

AUDITING

PAPER-III

*(As Per the Revised Syllabus of T.Y. BAF, 2015-16, Semester V,
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Preface

Syllabus

Auditing - Paper III

Sr. No.	Modules	No. of Lectures
1	Company Audit	15
2	Audit Report	15
3	Audit under Computerized Information System Environment	15
4	Professional Ethics	15
Total		60

Sr. No.	Modules/Units
1	Company Audit
	Powers & Duties of Auditors, Liabilities of Auditors Branch Audit, Joint Audit, Special Audit, Tax Audit
2	Audit Report
	Reporting Requirement under the Companies Act Qualifications in Audit Report, Disclaimers in Audit Report Adverse Opinion, Disclosures, Reports & Certificate
3	Audit under Computerized Information System Environment
	Special Aspects of CIS Audit Environment, Need for Review of Internal Control Especially Procedure Controls and Facility Controls Approach to Audit in CIS Environment Use of Computer for Internal and Management Audit Purposes Audit Tools, Test Packs, Computerized Audit Programmes Special Aspects in Audit of E-Commerce Transaction.
4	Professional Ethics
	Code of Ethics with Special Reference to the Relevant Provisions of The Chartered Accountant Act, 1949 and the Regulations thereunder The Chartered Accountant Act, 1949 Schedules Members who are deemed to be in Practice Significance of the Certificate of Practice Disabilities for purpose of Membership Disciplinary Procedure Professional Misconduct

Note: Relevant Law/Statute & Accounting Standards in force on 1st April of every Academic Year shall be applicable for examination.

Scheme Of Examination

Credit Based Grading System Scheme of Examination

- **Internal Assessment – 25%** **25 Marks**
- **Semester End Examinations – 75%** **75 Marks**

Question Paper Pattern

Duration: 2¹/₂ Hrs.

Maximum Marks: 75

All Question are Compulsory Carrying 15 marks each.

Questions to be Set: 05

	Particulars	Marks
Q.1	Objective Questions	
	(a) Sub Questions to be asked 10 and to be answered any 08	15 Marks
	(b) Sub Questions to be asked 10 and to be answered any 07	
	(*Multiple choice/True or False/Match the column, Fill in the blanks)	
Q.2	Full Length Practical Question	15 Marks
	OR	
Q.2	Full Length Practical Question	15 Marks
Q.3	Full Length Practical Question	15 Marks
	OR	
Q.3	Full Length Practical Question	15 Marks
Q.4	Full Length Practical Question	15 Marks
	OR	
Q.4	Full Length Practical Question	15 Marks
Q.5	(a) Theory Questions	08 Marks
	(b) Theory Questions	07 Marks
	OR	
Q.5	Short Notes	15 Marks
	To be asked 05	
	To be answered 03	

Note: Full length question of 15 marks may be divided into two sub questions of 08 and 07 marks.

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1

Company Audit

RIGHTS/POWERS OF COMPANY AUDITOR

Statutory Rights and Powers of a Co. Auditor can be Enumerated as follows:

SIR₃ SCALE

1. Rights to Seek Expert's Opinion
Auditor can seek opinion from different experts on technical matters like determining the remaining useful life of the asset for the purpose of calculating depreciation.
2. Right to be Indemnified (section 6.33)
Auditor has the right to be indemnified against the losses and charges incurred by him in defending himself against civil/criminal proceedings by the Co. This right exists only if:
 - (i) He is acquitted of the charges against him, or
 - (ii) The court is of the opinion that the auditor has acted honestly in his dealings with the
3. Right to receive notice of *general meetings and to attend the same* (section 231)
Auditor has the *right to receive notice of general meetings and to attend the same. Also the auditor has the right to make statement and give explanations at the general meeting in connection with the accounts.*
4. Right to receive remuneration
It is the right of the auditor to receive remuneration from the Co. provided he has completed the work undertaken by him.
5. Right to representation (section 225)
A retiring auditor has the right to receive a copy of special notice received by the Co. for proposed resolution at Annual General Meeting appointing a person other than the retiring auditor. In such cases the auditor has the right to be represented either in person or in writing.
6. Right to sign audit report
Auditor has the right to sign audit report. Balance Profit/Loss account including all documents attached to or therewith. The above is a right as well as duty of auditor.
7. Right to call information and explanation (section 227) (i)

In the course of his audit, an auditor can call for any information and explanation which are necessary for the purpose of his audit. All the officers and executives of a Co. Are required to provide necessary explanations and thereby assist the auditor in his audit work. This is a very wide power given to the auditor to enable him to form proper opinion on the accounts and if this right of the auditor is refused by the Co., auditor can state this fact in his audit report.

8. Right to have access to books of accounts, vouchers, etc.

Auditor has the right to examine the books of accounts, documents, agreements etc. relating to accounts. Management cannot prevent the auditor to examine the books of accounts maintained by the Co.

9. Right of lien

Statutory auditor has a right of lien on the working papers. Audit working papers are property of the auditor and he can retain it.

10. Enjoy right to visit the branches (section 228)

Auditor has the right to visit branches to audit the accounts maintained by such branches. This right is available subject to the following:

- (i) No qualified auditor has been appointed to audit branch accounts.
- (ii) No exemption has been granted by Central Government from getting branch account audited.

DUTIES OF AUDITORS (SECTION 227 AND 229)

An Auditor has to Perform the Following Duties:

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- (i) Duty to make an audit report
- (ii) Duty to make adequate disclosures in the audit report [Sections 227(1A), (2), (3), and (4A)]
- (iii) Duty to give significant reasons for qualifications [Section 227(4)].
- (iv) Duty to sign the audit report [Section 229].
- (v) Duty to attend the meetings of audit committee [Section 292.A(5)].
- (vi) Duty to comply with SAPs

SAM

These duties are explained as follows:

1. Duty to Make an Audit Report

1. **Scope of Audit Report:** The audit report, as laid before the company in the general meeting, shall relate to the following documents:

- the accounts examined by him.
- every balance sheet of the company.

- every profit and loss account of the company.
 - documents annexe to the balance sheet and profit and loss account.
- 2. Reading of Auditor's Report:** The auditor's report shall be read before the company in the general meeting and shall be open to inspection by any member of the company (Section 230). Generally, the balance sheet, profit and loss account, and the report of Board of directors are taken as 'read' after they are presented to the general meeting. However, in view of the specific provisions of section 230, the auditor's report cannot be taken as 'read', but must be actually read at the general meeting.
- 3. Report to Members:** It is the duty of the auditor to make a report to the members. However, he is not required to send his report to every member. The auditor's duty is only limited to sending the audit report to the secretary or the Board of directors of the company. It is the duty of the secretary or the Board of directors to convene a general meeting and consider the report.

2. Duty to Assist Investigation – Section 240

Section 240 imposes duty on the auditor in the event of investigation of the affairs of a company as follows:

- (i) To produce to an inspector all books and papers of, or relating to the company, or as the case may be, of or relating to the other body corporate, which are in his custody or power and,
- (ii) Otherwise to give to the inspector all assistance in connection with the investigation which he is reasonably able to give.

3. Duty to Sign Report – Section 299

It is duty of the auditor to sign the report prepared by him. In case of the partnership firm only the partner may sign the report.

4. Duty to Certify Statutory Report – Section 165 (4)

It is duty of the auditor to certify the statutory report as correct to the extent it relates to:

- (i) Number of shares allotted by the company.
- (ii) Cash received by the company in respect of the shares allotted.
- (iii) Receipts and payments of the company.

5. Duty to Certify the Profit and Loss Account in a Prospectus – Section 56 (1)

When an existing company issues a prospectus, it is required that such a prospectus should contain:

- (i) Statement of profit or loss
- (ii) Statement of assets and liabilities
- (iii) The rates of dividend paid by the company for the five preceding the issue of the prospectus. The auditor has duty to certify these as correct.

