check system can work in the interest of the business; the weaknesses of one person are disclosed due to leave.

6. Automatic machines: The principle of internal check is that machines must be used to do accounting work if permissible. The machines can do a lot of work without delay, the chances of frauds and errors are reduced to a minimum. The working of machines improves the efficiency of the accounting staff,

7. Checking: The principle of an internal check to check the work of other employees. Many' persons perform the work. The officer can put his Signature to verify the work done by his subordinate. In this way one Work passes many hands, the chances of errors and frauds are minimized due to checking and counter-checking.

8. Simple: The principle of internal check is simple working: The employee can understand the working of the internal check system. A person can work under the supervision of other employees. The line of authority moves from top to bottom level. Alt workers can understand their duties in the organization.

9. Documents classification: The classification of documents the principle of internal check. The business documents are prepared, collected recorded and placed in proper files. The index is prepared to compile data. The filing system as useful to place letters. In case of need, the documents can be traced quickly.

10. Dependent work: Dependent work is a principle of internal check. The work of one employee is dependent upon the others. One work passes through the hand of two or three persons till it is completed. The senior person checks the work of junior person, No person is, all In all, to start and complete the transaction,

11. Harmony: The principle of internal check is harmony among the employees and departments, the understanding is essential for business goals. The management is to achieve other social and national objectives. The harmony is the basis for the successful internal check.

DISADVANTAGES OF INTERNAL CHECK

1. Expensive: The system of internal check is more expensive and time consuming.

2. Not Applicable for Small Organization: This system is not applicable for small organization where there are only few employees. Only large organization having number of departments and complexity of jobs can get benefit of this system.

3. Monotonous for the Workers: As same work is done by the employees day after-day the job becomes boring and the employees lose their creativity.

4. Risky for the Auditor: When the auditor lies on the system of internal check and does not conduct tests he will be charged for negligence. complexity of jobs can get benefit of this system.

5. Disorder in Work: If the system is not fully organized and if there is any failure in the system, it creates disorder and confusion hence, chances of errors and frauds increases.

6. Chances of Collusion: Though internal check system protects errors and frauds but in reality there may be chances of collusion between two or more employee to indulge in frauds or malpractices.

INTERNAL AUDIT

As per the name, an internal audit occurs within an organization. So an independent auditor or team of auditors, who are actually employees of the organization, will review the financing, accounting and operating activities of the organization. It is actually a part of the internal control system of the company.

OBJECTIVES

1. Proper Control

One of the main objectives of an internal audit is to keep stringent control over all the activities of an organization. The management needs assurance of the authenticity of the financial records and the efficiency of the operations of the firm. An internal audit helps establish both.

2. Perfect Accounting System

An internal audit keeps a very close check on the accounting system of an organization. It checks everything from the vouchers, to the authority of transactions to mathematical accuracy. All entries are verified against documents and other proof. Chances of mistakes or frauds are greatly reduced.

3. Review of Business

The purpose of an internal audit is to keep a check on the financial and operational aspects of a business. So as the current financial year is ongoing, internal audit can point out the mistakes, weak points, and strengths of the business. This will allow an ongoing review, instead of waiting till the year-end.

4. Asset Protection

In the process of internal audit, there is always a valuation and verification of an asset. There is also a physical verification of the ownership and possession of the asset.

And in case of special transactions like sale, purchase or revaluation of the asset, the authorization of this is also audited in an internal audit. So the assets enjoy complete protection.

5. Keeps a Check on Errors

In a financial audit, the auditor will be able to determine if any mistakes were made in the financial records. But this only happens at the end of the financial year.

And the mistakes are corrected thereafter. But in case of an internal audit, the mistakes are spotted as soon as they are made, and corrected immediately.

6. Detection of Fraud

In case the company has an internal audit in place, the detection of fraud becomes much easier. This is because there is a year-round check on the employees.

In fact, an employee is less likely to attempt fraud in the presence of an internal auditor. He will not have any time gap between the occurrence of fraud and its detection to cover it up. This will dissuade employees from committing fraud

Benefits of Internal Audit

The following are the benefits of conducting an internal audit in an organisation.

