

Unit-5

Auditing

Meaning and Definition of Auditing

The word Audit is derived from Latin word “Audire” which means ‘to hear’. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

“Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate.”-**L.R.Dicksee**

“Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports.” - **R.K. Mautz**

“Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement.” -**R.E.Schlosser**

Objectives of Auditing

The objectives of auditing are changing with the advancement of business techniques. Earlier it was only to check the correctness of receipts and payments. The objectives of the auditing have been classified under two heads:

- 1) Main objective
- 2) Subsidiary objectives

Main Objective: The main objective of the auditing is to find reliability of financial position and profit and loss statements. The objective is to ensure that the accounts reveal a true and fair view of the business and its transactions. The objective is to verify and establish that at a given date balance sheet presents true and fair view of financial position of the business and the profit and loss account gives the true and fair view of profit or loss for the accounting period. It is to be established that accounting statements satisfy certain degree of reliability. Thus the main objective of auditing is to form an independent judgement and opinion about the reliability of accounts and truth and fairness of financial state of affairs and working results.

Subsidiary objectives: The subsidiary objectives of the auditing are:

1. Detection and prevention of fraud: the one of the important subsidiary objective of auditing is the detection and prevention of fraud. Fraud refers to intentional misrepresentation of financial information. Fraud may involve:

- a. Manipulation, falsification or alteration of records or documents
- b. Misappropriation of assets.
- c. Suppression of effect of transactions from records or documents.
- d. Recording of transactions without substance.
- e. Misapplication of accounting policies

2. Detection and prevention of errors: is another important objective of auditing. Auditing ensures that there is no mis-statement in the financial statements. Errors can be detected through checking and vouching thoroughly books of accounts, ledger accounts, vouchers and other relevant information.

Importance of Auditing

Importance of auditing can be judged from the fact that even those organizations which are not covered by companies Act get their financial statements audited. It has become a necessity for every commercial and even non- commercial organization. The importance of auditing can be summed in following points:

- a. Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.
- b. Dispute over correctness of profits can be avoided.
- c. Shareholders, who do not know about day-to-day administration of the company , can judge the performance of management from audited accounts.
- d. It helps management in detecting and preventing errors and frauds.
- e. Management gets advice on financial affairs from the auditors.
- f. Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.
- g. Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.
- h. Audited accounts are useful for the government while granting subsidies etc.
- i. It can be used by insurance companies to settle the claims arising on account of loss by fire.
- j. Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.
- k. It safe guards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

Types of audit

Statutory Audit is often called financial Audit. Independent financial audit is generally conducted to ascertain whether the Balance Sheet and Profit & Loss Account presents a true and fair view of the financial position and working result of the organization under audit. The need for financial audit arises as the control of the company is vested in the hands of the management of the company and the financial statements are also prepared by the management. The owners (shareholders), therefore, need assurance that the financial

independent expert – assures the owners about the reliability of the financial statements. Similarly, investors wish to invest their moneys in the shares of companies on the basis of their profitability and financial position. They will also place greater reliance on financial statements if they have been audited. Other users of financial statements, e.g., trade creditors, banks, financial institutions, tax authorities, other government authorities, labour unions, etc., also place greater reliance on audited accounts.

Sections 139 to 147 under chapter X of the Companies Act, 2013 contain provisions regarding statutory audit and auditors. Section 139 contains that at the first annual general meeting every company shall appoint an individual or firm as its auditor who will hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting. Section 141 contains that a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant and in case of a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company. Section 143 which contains provisions regarding powers and duties of auditors contains that the statutory auditor shall make a report to the members of the company on the accounts and financial statements examined by him.

The main provisions regarding statutory audit are:

- Auditor will have access to books of accounts and vouchers etc. at all times and he can seek information from officers of the company as he may deem necessary.
- In his report he must state, besides other things, whether the financial statements represent a true and fair view of the state of company's affairs as at the end of the financial year.
- In case of any qualifications in the audit report, the reason for same must be stated in the report.
- Auditor is required to comply with Auditing Standards.
- In case auditor suspects any fraud, he must immediately report the same to the Central

Internal Audit

Section 138 of the Companies Act, 2013 contains provisions regarding internal audit. As per Companies Act, 2013, certain class or classes of company as may be prescribed shall appoint an internal auditor who will conduct an audit of the functions and activities of the company and make a report thereon to the Board of Directors. Any chartered Accountant (except statutory auditor of the company) or Cost Account or other professional as may be decided by the Board, can be appointed to conduct the internal audit.