AUDITORS REPORT

Important Elements of Audit Report

The audit report should describe the scope and nature of the audit work and the opinion of the auditor. Besides this, there are various basic elements which should be there in an audit report. Important elements of an audit report, are described below:

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1. Introductory Paragraph

The introductory paragraph should identify the financial statements which have been audited (typically the balance sheet, profit and loss account and cash flow statement) and it also indicates that the statements are management's not the auditor's responsibility. The independent auditor is responsible only for expressing an opinion on the financial statements.

2. Ensure the Place of Signature

The report should name a specific location, which is generally the city in which the auditor maintains his office.

3. Addressee

The report should be addressed to the client or appointing authority. In case of a limited company, the report should be addressed to the shareholders.

4. Title

An appropriate title such as Auditor's Report helps the readers to identify the report and to distinguish it from the reports issued by others.

5. Date of the Report

It is the date on which the audit report is signed.

6. Opinion Paragraph

The opinion paragraph should make a reference to financial reporting framework being used by the entity to prepare the financial statements and whether the financial statements present a true and fair view of all material matters in accordance with the financial reporting framework being used. It should also state whether the financial statements comply with statutory requirements, if any.

7. Scope Paragraph

The scope paragraph should state that the audit was conducted in accordance with auditing standards generally accepted in India and describes what the auditor did in the audit. The description identifies several limitations of an audit.

These include:

1. the reasonable (not obsolete) assurance
2. discovery of material (not all) misstatements

3. reliance on test basis for audit examination
4. reliance on judgment for assessing adequacy of accounting principles and assessing estimates

8. Auditor's Signature

An audit report should be signed by the auditor in his personal name and in case of a firm being appointed, in the name of audit firm also. Membership number assigned by the Institute of Chartered Accountants of India should also be mentioned.

WHAT IS MEANT BY AUDITORS REPORT? WHAT ARE THE DIFFERENT TYPES OF AUDIT REPORT?

Meaning

An auditor is appointed by the shareholder to collect the real information of the state of affairs of the Co. Therefore under section 227, it is the duty to report to the shareholders. An auditor's report is the instrument or a medium through which the auditor expresses his opinion to the shareholder of the Co. In his report the auditor has to state whether on the basis of the information supplied and the explanation given to him, in his opinion the accounts are fair and give true information regarding the financial condition of the concern as required by the Companies Act 1956. If the auditor is not satisfied with the accounts and if he finds any loopholes (weakness) in the accounts, he has to mention the fact in his reports and suggest remedies and also ways and means for the betterment of the affairs of the Co.

DIFFERENT TYPES OF AUDIT REPORTS

1. Clean or Unqualified Report

A *clean report* is a report given by an auditor when he accepts all the figures of financial statements without any adverse remark or reservation. A clean report is given when the accounts of the Co. are as per the requirements of law and the financial statements are drawn in conformity with the books of accounts and as per the requirement of the Companies Act, 1956, and he is of the opinion that they (financial statements) give a true and fair view of section 227 (2) of the Co.s Act which lays down certain questions which the auditor of the Co., must answer in his reports. When all the questions are answered in the positive the auditor submits clean reports.

In Other Words, a Clean Report Indicates the Following

- (i) That he has received all the information and explanation.
- (ii) That the books are maintained as per the requirements of law and that the financial statements are drawn in compliance with the provision of law.
- (iii) That the generally accepted accounting principles are properly adopted.
- (iv) That there is no violation of any provision of articles and memorandum of association of the Co.
- (v) That there is no violation of any Co.s Act, 1956.
- (vi) That the financial statements given a "true and fair" view.

2. Qualified Report

When the auditor is not satisfied with the accounts presented to him or if he has some discrepancy in the treatment of some items he gives a *qualified report*. This report is given when he finds that the profit and loss account and the balance sheet do not give true and fair view of the state of affairs of the Co. and the management is not prepared to make the desired changes. Whenever the auditor gives the qualified report he should also state the reason for the qualification mentioned in his report. Before giving qualified report the auditor should ask the director to put the matter right and allow him to alter the figures of the financial statements as per his qualification. However, he will be left with no alternative but qualify his reports.

A qualified report is normally not necessary unless the amount involved is substantial. Whenever a qualified is given it will result into very serious consequences. The reputation of the co. and its management is likely to suffer severely. The banks and the financial institutes may try to recover the loans and advances. The share prices in the stock exchange may come down etc.

Reasons for Qualified Reports

The matter in respect of which the auditor qualifies his reports is as follows:

- (i) Inadequate provision for bad and doubtful debts.
- (ii) No provision or adequate provision may have been made for tax liability.
- (iii) Inadequate provision has been made for depreciation of fixed assets.
- (iv) The closing stock may have been valued at cost price which is higher than the market price.
- (v) Contingent liability may have been omitted.
- (vi) Assets may be undervalued or overvalued.
- (vii) The secret reserve may have been secretly created.
- (viii) Provision of Co.s Act, may not have been complied with.
- (ix) He may not have received proper explanation that was necessary for the purpose of his audit.
- (x) Revenue expenses have been shown as capital expense or *vice versa*.

3. Negative or Adverse Report

When an auditor expresses his opinion that the Financial statement of a concern does not exhibit true and fair view of the state of affairs in that concern and of the result of the working, the report is said to be a negative report or adverse report.

This kind of report is made when the auditor is of the firm opinion that he has got the definite material to substantiate his negative opinion regarding the state of affair of the concern under audit as expressed by its account. In submitting such a report the auditor should of course have substantial proof and I person for expressing such an opinion in his report.

4. No Opinion Report or Disclaimer of Opinion

Sometimes it may happen that part of the books may not be available for verifications etc. and the auditor is not capable of forming his opinion therefore, he cannot express his opinion andi such a

report is called *no opinion report*. In such case the auditor give up the responsibility of expressing any opinion about the financial statements.

Certificate vs. Report

A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. Thus, an auditor's certificate is a guarantee of absolute accuracy and correctness of the information contained therein. This information is based on the documentary evidence made available to the auditor. On the other hand, a report is a formal statement usually made after an inquiry, examination or review of specified matters, under report and includes the reporting auditor's opinion thereon. We can, thus, say that auditor's report is an expression of independent opinion in the financial statements of a company. It is based on verification and examination of pertinent records and documents and is not a guarantee of accuracy and correctness.

Objective

The main objective of an independent financial audit is the expression of an opinion regarding the truthfulness and fairness of presentation of the financial statements. This opinion is communicated to the owners/members through the medium of audit report.

Signing of Audit Report

Under section 229 of the Companies Act, only a person appointed as auditor of the company, or where a firm is so appointed, a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

The Council of the Institute of Chartered Accountants of India has advised its members to sign the statutory audit reports of companies as follows:

For X and Co. Chartered Accountants (Name of the member) Partner

Where there is no statutory requirement to disclose the name of the member signing the audit report, the audit report may be signed in the name of the firm. This implies that only the name of the firm is given without disclosing the name of the proprietor/partner signing the report.