- **Proper Accounting Systems:** Internal audits introduce an appropriate system of accounting. An accounting system comprises of a chain of activities in a company by which transactions are processed in order to maintain financial records. To achieve desirable results, a need for orderly devices is required, and that can be achieved through internal auditing.
- **Better Management:** Internal audit ensures that there is better management of the business in the organisation. An auditor would be able to point out the areas of weakness in the management. The objectives of the business can be achieved if there is a proper internal control, internal check and internal audit. It should be noted that the management has the option to rely on internal audit for the best results completely.
- **Progressive Review:** The progress of the business can be reviewed with the help of an internal audit. The figures from the previous years are compared to those of the present year. The performance result of various other similar companies can be considered and compared to in order to determine the progress of the entity. An internal audit helps the management to review the growth of the entity.
- **Effective Control:** An internal audit is essential in order to retain effective control over business activities. Control comes under the functions of management and is related to the supervision and direction of ongoing operations. The concerned manager can make the necessary changes according to the internal audit and remove the difficulties for the smooth working of a business.
- **Assets Protection:** The protection of assets is possible through an internal audit. The management has the option to only use the assets for the benefit of the business and not for private purposes. Internal auditing keeps an eye on embezzlement of cash, misappropriate use of stock and misuse of other assets from ever occurring.
- **Division of Work:** An internal audit can be conducted to apply the division of labour. This is necessary in order to watch the activities of every employee, including the members of the management. The auditor may choose to suggest a way and means on how to improve the performance of the business.

- **No Error and Fraud:** Internal audits can be conducted to protect the accounting records from errors and fraud. Accounting and auditing in a company go hand in hand as the latter begins when the former is done. In such situations, the mistakes and deceptions committed by accounting personnel would be detected and rectified easily.
- **Fixing Responsibility:** Internal audits would be able to set the responsibilities of employees having poor performances. The management would establish performance standards, and the internal auditor can evaluate the result of all the employees. This way, the concerned individuals can be held responsible for their work that does not meet the standards of the company, and appropriate changes could be taken.
- **Helps External Auditing:** The work performed by an internal auditor would be a great help to an external auditor in conducting the audit. The audit procedure of the internal and external audit is very similar. However, an external auditor would be responsible for an external audit even if they choose to go through the internal audit report.
- **Improved of Performances:** An internal auditor would be helpful in improving the performance of the organisation. The company's achievements in the previous year would be the basis of the budget preparations for the present year by drawing up income statements and balance sheets. Therefore, an internal audit improves the performance of a business and its employees.
- **Proper Use of Resources:** The check on the appropriate use of resources is maintained through an internal audit. The misuse of resources would undoubtedly lead to an increase in costs for the organisation. The optimum use of resources in a company could be determined with the control of the cost of output. Internal audits can be considered as a tool to use the resources of a company in the best interests of the business.
- **Investigation:** Internal audits help to investigate various matters of the business. In situations that bring doubts, the internal auditor can be given the responsibility to examine the facts and figures to confirm. Such investigations can be conducted at the request of the management of the company.

Limitations of Internal Audit

The following are the limitations of an internal audit.

- **Staff Shortage:** One of the few limitations of an internal audit is the shortage of staff. Reasonable audit staffs are required to examine the **records** and conduct a proper internal audit. The lack in the team would restrict the organisation from reaping the benefits of the internal audit.

- **Time Lag:** As internal audits begin when accounting end, there is a significant time lag between the recording and the checking of the entries.
- **Error:** The limitation of an internal audit is that there may be undetected errors that remain in the books of accounts as it depends upon the expertise of the internal audit staff. If an audit staff is experienced and competent, the chances for an error to go undetected would be very less. In the case of poor audit staff, there would be no guarantee if the audited accounts are free from errors.
- **Responsibility:** The limitation of an internal audit is that management does not feel that it is their responsibility to complete the formalities of the audit. The audit staff could offer suggestions for the proper functioning of a business. However, the top-level management would not necessarily pay attention to the suggestions offered, which would be of no help or a loss to the company.
- **Duties:** The whole purpose of an internal audit may fail if the duties of the audit staff are not adequately divided and implemented by using a method that would ensure the optimum utilisation of organisational resources.