According to Rule 13 of The Companies (Accounts) Rules, 2014 following class or classes of companies shall be required to appoint an internal auditor or firm of internal auditors, namely:

(a) Every listed company;

(b) Every unlisted public company having-

(i) Paid up share capital of **50** crore rupees or more during the preceding financial year; or

(ii) Turnover of **200** crore rupees or more during the preceding financial year; or

(iii) Outstanding loans or borrowings from banks or public financial institutions exceeding **100** crore rupees or more at any point of time during the preceding financial year; or

(iv) Outstanding deposits of **25** crore rupees or more at any point of time during the preceding financial

year; and

(c) Every private company having-

(i) Turnover of **200** crore rupees or more during the preceding financial year; or

(ii) Outstanding loans or borrowings from banks or public financial institutions exceeding **100** crore rupees or more at any point of time during the preceding financial year:

The rules also provide that every existing company covered under above criteria in Financial Year 2013-14 shall comply with requirements of Section 138 and Rule 13 of Companies (Accounts) Rules, 2014 before 30th September, 2014 (within 6 months of the commencement of Section 138, i.e. 01st April, 2014) Government.

Secretarial Audit

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures. Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due processes. It is essentially a mechanism to monitor compliance with the requirements of stated laws. A Company Secretary in Practice has been assigned the role of Secretarial Auditor under section 2(2)(c)(v) of the Company Secretaries Act, 1980. Ever-increasing complexities of laws and responsibilities of directors (especially non-executive directors) make it imperative that a Practising Company Secretary (PCS) reports whether or not there exists proper compliance mechanism and systems in the corporate structure. PCS has also to verify whether diverse requirements under applicable laws have been duly complied with or not and if there is a need for any corrective measures or improvement in the system.

Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is recommended

that the Secretarial Audit be carried out periodically (quarterly / half yearly) and adverse findings if any, be communicated to the Board for corrective action.

Based on ownership: On the basis of ownership audit can be:-

1. Audit of Proprietorship: In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. Sole trader will decide about the scope of audit and appointment of auditor. The auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.

2. Audit of Partnership: To avoid any misunderstanding and doubt, partnership audits their accounts. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of auditor are defined in the mutual agreement and can be modified by the partners.

3. Audit of Companies: Under companies Act, audit of accounts of companies in India is compulsory. Chartered accountant who is professionally qualified is required for the audit of accounts of companies. Companies Act 1913 for the first time made it compulsory for joint stock companies to get their accounts audited from a qualified accountant. A number of amendments have been made in companies Act, 1956 and 2013 regarding appointment, duties, qualification, power and liabilities of a qualified auditor.

4. Audit of Trusts: The beneficiaries of the trusts may not have access and knowledge of accounts of the trust. The trustees are appointed to manage and look after the property and business of the trust. Accounts of the trust are maintained as per the conditions and terms of the trust deed. The income of the trust is distributed to the beneficiaries. There are more chances of frauds and mis-appropriation of incomes. In the trust deed as well as in the Public Trust Act which provide for compulsory audit of the accounts of the trust by a qualified auditor. The audited accounts of the trust ensure true and fair view of accounts of the trust.

5. Audit of Accounts of Co-operative Societies: Co-Operative societies are established under the Co-Operative Societies Act, 1912. It contains various provisions for the regulations and the working of these societies. Some of the states have adopted it without any change, while others have brought certain changes to it. The auditor of the Co-operative Society should have an expert knowledge of the particular act under which Co-operative society under audit is functioning. He should also study by-laws of the society and make sure that the amendments made from time to time in the by-laws have been duly registered in the Registrar's Office. Companies Act is not applicable to the co-operative Societies. The Registrar of co-operative societies shall audit or cause to be audited by some person authorized by him, the accounts of the society once in every financial year.

6. Government Audit: Audit of government offices and departments is covered under this heading. A separate department is maintained by government of India known as Accounts

and Audit Department. This department is headed by the Comptroller and Auditor General of India. This department works only for the government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

Based on Time: On the basis of time the audit can be of following types:

1. Interim Audit: When an audit is conducted between two annual audits, such audit is known as Interim audit. It may involve complete checking of accounts for a part of the year. Sometimes it is conducted to enable the board of directors to declare an Interim dividend. It may also be for the purpose of dealing with interim figures of sales.