MATTERS TO BE INCLUDED IN THE AUDITOR'S REPORT

The auditor's report on the account of a company to which this order applies shall include a statement on the following matters, namely:

1. Fixed Assets

- (a) Whether the company is maintaining proper records showing full particulars including quantitative details and situation of fixed assets;
- (b) Whether these fixed assets have been physically verified by the management at reasonable intervals: Whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) If a substantial part of fixed assets have disposed off during the year, whether it has affected the going concern;

2. Inventory

- (a) Whether physical verification of inventory has been conducted at reasonable intervals by the management;
- (b) Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business? If not, the inadequacies in such procedures should be reported;
- (c) Whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;

3. Loans – Inter Group

- (a) Has the company either granted any loans, secured or unsecured to companies, firms or other parties covered in the register, maintained under Section 301 of the Act. If so, give the number of parties, and amount involved in the transactions.
- (b) Whether the rate of interest and other terms and conditions of loans given taken by the company, secured or unsecured, are *prima facie* prejudicial to the interest of the company;
- (c) Whether payment of the principal amount and interest are also regular;
- (d) If overdue amount is more than one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest;

4. Internal Control

Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weakness in internal control system;

5. Inter-Group Transactions

- (a) Whether particulars of contracts or arrangements referred to in Section 301 of the Act has been entered into the register required to be maintained under that Section.
- (b) Whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;

6. Public Deposits

In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of Sections 58A and 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank Of India or any other Tribunal whether the same has been complied with or not?

7. Internal Audit System

In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business;

8. Cost Records

Where maintenance of cost records has been prescribed by the central Government under clause (d) of sub-Section (1) of Section 209 of the Act, whether such accounts and records have been made and maintained;

9. Statutory Dues

- (a) Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income Tax, Service Tax, Sales Tax, Wealth Tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.
- (b) In case dues of Income tax Sales tax/Wealth tax/Service tax/Custom duty/Excise duty/Cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may please be mentioned. (A mere representation to the Department shall not constitute the dispute).

10. Accumulated Losses

Whether in case of a company which has been registered for a period not less than five years, its accumulated losses' at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;

11. Default in Repayments

Whether the company has defaulted in repayment of dues to financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;

12. Secured Loans Given

Whether adequate documents and records maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; if not, the deficiencies to be pointed out;

13. Chit Funds

Whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/mutual benefit fund/societies;

- (a) Whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;
- (b) Whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets;
- (c) Whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers;
- (d) Whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;

14. Dealer in Shares

If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been made of the transactions and contract and whether timely entries have been made therein; also whether the company, in its own securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under Section 49 of the Act;

15. Guarantee for Loans

Whether the company has given any guarantee for loans taken by others from bank of financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;

16. Use of Term Loans

Whether term loans were applied for the purpose for which the loans were obtained;

17. Funds Flow

Whether the funds on short-term basis have been used for long term investment. If yes, the nature and amount is to be indicated;

18. Preferential Allotment

Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the act and if so whether the price at which shares have been issued is prejudicial to the interest of the company;

19. Securities for Debentures

Whether security or charge has have been created in respect of debentures issued?

20. Use of Issue Funds

Whether the management has disclosed on the end use of money raised by public issues and the same has been verified;

21. Fraud

Whether any fraud on or by the company has been noticed or reported during the year; if yes, the nature and the amount involved is to be indicated.

COMPLY WITH CEILING ON NO. OF AUDITS

The Companies Act, places a ceiling on the number of company audits that an auditor can hold. This ceiling was introduced to distribute the audits among larger number of auditors, to avoid, monopoly of audit work by a few major firms of chartered accountants.

- (A) **20 Companies:** According to Section 224(b) of the Act, an auditor cannot hold more than the specified number of company audits, i.e., 20 companies.
- (B) **10 Companies with Capital of ₹ 25 Lakhs:** Out of these 20 companies not more than ten shall have a paid-up share capital of ₹ 25 lakh or more.

The specified number (i.e., 20 or 10) is to be computed in the following manner:

1. **Individual:** A Chartered Accountant in practice can audit up to 20 companies out of which not more than 10 shall have a paid-up share capital of ₹ 25 lakhs or more.
 2. **Per Partner:** In the case of a firm of chartered accountants, the specified number should be computed per partner who is not in whole-time employment elsewhere. If such a partner of the firm is also a partner in any other firm or firms of auditors, the total number of audits held by him individually and by different firms on his account shall be considered in determining the specified number of audits.
 3. **Joint Audits:** In computing the specified number, all company audits where a person or a firm is appointed as joint auditor shall also be taken into account.
 4. **Non-profit/Guarantee Companies:** All types of companies including non-profit companies and companies limited by guarantee, etc., are to be taken into account while computing the specified number.
 5. **Branch Audits:** Branch audits are not to be counted in computing the specified number.
 6. **Special Audits etc.:** Special audits, investigations and audits of corporations set up under a separate Act are not to be counted for this purpose.
 7. **Foreign/Private Companies:** Audits of the accounts of foreign companies or private companies (as per Companies Amendment Act, 2000) are also not to be included within the specified number as such companies are outside the scope of Section 224.
- (C) **Certificate of Compliance from Auditor:** In order to ensure that the provisions relating to the ceiling on the number of audits are complied with, Section 224(1) provides that before any appointment or reappointment of auditor or auditors is made by any company at any annual general meeting, a written certificate shall be obtained by the company from the

auditor or auditors proposed to be so appointed to the effect that the appointment or reappointment, if made, will be within the limit specified.

“TRUE AND FAIR” IN COMPANY AUDIT REPORT

1. **S. 211:** The requirements of the Companies Act, 1956, are that the auditor should specifically express an opinion whether the published accounts give a true and fair view of the company's state of affairs and of the profit and loss for the financial year. What constitutes a 'true and fair view' has not been defined in the Act. Sub-Sections (1) and (2) of Section 211 merely require that every balance sheet and profit and loss account of a company shall give a true and fair view of the state of affairs and of the company and shall comply with the requirements of Schedule VI of the Companies Act, 1956, so far as they are applicable.
2. **Sch. VI:** Sub-Section (5) of this Section implies that the balance sheet and the profit and loss account of a company shall be deemed as not showing a true and fair view, if they do not disclose any matters, which are required to be disclosed by virtue of the provisions of Schedule VI or by virtue of a notification or an order of the central government modifying the disclosure requirements. It is clear that the auditor will have to examine whether the financial statements are drawn up in conformity with the provisions of Schedule VI and whether they contain the matters required to be disclosed therein. Thus, one of the tests for determining whether or not the financial statements show a true and fair view is to check whether all relevant disclosures as required by the governing Act have been properly made.
3. **SA 200A:** The phrase 'true and fair' in the auditor's report signifies that the auditor gives an opinion as to whether the financial statements represent fairly the actual financial position as at the end of the accounting period and profit or loss for that period. SA 200 "Objective and Scope of the Audit of Financial Statements" states that, "in forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The auditor recognises that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that some material misstatement may remain undiscovered. While in many situations the discovery of a material misstatement by management may often arise during the conduct of the audit, such discovery is not the main objective of audit nor is the auditor's programme of work specifically designed for such discovery.
4. **Guidelines:** However, the following general guidelines may be laid down in this regard.
 - (i) **Laws:** The balance sheet and the profit and loss account should be drawn up in conformity with the requirements of the Companies Act or those of the specific Acts governing certain classes of companies.
 - (ii) **As it is:** Relevant information should be so disclosed in the balance sheet and the profit and loss account that the financial position and the working results are shown as they are, i.e., there is neither an overstatement nor an understatement. There should be no window dressing: the balance sheet and the profit and loss account should not beam

attempt to show a better picture than what it is in reality. Similarly, there should be no secret reserves (Unless the Statute specifically permits the creations of such reserves).

- (iii) **Materiality:** All material facts regarding expenses, revenues, assets and liabilities of the company should be disclosed. There should be no misstatement.
- (iv) **Exceptional Items:** All unusual, exceptional, or non-recurring items should be disclosed separately.
- (v) **GAAP:** The balance sheet and the profit and loss account should be prepared and presented in conformity with the generally accepted principles of accounting. Such principles should be consistently applied. The effect of a change in these principles should be suitably disclosed.
- (vi) **Subsequent Events:** The auditor should examine the situation as it exists at the end of the accounting period. If certain subsequent events help the auditor in making a better assessment of the position as at the date of the balance sheet, the auditor should take such events into account.
- (vii) **Clarify:** The financial statements should convey the required information clearly. As has been held in many legal cases, information and means of information are by no means equivalent terms. A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much of information as it calculated to induce them, or some of them, to ask for more.