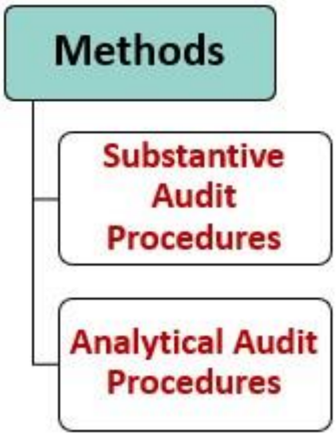
AUDIT PROCEDURES

Audit Procedures are steps performed by auditors to get all the information regarding the quality of the financials provided by the company, which enable them to form an opinion on financial statement whether they reflect the true and fair view of organisation financial position. They are identified and applied at the planning stage of the audit after determining audit objective, scope, approach, and risk involved.

AUDIT PROCEDURE METHODS

During the process of the preliminary assessment, an auditor is required to identify and ascertain the amount of risk involved and accordingly develop an audit plan. The audit plans should define these steps which will be applied by the auditor to obtain audit evidence.

They can be divided into two types:



1 – Substantive Audit Procedures

Substantive procedures are processes, steps, tests performed by auditors which creates conclusive evidence regarding accuracy, completeness, existence, disclosure, rights, or valuation of assets/ liability, books of accounts or on financial statements. For any procedure to be concluded, the auditor should collect enough audit evidence so that another competent auditor when applies the same procedure on the same documents, makes the same conclusion. It can be regarded as complete checking. Auditor usually uses this procedure when he is of opinion audit area includes a high frequency of risk.

2 – Analytical Audit Procedures

Analytical procedures can be defined as tests/ study/ evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. In simple language, certain checks/tests conducted by auditor based on study/ knowledge/ previous year figures to check and form an opinion on financial statements. Depending on the audit area, the analytical audit procedure may differ. For example, the auditor may compare two sets of financial statement of same entity pertaining to two different financial years or sometimes may compare two different entity's financial data for obtaining audit evidence.

TYPES OF AUDIT PROCEDURES

- **Inspection –** Inspection is the most commonly used method. Under this auditor checks every transaction/ document as against written steps, procedures so as to ensure accuracy.
- **Observation –** Under this technique of audit, the auditor usually tries to inspect others doing/ performing a particular process. For e.g. an auditor may observe steps followed in processing GRN against goods purchased.

- **Confirmation –** This type is applied to ensure the correctness of financial statement either from internal sources within auditee organisation or from external sources.
- **Recalculation –** Under this audit method, the auditor usually crosses checks information presented by the client. This is generally used in case of checking mathematical accuracy.
- **Reperformance –** Using this procedure, the auditor re-perform entire process is performed by the client so as to find out gaps, audit findings, etc.

ADVANTAGES

Some advantages are as follows:

- It helps an auditor to obtain conclusive and substantial audit evidence for forming an opinion on financial statements.
- Well defined procedures define the quantum of time and energy which needs to be deployed for finding audit evidence.
- Pre-established procedures help an auditor to follow a defined set of steps which needs to be followed for finding audit evidence.
- They also help and auditor to well plan in advance areas which need to be focussed and deciding the type of audit procedure which needs to be applied.

Limitations

Despite several audit procedures applied by an auditor, he/she cannot conclude whether financial statements prepared presents a true and correct view. An auditor expresses an opinion which is always subjected to inherent limitations of audit which are described as follows:

- **Human Error:** Despite checking at thorough level, there are chances of being expressed an inadequate opinion due to human errors and omissions. Since there is always a person present behind any machine.
- **Absence of Clear Instructions in Accounting:** Auditing standards do prescribe series of steps to be followed while conducting an audit but there are situations which are still undefined. Treatment needs presumptions in these cases.
- **Existence of Management Fraud:** There may be chances of fraud committed at high-level management or by collusion of the group of

employees. Since auditor forms an opinion based on data shared by the audited, the audited may not be in a position to detect such fraud.

- **Judgements:** In preparing financial statement there are situations where management needs to make a judgement which may differ from one to another. With this change in judgements, an auditor may not depict the exact position of that business.

VOUCHING

MEANING

Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc.The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called "Vouching". Vouching is a technical term which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction. Simply stated, vouching means a careful examination of all original evidence i.e. invoices, statements, receipts, correspondence, minutes and 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. Therefore, vouching is the act of testing the truth of entries appearing in the primary books of accounts. It is initial for auditing.

VOUCHING.

Vouching is the process of checking the evidence between the accounting systems; booking records (transactions) and the supporting documents (invoice, receipt. bills…) to detect or to find out errors or frauds, and to check the accuracy and reliability of records.