2. Continuous Audit: The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

“A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals say weekly, fortnightly or monthly, during the whole period of trading.” - T.R. Batliboi

“A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends at regular or irregular intervals during the period.” -R.C Williams

Advantages of continuous Audit:

a. Complete checking of all the records: Since the audit is carried out throughout the year, sufficient time is available for detailed checking. Any enquiry and doubt arising in the course of audit can be tackled in a better way.

b. Proper planning: Auditor can plan his audit work in a systematic manner. He can evenly spread his work throughout the year. It will improve efficiency of auditor.

c. Early detection of frauds and errors: The work of auditor becomes easier for detecting frauds and errors, otherwise it will involve more time.

d. Up-to-date accounts: The efficiency of account staff will increase and their work will be up-to-date and accurate.

e. Valuable suggestions: Continuous audit will help the auditor to understand the technicalities of business. This will help the auditor to make suggestions for the improvement of business.

f. Preparation of interim accounts: Interim accounts can be prepared without much delay. It will help the Board of Directors to declare interim dividend.

Disadvantages of Continuous Audit:

a. Expensive: It is an expensive system as it may not suit the budget of small organizations.

b. Dislocation of routine work: Frequent visits by auditor may dislocate the smooth flow of office work.

c. Alteration of Figures: after the accounts have been audited, the figures may be fraudulently altered by the staff.

d. Losing link in the audit work: As the work is not completed continuously, the auditor may lose continuity and certain questions and inquiries may be left unanswered.

3. Final Audit: Final Audit means when the audit work is conducted after the close of financial year. A final 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.

4. Balance Sheet Audit: Balance Sheet Audit relates to the verification of various items of balance sheet such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

Based on Objectives: On the basis of objectives the audit can be of following types:

1. Internal Audit: It implies the audit of accounts by the staff of the business. Internal audit is an appraisal activity within an organization for the review of the accounting, financial and other operations as basis for protective and constructive service to the management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and financial matters but it may also properly deal with matters of operating nature.

2. Cost Audit: Cost Audit is the verification of the correctness of cost accounts and adherence to the cost accounting plans. Cost Audit is the detailed checking of costing system, techniques and accounts to verifying correctness and to ensure adherence to the objectives of cost accounting.

3. Secretarial Audit: Secretarial Audit is concerned with verification compliance by the company of various provisions of Companies Act and other relevant laws. Secretarial audit report includes

a. Whether the books are maintained as per companies act, 2013.

b. Whether necessary approvals as required from central Government, Company law board or other authorities were obtained.

4. Independent Audit: Is conducted by the independent qualified auditor. The purpose of independent audit is to see whether financial statements give true and fair view of financial position and profits. Mainly it is for safeguarding the interest of owners, shareholders and other parties who do not have knowledge of day-to-day operations of organization.

5. Tax Audit: Now-a-days tax audit has become very important to ascertain the accuracy of tax related documents. Tax audit mostly covers income returns, invoices, debit and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has

added one more chapter to the practice of auditing. Tax audit ensures the validity and credibility of tax related documents.

Vouching

Meaning and Definition

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

“Vouching means testing the truth of items appearing in the books of original entry.” – J.R. Batliboi

“Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof.” - Dicksee

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

Objectives of Vouching:

1. All the transactions which are connected with the business have been recorded in the books of accounts properly.
2. To verify that all transactions recorded in the books of accounts are supported by documentary evidence.
3. The vouchers which support the entries are legally valid from the view point that they are authentic, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account

Vouching of cash Transactions:

How to vouch various cash receipts (Receipt side)

1. Cash sales: In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same. Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.

2. Cash received from the debtors: The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.

3. Loans: While vouching the loans received, the terms and the conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.

4. Bills receivable: Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonor of such bill has been made.

A verification of the bills discounted should be made. Whether, entry for discount has been made. Such bills should appear as contingent liability in the balance sheet; if the date of maturity is after the date of balance sheet.

5. Sale of Investment: If the sales have been affected through a bank, the auditor should examine the bank advice to know the various details. Sometimes the investment is sold through the broker. Broker's sold note or commission should be examined to verify the sale proceeds and commission charged by the broker.

If the investments are sold at cum-dividend price, auditor should see that proper apportionment has been made between capital receipts and revenue receipts.