LIABILITIES OF AUDITORS

The liabilities of auditors who fail to discharge their duties properly can be broadly classified as follows:

1. **Civil Liability for Negligence:** Civil case can be filed in a Court of Law against auditors or damages caused by negligence in discharge of duties.
2. **Liabilities Under Companies Act:** An auditor of a Company can be held liable under The provisions of the ‘Companies Act under which he performs his functions, – (a) as an “officer” of the company (b) for misfeasance (i.e., breach of duty)

CIVIL LIABILITY FOR NEGLIGENCE

If the auditor is negligent in his duties he is liable to pay compensation to the person who has suffered loss due to his negligence. This is called civil liability for negligence. The following points need to be considered in this regard

1. To whom is the auditor liable? Is he liable to third parties?
2. Has there been any negligence in the performance of duties?
3. Has there been a loss or damage as a result of negligence?

LIABILITY – TO WHOM?

An auditor has a duty to the shareholders who appoints him because he has a direct contractual relationship with them. This is known as “privity of contract.” However, although the auditor is liable to shareholders as a body, he has no duty to an individual shareholder.

It is a controversial legal question as to whether an auditor is liable to third parties like bankers, tax authorities, potential investors, etc., who may rely on statements audited by him. In case of a fraud, any person, whether or not he is in contractual relationship with the auditor, can file a case against the auditor. But whether an auditor is liable to third parties in case, of negligence only has been examined by the courts in a number of cases.

In the past, it has been held that the auditor has no responsibility towards persons with whom he had no privity of contract. **Thus, in Commissioner Income-Tax v/s G.M. Dandekar**, it was held that since the defending accountant was not employed by the Income-Tax department, he was not liable to it. Many recent judgements of the Courts in U.K and U.S.A do not accept the above view. They take a broader view of an auditor's liability.

According to **Lord Denning** the auditors owe a duty of care not only to their clients, but also to all those who they know will rely on their accounts. Lord Denning's viewpoint was upheld later in another case, **Hedley Byrne and Co. Ltd v/s Heller and Partners**.

A statement of the Council of the Institute of Chartered Accountants in England and Wales also recognises that a liability to third parties may arise "Whenever a professional person does work for his client in circumstances where he knows or ought to know:

1. That his work is liable to be relied upon by a third party; and
2. That third party may suffer financial loss if the work in question has been done negligently, Liability will arise when the work in question is of a kind which it was reasonable for the third party to rely on for his particular purpose."

What Constitutes Negligence

Negligence means acting carelessly or failing to perform a duty enjoined upon a person. An auditor can be said to be negligent if he has not exercised a reasonable degree of care and skill in the performance of his duties. An auditor should conduct audit with reasonable care and skill according to standard auditing practices. This does not require him to undertake detailed investigations. He is, as has been said, "a watchdog but not a bloodhound.

Legal Cases on Negligence

In some of the cases discussed below, damages were claimed from the auditors for alleged negligence. These cases throw light on the meaning of negligence.

1. **The Leeds Estate Building and Investments Society Ltd. v/s Shepherd:** Add that the auditor was liable in respect of dividends paid out of capital and for fees paid to the directors. The balance sheets of the company contained fictitious items included with a view to declare dividend and pay fees etc., to directors.
2. **London Oil Storage Co. Ltd. v/s Sear, Hasluck and Co.:** Held that verification of the existence of assets stated in the balance sheet is an important duty of the auditor. The auditors were charged with negligence for not discovering the misappropriation of the petty cash balance which was shown at pound sterling 796 but was in fact only pound sterling 30.

3. **Arthur E. Green and Co. v/s The Central Advances and Discount Corporation Ltd:** Held that an auditor cannot blindly accept the statements of the officials of a company if there are circumstances which call for enquiry.
4. **Armitage v/s Brewer and Knott:** The auditors were held liable for negligence for not discovering the defalcations (misappropriations) amounting to pound sterling 1400. The defalcations consisted of fraudulent alternations of time sheets and petty cash vouchers. The client had specifically requested for a detailed audit as a protection against his staff.
5. **Tri-Sure India Ltd. v/s A.F. Ferguson and Co.:** This case is important as it supports the view that an auditor is a watchdog and not a bloodhound. It supports the practise of sample checking where internal controls are found to be satisfactory.

Damages Arising out of Negligence

Auditor is liable to pay compensation only if the client or the third party has actually suffered any loss due to the auditor's negligence. The principles of awarding damages have been laid down by the Court in the leading case of Hadley v/s Baxendale. These principles of damages have also been enunciated in Section 73 of the Indian Contract Act.

LIABILITIES UNDER COMPANIES ACT

Under the Companies Act, an auditor attracts both civil and criminal liabilities. The Act holds an auditor liable for negligence (A) as an 'officer' (B) or for misfeasance.

As An Officer

1. **Fraud in or since Formation of Company:** The Court has powers to summon and order public examination of officers of the company including the auditor on receiving a report from the liquidator of a company being wound up about any fraud in the promotion or formation of the company or since its formation (S.477 and 478).
2. **Falsification of Books:** Section 539 of the Companies Act deals with criminal liability for falsification of books. It states. If any officer (including an auditor) of a company which is being wound up, with an intent to deceive:
 - (a) Destroys, mutilates, alters, falsifies or conceals any books, papers or securities, or
 - (b) Makes any false or fraudulent entry in any register, book of account or document belonging to the company; he shall be imprisoned for a term upto 7 years and be liable to a fine (S. 621).
3. **False Statement:** Under Section 628, if an auditor makes any statement in any return, report, certificate, balance sheet, prospectus, statement or other document required under the Companies Act, which is false in any material particular knowing it to be false or which omits any material fact knowing it to be material, he shall be imprisoned for a term upto two years and shall also be liable to fine.
4. **Default in Making/Signing Auditors Report:** Section 233 lays down penalty for noncompliance with Sections 227 and 229. Thus, in case of wilful default in making the

report or authenticating or signing a document, the auditor shall be punishable with fine upto ₹ 1000.

5. **Relief By Court:** Under Section 633, the Court can grant relief to an officer of a Company, including an auditor if it is convinced that though the officer concerned may be liable under above Sections, he had acted honestly and reasonably and in view of the circumstances of the case he ought to be excused from the charges made against him.
6. **No Exemption or Indemnity:** Under Sections 201, a provision in the articles or in an agreement or in any other instrument seeking to exempt or indemnify the auditor of the company against any civil or criminal liability for negligence, etc., shall be void. However, where the court acquits him or grants him relief under Sections 633, the company may indemnify the auditor against the expenses incurred by him in defending the case.

Civil Liability for Misfeasance

Under Section 543, the court can take the following action against an auditor for misfeasance i.e., breach of duty or breach of trust.

1. If during the winding up of a company, it appears that the auditor of the company – (a) has misused any money or property of the company; or (b) has been guilty of any misfeasance or breach of trust in relation to the company; the court may examine his conduct and compel him to repay the money with interest or pay compensation.
2. An application under sub-section (1) shall be made within five years from the date of the order for winding up. or of the first appointment of the liquidator in the winding up, or of the breach of trust, as the case may be, whichever is longer.
3. The Section shall apply notwithstanding that the matter is one for which the person concerned may be criminally liable (S. 545).

Legal Cases on Misfeasance

Some of the more important cases in which, suits were filed against the auditors for misfeasance under the Companies Act in the UK and in India are discussed below.