OBJECTIVES

Main objective of vouching is to find out the regularity or irregularity of transactions, frauds and errors. Regularity means maintaining record and performing the work compliance with the rules, regulation and law. But irregularity means doing the work crossing to the line of rules, regulation and laws. Some of the

Major objectives of vouching are given below:

1. To Detect Errors and Frauds all transactions are to be supported by evidence. Each document should be proved by authorized authority. With the help of vouching we can detect errors and frauds by verifying each transaction. Planned fraud can be detected through vouching.

2. To Know the Truth of Account Each and every transaction is checked and ratified on the basis of support document. So, we can easily know the truth of account.

3. To Find the Unrecorded Transactions Each and every transaction is checked and ratified on the basis of document. Vouching helps to find out the unrecorded or missing transactions. If any voucher is found unrecorded, auditor can suggest recording such transactions.

4. To Know That All the Transactions Are Authorized; If the transactions are made on the consent of concerned authority, such transactions are known as authorized transactions. If transactions are not authorized, such transactions can be fictitious transactions. So, such fictitious transactions ca be found with the help of vouching.

5. To Know That Only the Business Transactions Are Recorded Sometimes, transactions are performed for individual purpose but payment is made out of business. Such transactions should not be recorded in account of business. If such transactions are recorded, we can find it with the help of vouching. To know the real profit or loss of business, such transactions are to be separated.

IMPORTANCE

1. Vouching is the corner stone of auditing As we know the main objective of auditing is to detect errors and frauds to prove the true and fairness of financial statements (Balance Sheet, Income Statement, Change in Equity, Cash-Flow and Notes); so that's why vouching has a weight in the auditing.

2. Vouching is the core substance of auditing The role of auditing is not limited to check only the accuracy of accounts but it's to check whether the transactions are related to the business or not. We check also if the transaction is real or not because sometimes an accountant may include fictitious transactions for fraud purposes. So vouching helps the auditor to find all these facts.

3. The importance of vouching resides to see whether evidence are correct or no Frauds have multiple indicators. Fraud may be showed by duplication of transactions. So by doing vouching, we get evident documents and records to detect fraud or error. Finally, I can said that vouching considered as the heart of auditing without it we cannot perform an audit.

VERIFICATION

Verification means `proving the truth' or `confirmation'. One of the most important duties of an auditor in connection with the audit of the accounts of a concern is to verify the assets and liabilities appearing in the balance sheet. The fact that there is an entry regarding the purchase of an asset and has been be correctly recorded, is not a proof that the asset is in the possession of the concern at the date of the balance sheet. It is possible that after purchase and passing the entries, the asset might have been disposed of or pleadged and no entry has been made concerning this before the closing of these books. Therefore, he has to see whether a particular asset as recorded in the balance sheet on the day of the closing of the books of account exists or not. If he fails to verify the asset, he will be liable for any damage suffered by the client as it was decided in the case of London Oil Storage Co. Ltd. Vs. Sear Haslock and Co. (1904).

Thus we can say that verification is a process by which the auditor satisfies himself not only about the actual existence, possession, ownership and valuation but also ensures that the assets are free from any charge or lien. The verification of assets

Involves the following points:

1. Comparing the ledger accounts on the date of the balance sheet.

2. Verifying the existence of the assets on the date of the balance sheet.

3. Satisfying that they are free from any charge of mortgage.

4. Verifying their proper value.

5. Assets were acquired for the business.

Difference between Vouching and Verification

1. Vouching is based only on documentary evidence whereas verification is based on physical inspection as well as documentary examination.

2. Vouching examines the entries relating to the transaction recorded in the books of account whereas verification examines the assets and liabilities appearing in the balance sheet.

3. Vouching of books of account is done for the transactions for the whole year. Verification, on the other hand is done at the end of the year when the balance sheet has been prepared.

4. Vouching indicates though a particular asset must be in possession of the concern whereas verifies certifies the existence of the asset.

The auditor should as far as possible, inspect the assets personally on the date of the balance sheet like cash, bills receivable and investments etc.

Verification of assets is important as it will avoid the possibility of the improper inflation of values, or of the existence in the books of record of an asset which does not exist or which in fact never existed. This may be done in most of the cases to inflate the profits, and to show a better position of the business than what is actually is. An example of this is inflation of the value of stock. If the auditor is negligent is performing his duties in respect of verification, he may not be in a position to detect misappropriation of assets, inflation of profits and falsification of the balance sheet. In such case he may be held liable for damages.