Sometimes the investments are made against specified funds. Profit or loss on sale of such investments must be transferred to such funds account.

6. Sale of Fixed Assets: Sale of fixed assets may be vouched with minute book of board of directors, correspondence, agents' sale account and sale contract. It should be seen that proper account has been credited. Any profit arising on the sale of asset shall be credited to revenue account which is not available for distribution of dividends. If any expense on the sale of assets is paid, the sale proceeds of the asset should be reduced by such amount and the balance should be credited to asset account. It must be seen that sale of fixed assets has been sanctioned by the authorized person or committee.

Vouching of cash payments (payment side):

1. **Cash Purchases:** goods purchased are actually received by store keeper. Cash memos can be compared with goods inward book to verify the goods received. Only the net amount (after trade discount) should be entered in the books.

2. **Payment to creditors:** Should be examined with the receipts issued by the creditors. The receipts should indicate the purpose for which the payment has been made. If the payment is made in full and final settlement of account, the balance should be accounted for as discount received. Where the payment is made in excess of the bill, either the excess payment is in advance or the payment is made by mistake, which should be recovered back from the creditor.

3. **Bills payable:** Bills payable honored on the date of maturity and is returned by the payee after receiving the payment. These bills should be cancelled after being paid. Bills payable paid can be vouched with bills book. If the payment is made by the bank, bank statement or pass book can be examined to verify the payment of bill

4. **Wages:** wages paid and calculated for various months should be compared. If the wages of particular month differ from the preceding month, the auditor should look into the reasons for difference. Random checking of wages calculations should be made. The auditor should see the proper record is maintained for unpaid wages, deductions for any advance taken by the worker should also be verified, and deductions made from the wages should also be entered in the proper account. Special attention should be given to the payments made to casual workers.

5. **Payment Of Salaries:** in vouching the payment of salaries following points are important

a. Auditor should check salary register with the entries made in the cash book

b. He should examine carefully alterations in the amount of deductions on account of fines, funds, loans, insurance etc.

6. **Purchase of Investment:** the auditor should compare the investment purchased with Broker's Bought Note. If the possible, physical verification of investments should be made. Investments must be in the name of the company. Where the investments are purchased at cum-interested price, interest included in the purchase price should be debited in the interest account and the balance in investment account. Later on when the interest is received on the investment, it should be credited in the interest account.

7. **Rent paid:** the auditor should verify the payment of rent from the agreement. The rent voucher should be supported by rent receipt from the landlord. It should be seen that payment of rent is sanctioned by responsible officer.

8. **Loans:** Auditor should be that the loan voucher should be supported by the receipt given by the party. Further details regarding terms and condition of the loan can be verified from the loan agreement. It should be seen that installment of loan along with interest are received in time. Mortgage Deeds and other documents should also be examined.

9. Interest on Loan: Auditor should verify that rate of interest on loan does not differ from the terms and conditions of loan agreement. Debenture interest can be verified from

Vouching of purchase book:

The main aim vouching of purchases book is to see that all purchase invoices are entered in purchases book and the goods entered in the purchases book are entered are actually received by the business.

While vouching credit purchases the auditor should examine and see the following points.

- i. There should be proper record for all purchase orders. A duplicate copy of the order is kept in office for record.
 - ii. A copy of purchase order shall be send to the Accounts Department.
 - iii. All goods received should be recorded on goods received note; a copy of it should be sent to Accounts Department.
1. The auditor should see that only credit purchases of the goods are recorded in purchase book.
 2. The purchases book can be verified from purchase invoices, copies of orders placed, goods received note, goods inward book, copies of challans from suppliers.
 3. The quantity mentioned in the invoice must be same as is shown in the purchase order.
 4. The price charged by the supplier must be as per quotation/pricelist of the supplier.
 5. The supplier bill must be in the name of business and for the period under audit.
 6. While vouching the purchase vouchers, each voucher should be stamped or initialed after examination, so that it could not be produced again.
 7. Any purchase, made not for the purpose of business of the client, must not be debited to purchase account.
 8. Duplicate invoices must not be entered in the purchase book if original invoices have already been recorded.
 9. The auditor should be more careful while vouching the purchase made in th first and last month of the accounting period, because sometimes the purchase of last year may be included in the purchases of first month of current year or purchases of the last month of current year may be recorded in the next.

Vouching of Credit Sales

1. The sales register should be examined with copies of sales invoices. The sale of capital items should not be recorded in the sales book, otherwise the profits will be inflated.