1. **Re. The London and General Bank Ltd.:** Held that an auditor must ascertain that the books of account show the true financial position of the company. Also he must clearly point out the grounds for his dissatisfaction in his report, if he is not satisfied with accounts of company. The Hon. Judge remarked that - “Such take to be the duty of the auditor; he must be honest, that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.”
2. **Re. The Kingston Cotton Mills Co. Ltd.:** Held that an auditor can rely upon the statements of trusted official of the company if there are no suspicious circumstances.
3. **The Irish Woollen Co. Ltd v/s Tyson and Others:** Held that an auditor is liable if dividends have been improperly paid out of capital due to such understatement of the liabilities of the company as could have been discovered by the exercise of reasonable skill and care.

4. **Re. The City Equitable Fire Insurance Co. Ltd.:** Held that an auditor should personally inspect the securities in the custody of a person or company with whom it is not proper that they should be left.
5. **Re. The Westminster Road Construction and Engineering Co. Ltd.:** Held that it is the duty of the auditor to ascertain the existence of outstanding liabilities for which bills are not received. He must also check the value of the work-in-progress, which is included in the balance sheet.

LIABILITIES FOR NEGLIGENCE OF ASSISTANTS

The auditor's liability for the negligence of his staff is as follows:

1. **The Statement on Auditing Practices 1:** Basic Principles governing an Audit (issued by the Institute of Chartered Accountant of India), states that, when the auditor delegates work to assistants - "He will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. However, the auditor should carefully direct, supervise and review work delegated to assistants. It is the responsibility of the auditor to ensure that his assistants are not negligent and that the audit is conducted with due care and skill."
2. **In Henry Squire (Cash Chemists Limited) v/s Ball Baker and Co.:** It was held that "the principal must not excuse himself for his clerk's negligence by saying that he employed clerk".
3. **Similarly, in Superintendent of Police v/s M. Rajamany** it was held that no auditor can escape from personal liability by taking cover under the misconduct of his own employees. The decision in this case also limits the extent to which an auditor may delegate his duties to his assistants. "Callousness and irresponsible abdication of his (auditor's) work can never be regarded as anything but misconduct..... An auditor who does not personally look into the accounts but merely delegates it to his assistants cannot be said to be acting with "due skill and care."

LIABILITY FOR RELYING ON WORK OF AN EXPERT [AAS 9]

According to AAS 9, an auditor is liable for relying on the work of an expert if:

1. Before asking for an expert's opinion, the auditor does not satisfy themselves about the skill and competence and objectivity of that expert.
2. The expert's work does not constitute appropriate audit evidence in support of the financial information.
3. The auditor fails to ascertain whether the expert has used source data which are appropriate in the circumstances.

LIABILITY FOR RELYING ON WORK OF ANOTHER AUDITOR [AAS 10]

According to AAS 10, an auditor is liable for relying on the work of another auditor if he fails to consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a Chartered Accountant.

RESPONSIBILITY OF JOINT AUDITORS [AAS 12]

1. Each joint auditor is responsible only for the work allocated to them, whether or not she/he has prepared a separate report on the work performed by them.
2. All the joint auditors are jointly and severally responsible in the respect of the audit work which is not divided amongst them for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute, for ensuring that the audit report complies with the requirements of the relevant statute and in respect of matters which are brought to the notice of the joint auditors by anyone of them and on which there is an agreement among the joint auditors.

LIABILITY FOR NON-COMPLIANCE WITH LAWS [AAS 21]

1. It is management's responsibility to ensure that the entity's operations are conducted in accordance with laws and regulations.
2. The auditor is not responsible for preventing non-compliance.
3. The auditor should recognise that non-compliance by the entity with laws and regulations may materially affect the financial statements. The auditor should plan and perform the audit recognizing that the audit may reveal conditions or events that would lead to questioning whether an entity is complying with laws and regulations. The auditor should obtain a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework. After obtaining general understanding, the auditor should perform procedures to identify instances of noncompliance with these laws and regulations where non-compliance should be considered when preparing financial statements. Further, the auditor should obtain sufficient appropriate audit evidence about compliance with those laws and regulations generally recognised by the auditor to have an effect on the- determination of material amounts and disclosures in financial statement.

Professional Negligence

Professional Negligence Consists of the Following three Elements

1. Exercise of Duty or Responsibility

A professional will be deemed to be negligent only if he owes some duty to another and failed to perform it. If the client through the action of the auditor incurs loss, his liability will be determined on the basis of the terms of engagement. However, when a third party incurs loss it is necessary to find out whether the auditor owed any duty to him. It is now a well-established contention to hold the auditor responsible for negligence in auditing the financial statements, to persons whom he knew or ought to have known, to rely on those statements.

2. Breach of duty

To charge a professional with breach of duty or negligence, it is necessary to prove deviation from established performance procedures and standards. Though the auditor does not guarantee success of his efforts, he should nevertheless exercise reasonable skill and judgment while discharging his duties.

3. Led to losses

The established rule of law is that there will be no damages without losses, the auditor will be liable to reimburse losses to the extent caused due to his negligence.

Liabilities Under Income Tax Act, 1961

A Chartered Accountant acts as an authorized representative of his clients and attends before the Income Tax Authorities or the Appellate Tribunal His liabilities as a representative under the Income Tax Act are given below:

1. Under Section 288

In the following cases a Chartered Accountant is prohibited from representing his Clients before the Income Tax Authorities:

- (i) he has been, convicted of any offence under the Income Tax Law; or
- (ii) he has been found guilty of professional misconduct by the ICAL

2. Under Section 278

Where a Chartered Accountant makes or induces any persons to deliver false documents, accounts or statements to the Income Tax Authorities, relating to income chargeable to tax which he knows to be false or does not believe to be true.

3. Under Rule 12

Under this rule a Chartered Accountant who as an authorized representative has prepared the return filed by the assessee, has to furnish to the Assessing Officer the particulars of accounts, statements and other documents supplied to him by the assessee for the preparation of the return. Where a Chartered Accountant has conducted an examination of such records, he has also to submit a report on the scope and results of such examination. If the report contains any false information, which the Chartered Accountant knows or believes to be false, he would be liable for imprisonment and a fine.

Civil Liabilities Under Companies Act, 1956

The civil action against the auditor may take the form of claim for damages on account of negligence in performance of duties or misfeasance proceeding.

1. Damages for Negligence

Action for damages can be brought against the auditor for:

- (i) Untrue statement given by him as an expert in the prospectus. The auditor will be able to avoid this liability if he
 - Withdrew his consent before delivery of the prospectus to the registrar; or

- After the registration of prospectus but before any allotment was made there under, has withdrawn his consent to it and given public notice of the withdrawal of consent; or
 - Was competent to make such statement and had reasonable ground to believe that his statements were true.
- (ii) Liability for damages may also arise in cases where a loss is suffered by the company or third party due to professional negligence on the part of the auditor.

2. Liability for Misfeasance

The term misfeasance implies breach of trust or duty. The auditor of a company can be held liable for misfeasance if he has been guilty of any breach of duties or negligence in performance of duties, which has resulted in some loss or damage to the company.

Criminal Liabilities Under Companies Act, 1956,

In the Following Cases Criminal Proceedings can be Instituted Against the Auditors

1. In case the auditor authorized the issuance of a prospectus containing an untrue statement. If, however, the auditor acting only as an expert gave an untrue statement, only civil proceedings can be instituted.
2. He can be held criminally liable if, with the intent to defraud or deceive any person, he
 - destroys, mutilates, alters, falsifies etc. any books, papers or securities of the company; or
 - of accounts or documents belonging to the company.
3. In case he, as a past or present auditor, has been held guilty of an offence in relation to the company.
4. In case the auditor in any return, certificate, prospectus or other documents required by or for the purpose of the act, makes a statement which
 - is false in any material particular, knowing it to be false; or
 - omits any material fact, knowing it to be material.