VALUATION

Valuation of assets is an important part of their verification. The correct profits can not be calculated unless the assets are properly valued. Only then the balance sheet will reveal the true and fair position of the financial affairs of the business. The valuation as such is to ensure the correct valuation of the assets while in verification; the auditor has to verify the authority, and the existence of the property also besides its valuation. Thus valuation means to test the exact value of an asset on the basis of its utility. Normally, valuation is done after deducting the depreciation for the value of an asset. If proper depreciation on assets is not provided for, the profits will be overstated or understated which will have adverse effect on the company's solvency.

The auditor should consider the following points while valuing the assets:

1. Original cost of the assets.

2. Expected working life of the assets.

3. Wear and tear of the assets.

4. Break-up value of the assets.

5. The chances of the assets becoming obsolete.

Mode of valuation of different types of assets.

The mode of valuation of different types of assets differs depending upon the nature of the business and the purpose for which the assets are held. The basis of valuation for different types of assets is given as below:

1. Fixed assets: These assets are of a permanent nature with which the business is carried on and which are held for earning income and not for re-sale in the ordinary course of the business. For example, land and building, plant and machinery and furniture etc. These assets are to be valued at cost price less total depreciation in their value by constant use. Additions and sales should be taken into account.

2. Wasting Assets: These assets are of fixed nature and are depleted gradually lose a part of their value in the process of working such as mines, quarries and oil wells etc. The common method of valuation in such a case is that the value of such assets must be shown in the balance sheet at its original cost and provision is made for depreciation and depletion according to the estimated exhaustion of these assets.

3. Intangible assets: There are the assets which have income producing ability but can not be seen of touched. For example, goodwill, patents, copyrights, licences etc. They are generally valued in the same manner in which fixed assets are valued, that is at the cost price.

4. Current Assets: These are the assets which are acquired in the business held for purposes of consumption, resale or subsequent conversion into cash. For example, stock-in-trade, book-debts, cash and bills receivable etc. These assets should be valued at original or the market price whichever is lower.

VERIFICATION AND VALUATION OF ASSETS

1. Property: In order to verify this item, the auditor should distinguish between two

Types of property.

(a)Freehold Property: Where Freehold property has been purchased, he should examine the title deeds e.g., the purchase deed, the certificate of registration, the broker's note and the auctioneer's account etc., in order to verify the correct position. However, an auditor cannot guarantee that the title is good; all he can do is to see that the deeds are in client's possession and appear to be in order. In case of any doubt on any point, he should refer the matter to the client's solicitors.In case where property has been mortgaged, the auditor should obtain a certificate from the mortgagee regarding the possession of title deed and outstanding amount of loan. In case the property has been acquired in the current year the cost may be verified with the help of the bank pass book. He should also vouch all the payments made in this connection. He should see that the property account should be shown in the balance sheet at cost price including the legal and registration charges less depreciation up-to-date. He should also see that a separate account for building and land on which it is constructed is maintained. It is necessary because depreciation is provided for building and not for the land.

(b)Leasehold Property : The auditor should verify this by inspecting the lease contract to find out value and duration. He should see that the terms and conditions of lease are properly complied with. In case property has been mortgaged, the auditor should obtain a certificate from the mortgagee regarding the possession of title deed. Where the leasehold property has been sub-let, the counter part of the tenant's agreement should also be examined. Wherever possible, the auditor should physically inspect the properties. He should also note that proper provision has been made for depreciation of leases and for any possible claims arising there under.

2. Furniture, Fixtures and Fittings : In case the assets have been acquired during the current accounting period, the auditor should examine the invoice of the dealers. It should be noted that adequate depreciation has been written off, based upon the working life. In the case of fixture and fittings on lease hold premises, the whole cost should be written off over the period of the lease of their estimated working life, whichever is shorter. A stock register to record furniture etc., purchased should be maintained. The old and unserviceable furniture must be discarded by a responsible officer. He should ask the management to prepare an inventory and reconcile it with the stock register.