2. Test check should be applied on the calculations made in sale invoices.
3. The totaling and the castings of sales book should be verified.
4. Sales Tax, duties collected thorough sales invoices must be recorded under separate accounts.
5. It should be verified that all sales invoices are prepared on the basis of challans and then sales invoices are entered in sales book and from there, posted to their respected accounts.
6. Sales made in the current year must be recorded under that year and shall not be treated as sales of subsequent year.
7. All cancelled sales invoices must be kept together for verification by auditor, Who should see that cancelled invoices are properly treated in the books.
8. The statement of accounts should be verified by getting confirmations from the customers.

Vouching of Sales Return

The Auditor should pay special attention to the following while vouching the sales return

1. Date on which the goods are actually returned.
2. Credit note or Debit note of sales return.
3. Gatekeeper's receipt book.
4. Return inward register.
5. Stores records.
6. Corresponding entry for the return of goods in customer's account.
7. Goods returned should form the part of closing stock at cost price or market price whichever is less.

Internal Control

Meaning and Definition

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

According to The American Institute of Certified Public Accountants, "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."

The system of internal control can be defined as, “the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management’s objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business.”

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

Objectives/Need of the Internal Control:

1. Providing reliable data: Business decisions require accurate information to run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.
2. To promote operational Efficiency: the controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use of resources so as to promote the operational efficiency.
3. To encourage adherence to the prescribed policies: the system of internal control is meant to provide reasonable assurance that procedures and rules of various institutes are followed by company personnel.
4. Safeguarding assets and records: the physical assets of the company can be stolen, misused or accidentally destroyed if not properly protected by adequate controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company.

Internal Check

Meaning and Definition:

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

According to F.R. M.e paula, “internal check means practically a continuous 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.”

According to D.R. Davar, “ Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim.

According To Joseph Lancaster, “The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion.”

Objectives of internal check:

1. To exercise moral pressure over the staff.
- 2. To ensure that the accounting system produces reliable and adequate information.**
3. To provide protection to the resources of the business against fraud, carelessness and in efficiency.
4. To distribute work in such a manner that no business is left unrecorded.
5. To allocate duties and responsibilities of each clerk in such a way that he may held responsible for particular fraud or error.
6. To increase the efficiency of clerks because the allocation of duties is based on the principle of division of labour.
7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Advantages of Internal Check:

1. Proper division of work: internal check entails a proper and rational distribution of work among the members of staff of the enterprise keeping in view their individual qualifications, experience and area of specialization.
2. Detection of errors and frauds: since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds.
3. Increased efficiency coupled with economy: A good system of internal check increases the efficiency of work among the staff and leads to overall economy.
4. Convenience to auditor: where an organization is operating the system of internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.
5. Accuracy of the accounts can be relied upon: If there is a good system of internal check the owner of the concern may rely upon the genuineness and accuracy of the accounts.
6. Increase in Profits: overall efficiency and economy in operations result in more profits- thus ensuring larger dividends for the owners or shareholders.

Internal Check With Regard To Purchases:

1. Requisition: the procedure for issuing purchase requisitions should be specified. The head of the department, who is need of goods, should fill a requisition slip duly signed and then

should send to the purchase department. The details about the quality, quantity and the time by which the goods must be supplied be clearly mentioned in the requisition slip.

2. Enquiry: Purchases department makes an enquiry about terms and conditions of the purchases from different suppliers for these purposes tenders are generally invited. But, who shall open and accept the tenders, should be clearly specified. As rule lowest tender should be accepted and decision be taken.

3. Purchase Order: the purchase department places orders which should be recorded in the purchase order book. Four copies of purchase order should be prepared. One copy will be sent to vendor, the second to the store department, third to the accounting department and fourth will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.

4. Receipt of goods: on receipt of goods, the purchase department should properly inspect them, and after an entry in the goods inward (receipt) book, the same should be sent to the stores. Concerned department should be informed about the receipt of goods.

5. 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 the purchase order and incoming inspection report and

Internal check with regard to fixed assets:

1. A proper authority should be designated for the sanction of capital expenditure. The authority may be given to managing director, a factory manager or a committee may be set up for this purpose.

2. A proper authority should be designated even for sale of fixed assets, transfer or even for discarding of an asset.

3. Proper accounting records in respect of fixed assets should be maintained and it should be ensured that the proper accounting distinction is observed between capital and revenue expenditure.