SPECIAL AUDIT

Audit of Educational Institutions: (School, College or University)

The special steps involved in their audit are the following:

1. Examine the Trust Deed Regulations in the case of School or College and note all the provisions affecting accounts. In the case of a University, refer to the Act of Legislature and the Regulation framed thereunder.
2. Read through the minutes of the meeting of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards to the operation of Bank accounts and sanctioning of expenditure.

3. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of Students on rolls and test amount of fees charged and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
4. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
5. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
6. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
7. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
8. Confirm that fines for late payment or absence, etc., have been either collected or deposited under proper authority.
9. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.
10. Verify rental income from landed property with the rent rolls, etc.
11. Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
12. Verify any Government or local authority grant with the memo of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.
13. Report any old heavy arrears on account of fees, dormitory rents, etc., to the Managing Committee.
14. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet not transferred to revenue, unless they are not refundable.
15. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
16. Verify that the Provident Fund money of the staff has been invested in appropriate securities.
17. Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
18. Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
19. Vouch in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. If there was any annual budget prepared, see that any excess under any head over the amount budget was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report.

20. See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
21. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
22. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Stock Register or corresponding inventories of the previous year and values applied to various items should be test checked.
23. Confirm that the refund of taxes deducted from the income from investment (interest on securities etc.) has been claimed and recovered since the institutions are generally exempted from payment of Income Tax.
24. Finally, verify the annual statements of account and while, doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.

Audit of Hospital

1. Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patient's attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills. counterfoils of dividend and other interest warrants, copies of patients bills, counterfoils of dividend and other interest warrants. copies of rent bills, etc.
3. See by reference to the property and investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities settled on the hospital has been collected.
4. Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. Trace all collections of subscriptions and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due as shown by the Subscription Register and the amount collected and that still outstanding).
6. Vouch all purposes and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointment and increments to staff have been duly authorised.
7. Verify that grants, if any, received from Government or local authority have been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee significant verifications which have taken place.

9. Examine the internal check as regards the receipt and issue of stores; medicines, lines, apparatus, clothing, instruments, etc., so as to ensure that purchases have been properly recorded in the Stock Register and that issues have been made only against proper authorization.
10. See that depreciation has been written off against all the appropriate rates.
11. Inspect the bonds; share scripts, title deeds of properties and compare their particulars with those entered in the property and investment Registers.
12. Obtain inventories, specially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.

Audit of Cinema

1. Verify:
 - (a) That entrance to the cinema-hall during show is only through printed tickets;
 - (b) That they are serially numbered and bound into books;
 - (c) That the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
 - (d) That for advance booking a separate series of tickets is issued; and
 - (e) That the stock of tickets is kept in the custody of a responsible official
2. Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
3. Verify that a record is kept of the 'free passes' and that these are issued proper by authority.
4. Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.
5. Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different show on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.
6. Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.
7. Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalised except the expenditure on extensive redecoration, and that should be adjusted as deferred revenue expenditure.
8. Confirm that depreciation on machinery and furniture has been charged at appropriate rates which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.
9. Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
10. Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an

advance was paid has already run, It should be enquire as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.

11. The arrangement for collection of the share in restaurant income should be enquired into either a fixed percentage of the taking may be receivable annually. In case the restaurant is run by the Cinemas its accounts should be checked. The audit should cover sale of various items of foodstuffs. purchase of foodstuffs, cold drink, cigarettes, etc., as in the case of club.

Audit of Hotels

There are many problems involved in any hotel audit, some of which are peculiar to the hotel industry such as control of cash assume greater proportions.

Almost all sales points in a hotel make both cash and credit sales. The auditor should reconcile the total sales reported with the total of the bills issued by the sales point; this total may take the form of a bill roll or a series of numerically controlled bills. This numerical control must be checked to ensure that all bill are included in the total. The cash element of the sales must then be checked to the cash records and the credit sales in total and detail to the guest's bills.

The special problems in a hotel audit can be summarised as follows:

1. **Internal Controls:** Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be over stressed. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

If the internal control in a hotel perhaps breaks down, then a very serious problem exists for the auditor. As a result, the scope of his audit tests will necessarily be increased and. in the event of a material margin discrepancy being unexplained he will have to consider qualifying his audit report.

2. **Room Sales:** The charge for room sales is normally posted to guest bills by the receptionist or in the case of large hotels by the auditor. The source of these entries is invariably the guest are charged for the correct period. Any difference between the charge rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorised.

In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.

3. **Stocks:** The stocks in any hotel are both readily portable and saleable particularly the, food and beverage stocks. It is therefore extremely important that all movements and transfers of such stocks should be properly documented to enable control to be exercised over each

individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

Areas where large quantities of stock are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores areas except under constant supervision. In particular, any movement of goods in or out of the stores should be checked, it is not unknown for a full crate to be removed in error as an empty crate.

Many hotels use specialised professional valuers to take and value the stocks on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet stock figure at the year end. Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such stocks are reasonable. In order to satisfy himself of this the auditor should consider attending at the physical stock taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

4. **Fixed Assets:** The accounting policies for fixed assets of individual hotels are likely to differ. However, many hotels account for certain quasi-fixed assets such as silver and cutlery on stock basis. This can lead to confusion between each stock items and similar assets which are accounted for on a more normal fixed assets basis. In such cases it is important that very detailed definitions of stock items exist and the auditor should carry out tests to ensure that the definitions have been closely followed.
5. **Casual Points:** The hotel trade operates to very large extent of casual labour. The records maintained of such wage payments are frequently inadequate. The auditor should ensure that defalcation on this account does not take place by suggesting proper controls to the management.
6. **Other Points:**
 - (a) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
 - (b) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.
 - (c) The auditor should ensure that proper control for booking of halls and other premises for special parties and recovered on the basis of the tariff.
 - (d) The auditor should verify a few restaurant bills by reference to K.O.Ts (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.
 - (e) The auditor should see that costs of renovation and redecoration are treated as deferred revenue expenditure, where as costs of major alterations and additions to the hotel building and facilities capitalized.
 - (f) The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.

- (g) The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities.
- (h) In large hotels it is usual to operate a booth to facilitate conversion of foreign currencies to Indian rupees. The auditor should ensure compliance with the various applicable provisions of Foreign Exchange Regulation Act, 1973 and the rules framed by Foreign Exchange Dealers Association.

Compulsory Tax Audit

Section 44AB of the Income Tax Act provides for compulsory audit of accounts of certain persons. Accordingly, every assessee whose total sales, turnover or gross receipts for the previous year exceeds or exceeds 1 crore in the case of a business, or the gross receipts for the previous year exceed 25 lakh in the case of a profession, has to get his accounts audited. An assessee covered by the provisions of Sections 44AD, 44AE, 44AF, 44BB, or 44BBB would also have to get an audit conducted under this Sections, if he claims that his income is lower than the presumptive income deemed under this Section.

The provisions relating to tax audit seek to ensure that the books of account and other records of the assessee are properly maintained and that the revenue authorities are provided with audited financial statements along with the relevant data and information for assessment.

On the bass of the interpretation of terms in the earlier pronouncement, ICAI has expressed the following views.