3. Plant and Machinery : In case the machines are purchased in the current accounting period, the invoices and the agreement with the vendors should be verified. The auditor should ` examine the plant register in which particulars about the cost, records about sales, provision for depreciation, etc., are available. He should prepare a list of each machine from the plant register and should get the list certified by the works manager as he is not a technical man and therefore he has to depend upon the advice of the works manager regarding their valuation, etc. He should see that plant and machinery account is shown in the balance sheet at cost less depreciation after making proper adjustment regarding purchases and sale of some parts effected during the year under audit. In case any plant and machinery has been scrapped, destroyed or sold, he should ascertain that the profit or loss arising thereon has been correctly determined.

4. Goodwill: Goodwill should be shown as an asset in the balance sheet only if it has been purchased. In such a case goodwill should be shown at cost. But if the price paid for goodwill has not been fixed specifically in the contract of sale, the amount of goodwill will be the difference between the total purchase price and the other assets at agreed valuations, less any liabilities taken over from the vendors.Here it should be noted that the real value of the goodwill of any business can be said to fluctuate almost daily and it is not part of an auditor's duty to consider whether this value is greater or smaller that its book value at a balance sheet date. The auditor should see that the goodwill account represent the actual cost only, that is, improper items should not have been includedtherein.Sometimes a question is raised about the depreciation of goodwill. Legally, it is not binding on a company or a firm to write off goodwill, but, however, it is advisable from the financial point of view to write it off gradually within a reasonable period out of current profits or reserves. But it is for the proprietors or directors to decide. An auditor cannot interfere with this decision, though he may give advice, if asked for. However the auditor should very carefully look to the reasonableness of appreciation in its value, if any.

5. Patents: The auditor should first of all examine the patents and verify them with the help of the certificates which have granted for such patent rights. Where the patent has been purchased, the assignment as well as the patent should be inspected. If the number of patents is considerable, the auditor should call for a schedule thereof from the client giving particulars of each patent the register number, dates etc. and examine the same. Here it is important to note that the actual patent should be examined and it must be duly registered. He should also examine the last renewal fee receipt to satisfy himself that the patents have been renewed at the prescribed time. He should note that the cost of renewal fee should be debited to profit and loss account.

6. Trade Marks : The auditor should see that they are registered in the name of the client and this can be done by examining the certificate issued by the Registrar. In case a trade mark has been purchased he should also vouch the payment. Where it is registered by the proprietor of the business himself he should examine the registration documents and the certificates issued by the office of the registrar of trade marks and the last renewal payment fee receipt. He should also see that any expense incurred in the acquisition of thetrade mark has been treated as capital expenditure but any renewal charges has been treated as revenue expenditure.

7. Copyrights: This is a right to produce or re-produce some kind of literary works. Its effect is that the author or the publisher gets an exclusive right to publish or reproduce the work for a certain number of years of for the life time of the author or the publisher as the case may be the auditor should inspect the agreement between the author and the publishers. It is after seen that the value of the copyright is not stable because they lose their value by passage of time. Hence, in this case, the revaluation method of charging depreciation is considered to be most appropriate. The auditor may rely on the certificates of experts responsible for revaluation. If the sale of the publication is very low or nil, the copyright should be written off. Generally, copyright must be shown at cost less amounts written of from time to time.

8. Loose Tolls: The auditor should obtain a list of loose tools duly authorised by some responsible officer and examine the same. Revaluation of loose tools is the most appropriate method of valuation. The difference between the cost price and the current price should be treated as depreciation or loss to be charged to the profit and loss account.

9. Motor Vehicles: Motor Vehicles account is to be separately maintained. The auditor should compare it with the balance sheet in which it should be clearly stated under separate head. He should also see that they are shown in the balance sheet at cost less depreciation. If the number of vehicles is very large, a separate register maintained should be checked and compared with a schedule of motor vehicles by the auditor. He should check the registration books and licencesto ascertain that vehicles are registered in the name of client. He should check the premium receipts to ensure that they are fully insured.

10. Investments: Investments include government securities, shares, debentures, etc. When the number of investments is very large, the auditor should ask for a schedule of investments held by the client containing various particulars like name of the securities, date of purchase, nominal value, cost price, marketprice, etc., and examine the same. He should see that the asset has been shown separately in the balance sheet.