4. There should be a periodic inspection of assets.

5. A fixed asset register must be maintained giving details of all the fixed assets. In this register description of the assets, their cost and location should be mentioned. Management should also ensure that all the fixed assets are verified physically from time to time.

6. Perfect arrangements should be made to ensure that fixed assets are properly maintained and applied in the service of the company.

7. Where the fixed assets are transferred between branches or members of the sale group, proper arrangements in respect of their pricing, depreciation and accounting should be made.

8. Depreciation rates are to be authorized and evidenced and which persons are to be responsible for carrying out and checking the necessary calculations.

9. Lastly it should be seen that these fixed assets should be adequately insured.

Internal check with regard to cash transactions

CASH RECEIPTS:

1. There should be a separate clerk known as cashier to deal with the receipts of cash. Immediately upon receipts of cash a rough record of the amount should be made. The cashier should not be authorized to keep cash with him. He should not be allowed to make expenditure out of it and to make entries in the ledger and other books of prime entry.
2. All receipts should be banked daily. From time to time the bank reconciliation statements should be prepared to reconcile bank and cash balances.
3. Bank pay- in-slips should not be prepared by the same person who is incharge of making actual deposits in the bank.

CASH PAYMENTS:

1. The person in charge of making payments should have no connection with the receipts of cash.
2. All payments should, as far as possible be by cheque excluding petty cash payments. The cheques drawn for payment should be order cheques and as far as practicable they should be crossed.
3. Arrangements should be made to ensure that the vouchers supporting payments cannot be presented for the payments twice, such vouchers should be stamped as paid before the cheques are signed.
4. An official should check up the statements received from creditors and verify with the invoices and ledger accounts only after proper verifications cheques should be drawn in favour of the creditors.
5. For sanctioning the payments of special nature, only directors and senior officers should be empowered.
6. Bank reconciliation statements should be prepared to reconcile bank and cash balances from time to time by some authorities other than the cashier.
7. Bank cheques must be held under lock and key with a responsible officer.
8. Receipts duly signed and stamped should be obtained for each payment.
9. Receipts so obtained should be properly arranged and maintained through proper filing system.
10. To ensure the availability of cash discounts, monthly or periodic payments should be made on the fixed dates.

Verification

Meaning and Definition

Verification means the procedures normally carried out at the year end, to confirm the ownership, valuation and existence of items at the balance sheet date. In simple words verification means, 'proving the truth or conformation.'

"The verification of assets implies an enquiry into the value, ownership and title, existence and possession, and the presence of any charge on the assets." - **Spicer and Pegler**

Valuation

Meaning and Definition

Valuation means to set the exact value of an asset on the basis of its utility. Valuation forms an important part of the everyday audit. It is because the accuracy of balance sheet depends much upon how correctly the estimation of the value of various assets and liabilities has been made. Both over-valuation and under-valuation of assets and liabilities would exhibit wrong picture of the financial affairs of a concern. The auditor has to see that the assets and liabilities appearing in balance sheet have been exhibiting their proper value i.e. neither they have been over-valued nor under-valued.

Methods of Valuation:

- 1. Cost price:** The price which is paid for the acquisition of an asset is known as cost price, of course the expenses incurred in the purchase of an asset and its installation in its cost price.
- 2. Market value:** A value which an asset can fetch in the market when sold is known or termed as Market value.
- 3. Replacement Value:** It is a price at which a particular asset can be replaced. The assets such as commission, freight etc. is included in such a value.
- 4. Book Value:** A value at which an asset appears in the books of accounts is known as its book value. It is usually the cost less depreciation written off so far.
- 5. Going Concern value or Conventional value or token value or Historical value:** It is equivalent to the cost less reasonable amount of depreciation written off. No notice is taken of any fluctuation in the price of the assets. Reason for this is that these assets are acquired for use in the business and not for sale.
- 6. Residual Value:** A value which will be realized in the market and received from the sale of an asset it is known as its realizable Value.
- 7. Scrap Value:** A value which is obtained from the asset if it is sold as scrap.