1. Sales include the sale of by-product, scrap. etc., even though such sales are credited to 'Miscellaneous Income'.
2. Sales should be net of trade discounts, turnover discount, goods returned and price adjustment.
3. Commission allowed to third parties, cash discount otherwise than that allowed in a cash memo or sales invoice, bad debts written off, royalty, etc., should not be adjusted against sales and should be debited separately to the profit and loss account.
4. The treatment of extra ancillary charges such as packing, freight. forwarding. etc., would depend on the pricing policy followed by the assessee. If the assessee makes a composite charge which includes extra and ancillary charges, these should not be deducted from sales. If, however, such charges are shown separately in the invoices and are accounted for separately as reimbursement of costs, they should not be added to sales.
5. Sale proceeds of fixed assets or of property or shares/securities/debentures held as investments (and not as stock-in-trade) do not form a part of sales/turnover.
6. Sales by a commission agent or by a person who has received goods on consignment basis, should be treated as sales of such a person only if all significant risks and rewards of ownership of goods had been transferred to him immediately before the transfer of such goods by him to the buyer. Normally, transfer of risks and rewards of ownership of goods is the result of transfer of property in goods. If the property in the goods continues to belong to the principal at the time of sale, the sale would form part of the sales of the principal and not of the agent. To whom the property in goods belongs at the time of sale is a matter to be determined by examining the facts of a case.

7. As far as the issue of inclusion of excise duty or sales tax is concerned, ICAI's Statement on the Companies (Auditor's Report) Order, 2003 states that if excise duty or sales tax collected is credited separately to the Excise Duty Account or the Sales Tax Account, it should not be included in turnover. Thus, the treatment of excise duty or sales tax depends on the accounting practice usually followed. It may however be noted that the provisions of Section 145A of the Income Tax Act, 1961 clearly require that the valuation of purchase, sales and inventories should include any tax, duty, cess or fee. In view of this, it would seem proper to include excise duty and sales tax in sales for the purpose of Section 44AB also.

Gross Receipts in Business/Profession

The term includes "all receipts whether in cash or in kind arising from carrying on of business which will normally be assessable as business income under the Income Tax law". Thus, profit on sale of import licence, cash incentives for exports, duty drawback claims (other than those relating to fixed assets), liquidated damages, insurance claims, interest received by a money lender, commission and other charges in the business of chit funds, gross receipts from lease rents in the case of leasing business will be included in the term 'gross receipts'. Where reimbursements of expenses incurred on packing, forwarding, freight, insurance and traveling, etc., are credited to a separate account only the net surplus should be so included; otherwise, the total receipts on this account should be considered.

Examples of items which do not form part of gross receipts in business include sale proceeds of fixed assets or investments, rental income (unless it is assessed as business income), dividends on shares (except in the case of a dealer in shares), income from interest (unless assessed as business income).

Where the assessee is merely reimbursed for certain expenses incurred on behalf of the client, such moneys are not to be included, e.g., where a travel agent recovers the cost of the airline tickets from his clients. If, however, a travel agent arranges a group tour and charges a package price to cover the cost and his margin of profit, the entire amount should be included in his gross receipts. Similarly, in the case of an advertising agent, reimbursement of advertising costs received from clients will not be included, but if he books the advertisement space in bulk and then sells the space to his clients, the entire billing will be included in his gross receipts.

In the case of a professional, moneys received as reimbursement of expenses incurred or to be incurred on behalf of the client do not form part of his gross receipts, provided these are credited to a separate account and are utilized strictly for meeting the expenses incurred on behalf of the client. If, however, out-of-pocket expenses are not separately collected and accounted for but are included in the total fee, the whole of the fee forms part of gross receipts. Amounts received as advance, for which services are yet to be rendered, are not a part of gross receipts.

Persons Covered

A person who is wholly outside the purview of the Income Tax Act (e.g., an agriculturist) need not get his accounts audited for the purposes of Section 44AB (even though the total sales of agricultural produce exceed ₹ 60 lakh. However, persons who are covered by the Income Tax Act, but whose income is otherwise exempt under the said Act, are required to get their accounts audited. Thus, a charitable trust, a research association or a cooperative society carrying on business will have to get its accounts audited if its sales, turnover or gross receipts in business exceed ₹ 60 lakh even where its

income is exempt under the Income tax Act. Similarly, even if the income of a person, who is otherwise covered by the Act, is below the taxable limit, he has to get his accounts audited in case the limits specified in Section 44AB are exceeded. A nonresident assessee is also required to get the accounts of his Indian operations audited, if his global business sales/turnover/gross receipts exceed the specified limits.

The guidance note of ICAI suggests that in determining the applicability of Section 44AB to an assessee, the total sales, turnover or gross receipts should be taken as per the accounts maintained by the assessee. In case the Assessing Officer, at the time of the assessment, estimates the total sales, turnover or gross receipts at a figure higher than the prescribed limit whereas the books of accounts show a figure lower than the limit, he has to pass an order under Section 142(2A) directing the assessee to get his accounts audited in case he finds it necessary to do so. It cannot be deemed in such a situation that the assessee has contravened the provisions of Section 44AB.

Certain Incomes not Covered

The provisions of Section 44AB will not be applicable in the case of a person who derives income of the nature referred to in Sections 44B or 44BBA to be a accordingly which income from certain businesses is taxed on presumptive basis. i.e., under the head 'profits and gains of business or profession' is presumed certain percentage of the gross receipts, sales, etc., Similarly those provisions apply to business covered under Sections 44AD, 44AE, 44AF, 44BB or 44BBB assessee is entitled to be assessed on presumptive taxation basis in respect above businesses.

Specified Date

The accounts have to be got audited and the audit report furnished authorities by an assessee by Sept 30

Penalty

Under Section 271B, if a person fails to get his accounts audited as required Section 44AB or to furnish the report of such audit, a sum equal to 0.5% of sales, turnover or gross receipts. as the case may be or a sum of ₹ 1,00,000, whichever is less, can be levied as penalty. However, if the assessee can show had a reasonable cause due to which he could not get his accounts audited, no penalty would be levied in view of the provisions of Section 273B. Some of the cause which tribunals/courts have affirmed as 'Reasonable' are: delay due to resignation of auditor bona fide interpretation of what constitutes 'Turnover' based on expert advice death/physical disability of partner in charge of accounts, prolonged strike/lockout, fire/theft, seizure of accounts by authorities, natural calamities, and commotion.

Appointment of Tax Auditor

It has been opined that though the definition of the term 'accountant, Income Tax Act, refers to a Chartered Accountant, tax audit can also be conducted by a firm of Chartered Accountants, since this has been a recognized practice under the Income Tax Act. However, the name of the partner who signs the audit report of the firm should be stated. In all cases, the member signing the audit report give his membership number below his name.

Any Chartered Accountant in practice can perform tax audit, Thus, in the case of companies, the tax audit can be conducted by the statutory auditor or by a Chartered Accountant in practice. Where a statutory auditor has not been appointed or where the report of the statutory auditor is not available, the tax auditor should conduct the financial audit also and give his report regarding whether the financial statements give a true and fair view apart from certifying the relevant particulars for the purposes of Section 44AB. Before accepting the assignment, the Chartered Accountant should communicate with the auditor who conducted the tax audit in the previous year (as per the requirements of the Chartered Accountant Act). It would be a healthy tradition if communication is also made with the statutory auditor.

The appointment of the tax auditor can be made by the management of the entity. Thus, in the case of a company, the board of director or the officer so authorized by it can appoint the tax auditor. Similarly, a partner of a firm, a proprietor or any other authorized person can appoint the tax auditor. It is necessary that the auditor issues a letter of engagement and obtain the assessee's confirmation thereon so as to avoid any misunderstanding in future. The letter of engagement should specify clearly that the auditor shall conduct the audit as required under 'Section 44AB of the Income Tax Act. The letter should also states that the auditor shall have the right of access to the books of account, records and other documents and that he shall have the right to seek information and explanation. This is necessary since Section 44AB does not specify the powers of the auditor. It would also be useful if the letter affirms that no other auditor was appointed to conduct the tax audit for the year for which the appointment is being made. The letter may also give the name and address of the tax auditor for the previous year, wherever relevant. This would give the necessary information to the incoming tax auditor to enable him to communicate with the previous auditor. The letter of engagement should also specify the remuneration of the tax auditor (which is fixed and paid by the assessee).