VERIFICATION OF LIABILITIES

Verification of liabilities is equally as important as the verification of assets. If liabilities are not properly verified and valued, the balance sheet willnot reveal true and fair view of the state of affairs of a business concern. Therefore, the auditor

Should examine that:

(a) All the liabilities have been clearly stated on the liability side of the balance sheet;

(b) All these liabilities relate to the business itself;

(c) They are all correct and authorised, and

(d) They are shown in the balance sheet at their actual figures.

The auditor should also obtain a certificate from some responsible official of the

Business to the effect that all the liabilities for purchases or for expenses have been recorded in the books of account and all the contingent liabilities have been disclosed by way of footnote in the balance sheet.

The verification and valuation of various liabilities are given as below:

1. Capital : In case of a partnership firm the auditor should examine the partnership agreement. He must find out the original capital contributed by each partner and the rate of interest payable on capital. He must see that capital accounts are correctly maintained and verify all transactions affecting the capital accounts. He should examine the cash book, pass book, withdrawals of the partners and profits and loss earned. In case of a company while verifying the share capital, the auditor should examine the Memorandum of Association, Articles of Association, Cash Book, Pass Book, and the Minute Books of the Board of directors to find out the number and the different classes of shares issued and the amount received on each type of share. In case of a newly floated company he should undertake an exhaustive checking. If shares have been issued to the vendors or to the promoters for consideration other than cash he should examine the contracts between the vendors or promoters and the company. He should also check the entries regarding the forfeiture of shares, reissue if any, calls in arrears. -

2. Loans: Loans may be of two types:

A. Unsecured Loans and Advances: In such a case the auditor should examine the correspondence and relevant documents, if any. He should study the conditions for interest payable, repayment of loan, refund by instalments, etc. He should also ensure that the loans are taken for use in the business. He should also get confirmation from the lenders concerned certifying the balance of principal and interest outstanding at the date of the balance sheet.

B.Secured Loans and Advances: In order to verify such loans, the auditor should Note (a) Actual amount which has been advanced, and(b) Security for the loan. So far as the actual amount is concerned, the auditor should examine that this amount has been properly authorised and sanctioned by directors in case of a company and by partners in case of a partnership firm. He should examine the applications received and check the receipts which have been given in token of having received the loans. He should also verify that the payment in form of instalment and interest thereon has been received from the borrower himself.

3. Trade Creditors: The auditor should take a statement of balances of trade creditors duly signed by a responsible officer and should verify these balances with the bought ledger or the purchase ledger. He may get confirmatory statements from the creditors. He should also examine the invoices as sent by the suppliers and an `inward Goods Book' if it is maintained. He should carry out test checking of all the purchases made during the year particularly those made at the end of the year. He should also compare the percentage of the gross profit with that of the previous year. If there is material deviation, he should enquire into the reasons. For any purchases returns, he should examine the `Returns Outward Book' and verity them with the help of the credit notes as sent by the supplier.

4. Outstanding Liabilities for Expenses: The auditor should obtain a certificate from a responsible officer of the company stating that all outstanding liabilities for goods purchased or for expenses incurred, have been taken into account. He should verify those items of expenses which usually constitute outstanding liabilities like rent, rate, wages, salary, audit fee, legal expenses etc. He should ascertain the accuracy of the accounting records and test the calculations of such liabilities.

5. Bills Payable: The auditor should obtain a statement of bills payable and compare it with the bills payable book and bills payable account. For bills which have been met after the date of the balance sheet but before the time of audit, he should examine the cash book and bank pass book. He should ensure that the bills which have been paid are not recorded as outstanding. He should also obtain confirmations in respect of amounts due on the bills accepted by the client that are held by them.

6. Contingent Liabilities: Contingent liabilities are those liabilities which may or may not arise in the future for payment, for example, the liability for calls on partly paid shares, liability on bills discounted and the liabilities in respect of arrears of dividend of cumulative preference shares, etc.Contingent liabilities are divided into two broad categories. One is for those liabilities in respect of which

provision has to be made in the balance sheet, for instance, liability which may arise in connection with a suit, etc. Another is for liabilities for which no provision has been made in the books but merely a note has been made at the foot of the balance sheet, for example, bills receivable which have been discounted but not matured at the date of the balance sheet, arrears of fixed accumulated dividends, etc.The auditor should examine the director's minute book, correspondence made with the legal advisers and the information obtained from the officials of the business. He has to ensure that proper provision has been made for all such liabilities and if he is not satisfied, he should mention the fact in his report.

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