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Distinction between vouching, verification and valuation

	Vouching	Verification	Valuation
Meaning	Vouching is a process of comparing the entries in the books of accounts with the bonafide vouchers	Verification is a process which proves the existence, ownership and title to the assets	Valuation is a process which certifies the correct value of the assets and liabilities at the date of balance sheet.
Subject matter	Vouching is made of the entries recorded in the books of original entry and their posting in the ledger	Verification on the other hand is made of assets and liabilities appearing in the balance sheet at the end of the year	Valuation is also made of assets and liabilities appearing in the balance sheet at the end of the year
By Whom	Vouching is done by the senior auditor and audit clerks.	Verification on the other hand is done by the auditor himself or his associates	Valuation on the other hand is done by the auditor himself or his associates
When	Vouching is done after the entry of transactions in the account books	Verification on the other is done at the end of the financial year when the final accounts are to be prepared	Valuation on the other is done at the end of the financial year when the final accounts are to be prepared
Evidence	In vouching , bonafide vouchers are sufficient evidence for vouching	Verification is made on the basis of evidence such as the title deeds, receipts and payments etc.	In valuation an auditor has to depend upon the certificates of the owners/directors.

MANAGEMENT AUDIT

Meaning and Definition

Management audit is attempt made to evaluate various management functions and process. A detailed and critical review of all the objectives, policies, procedures and functions of

management is made with a view to bring about an overall improvement in managerial efficiency.

According to **Leslie R. Howard**, “ An investigation of a business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organization and smooth running of internal organization.”

According to **W.P. Leonard**, “A comprehensive and constructive examination of an organization structure of a company, institution or a branch of government or of any component thereof such as division or department, and its plans and objectives, its means of operations, and its uses of human and physical facilities.”

Investigation

Meaning and Definition

Investigation involves inquiry into facts behind the books and accounts into the technical, financial and economic position of the business. Investigation is a critical examination of the books and accounts with a specific objective.

“The term investigation implies an examination of the accounts of a business for some special purpose.” - Spicer and Pegler

“An investigation is an examination of accounting records undertaken for a special purpose; in fact, it is an audit of which the scope the scope is limited or extended in accordance with requirements of the particular purpose. Its object is usually to discover and display the facts in such a manner as will enable the parties for whom it is undertaken to draw conclusions and make their decisions accordingly.”

Features Of investigation

- 1.** It is critical examination and is based on Suspicion on the state of affairs to be investigated.
- 2.** It may even extend to the examining of individuals like Directors, Auditors and other officers of the company
- 3.** It does not confine itself only with the financial aspects but technical, political, economical and managerial aspect are also accounted for.
- 4.** The investigation is normally conducted with certain specific objectives.
- 5.** With the predefined objectives, the scope and the nature of investigation may be limited or extended.
- 6. The investigator submits his report of investigation only to his client, who appoints him.**
- 7.** In the investigation report, the factual information is given in an analytical and descriptive manner.
- 8.** No specific rules and provisions are framed for the investigation. Investigation is voluntary and contractual in nature, except in companies.

Audit Report

Essentials of Audit Report

(i) Title: An auditor report must have appropriate title, such as "Auditor's Report". It is helpful for the reader to identify the auditor's report. It is easy to distinguish it from other reports. The management can issue any report about the business performance. The title to the report is essential.

(ii) Addressee: The addressee may be shareholder or board of director of a company. The auditor can audit financial statements of any business unit as per agreement. The report should be appropriately addressed as required by engagement letter and legal requirements. The report is usually addresses to the shareholders or the board of directors.

(iii) Identification: The audit report should identify the financial statement that have audited. The financial statement may include trading profit and loss accounts, balance sheet and statement of changes in financial position and sources and application of cash flow statement. The report should include the name of the entity. Moreover the data and period covered by the financial statement are also stated in it.

(iv) Reference to Auditing Standards: The audit report should indicate the auditing standard or practice followed in conducting the audit. The international auditing guidelines need assurance that the audit has been conducted as per set standards.

(v) Opinion: The auditor's report should clearly state the auditor's opinion on the presentation in the financial statement of the entity's financial position and the result of its operations. The statement give a true and fair view is an auditor's opinion. This opinion is usually based on national standard or international accounting standards.

(vi) Signature: The audit report should be signed in the name of the audit firm, the personal name of the auditor or both as appropriate.

(vii) Auditor's Address: The address of auditor is stated in the audit report. The name of city is stated in the report for information of the readers.

(viii) Date of Report: The auditor's report shall be dated not earlier than the date on which the auditor has obtained sufficient appropriate audit evidence and date on which accounts are approved by the management.