An employee of an assessee or of a concern under the same management cannot be appointed as the auditor. Further, it will be necessary for Chartered Accountant to disclose his interest in his audit report relating to a concern, if he and or his relatives/partner/firm have a substantial interest therein. As per a resolution of the Council of ICAI, a Chartered Accountant who has written the books of account of the assessee should not audit such accounts. However, a Chartered Accountant in practice who renders tax consultancy or internal audit services on a professional fee basis (not as an employee) can conduct tax audit.

In the case of a company, compliance with Section 314 would necessary where the remuneration exceeds the prescribed limit.

Where accounts of an assessee are required to be audited under any other law, it would be sufficient if the audit report as required under such other law is furnished along with a further report by a Chartered Accountant in the prescribed form (i.e., Form 3CA with Form 3CA annexed thereto).

Removal of Tax Auditor

Though in the normal course, an auditor should not be removed during the tenure of his appointment, the management can remove a tax auditor if there are valid grounds for such removal, e.g., there is an unreasonable delay in the submission of the audit report. However, in case there is an unjustified removal of an auditor, he can refer the matter to a special committee of ICAI which looks into complaints of unjustified removal. ICAI has also suggested that no Chartered Accountant should accept an audit assignment, if the removal of his predecessor is not on valid grounds.

Ceiling on Tax Audit Assignments

ICAI has notified that Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments under Section 44AB of the Income Tax Act, 1961. The specified number of tax audit assignments has been defined as 45 tax audit assignments in a financial year. In the case of a firm of Chartered Accountant, the specified number of 45 tax audit assignments is to be counted for every partner of the of firm. In case a partner of the firm is also a partner in other firm(s), the number of all tax audit assignments which may be taken by all the firms in relation to such partner together with any assignments held by such Chartered Accountant in his individual capacity should not exceed the aggregate of 45 tax audit assignments in a financial year.

The following may be noted in this regard.

1. Each year's tax audit is to be counted as a separate assignment.
2. The notification does not distinguish between corporate and non-corporate assessee.
3. Where a tax audit assignment is conducted jointly by two or more firms, it will be counted as one assignment by each of them.
4. The tax audit of the head office and of the same concern should be counted as one tax assignment.
5. The audit of one or more branches of the same concern should be construed as one tax audit assignment.
6. The limit does not include audit of accounts of persons carrying on business covered by Section 44AD or 44AE or 44AF where the person claims that his income is lower than the deemed income under these Sections.
7. Every Chartered Accountant in practice is required to maintain a record of the tax audit assignments accepted by him in each financial year in the prescribed format.

Remuneration

ICAI has recommended that Chartered Accountants should charge reasonable fees depending upon the work involved and taking into consideration the responsibility involved in tax audit assignment. It has further advised that auditors should maintain reasonable standards of professional fees. In this regard, it may be noted that ICAI's prescribed minimum audit fee limits which have to be charged by specified categories of firms of Chartered Accountants do not apply to an audit under Income Tax Act when it is conducted by the statutory auditor. However, these limits apply if tax audit is conducted by a Chartered Accountant or firm of Chartered Accountants other than the statutory auditor.

Audit Report

In his audit report, the tax auditor is required to express his opinion as to:

- (a) Whether or not the financial statements give a true and fair view of the profit or loss and the state of affairs; and
- (b) Whether or not the prescribed particulars contained in the statement annexed to the audit report are true and correct.

Rule 6G of the Income Tax Rules prescribes the formats in which the auditor has to submit his audit report. The applicability of the various formats is as below.

1. In the case of a person who carries on business or profession and who is required under any other law to get his accounts audited, the tax auditor has to give his report in Form 3CA and the annex with the audit report a statement of particulars in Form 3CD. In Form 3CA, the tax auditor refers to the fact that the statutory audit of the assessee was conducted under some other law and annexes a copy of the report of the aforesaid audit along with the audited financial statements. The tax auditor also gives a statement of particulars in Form 3CD. ICAI has recommended that in such a situation, where the statutory auditor has not been appointed, the tax auditor may conduct the financial audit also and give his report in Form 3CB with the relevant particulars being certified in Form 3CD. Similarly, in the case of companies whose accounting year for company law purposes ends on any date other than 31st March, the accounts for the purpose of tax audit should be prepared as on 31st March, and the audit report should be in Form 3CB.
2. In the case of the person who carries on business but whose accounts are not audited under any other law, the tax auditor has to give report in Form 3CB and annex thereto a statement of particulars in Form 3CD. The audit report in Form 3CB is quite similar to that given under the Companies Act.

In the case of assessee whose accounts are not audited under any other law, the auditor should ensure that the financial statements are drawn up properly in a format as near to the format recommended by the ICAI as the circumstances admit.

The text of Form 3CA and 3CB is given in the Annexure to this chapter. The various clauses of Form 3CD are given in the following Section of this chapter together with an analysis of their retirement.

The following discussion regarding the various clauses of Form 3CD is on the basis of the ICAI's guidance note on the subject except that changes in the law since the publication of the guidance note have been given, it has been so stated.

The auditor should satisfy that where equity shares are in partly paid form, these partly paid instruments have been included as equity share equivalents to the extent to which they carry rights at the end of the period to participate in dividends relative to a fully paid-up equity share.

(a) Return on net worth

Return on net worth is computed by using, the following formula:

$$\frac{\text{Net profit before extraordinary items} \\ \text{but after adjusted tax}^*}{\text{Net worth excluding revaluation reserves} \\ \text{as at the end of the year}} \times 100$$

* Adjusted Tax means the provision for the period after adjusting for the tax attributable to extraordinary items.

(b) Net asset value – (NAV) per share

The auditor should check that the net asset value has been calculated as per the latest audited balance sheet date. NAV can be computed either by the *net assets method* or by the *net equity method*.

Under the former, from the *total assets* of the company all liabilities and *preference capital*, if any, *are deducted*. The net asset value as calculated from the assets side of the balance sheet in the above manner can be *cross-checked* by calculating the same by net equity method, whereby equity share capital is added to reserves and surplus, deducting there from miscellaneous expenditure to the extent not written off and the debit balance of profit and loss account to the extent not adjusted against reserves and surplus.

The following points *interalia* should be particularly kept in *view* by the *auditor* while examining the computations of the NAV whether on Net Asset Basis or Net Equity Basis.

- Intangible assets like goodwill, patents, trademarks, copyrights, etc., *have not been* taken into account
- Revaluation of assets, if any, has not been taken into account.
- Arrears of preference shares dividend have been provided for.

CEILING ON NUMBER OF AUDITS

It has been mentioned earlier that before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding company audit by the auditor concerned over the limit laid down in section 224(18).

No company or its Board of Directors shall appoint or re-appoint any person or firm as its auditors if such person or firm is at the date of such appointment or re-appointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies. The Companies Act, 2013 has further specified that no company or its Board of Directors shall appoint or re-appoint an individual or a firm (includes LLP) who is in full employment elsewhere. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits of which not more than 30 should be in companies having paid up capital of ₹ 100 crores or more. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

Section 139 further amplifies the manner of identifying the audit units for calculating the specified number. Under this explanation, when an auditor is appointed to audit even a part of a company's accounts, the part will be considered as a unit of audit for the purpose of calculation of the ceiling. Often, nowadays, one comes across what is known as joint audit – when two or more auditors are appointed to audit the account of a company. Each of the joint auditor is considered a part auditor for the purpose. Any joint audit held by an auditor will be included as one audit unit for the purpose of calculating the ceiling of audits. However, audit of a branch of company is not included in the computation of the ceiling. Similarly, audit of corporations which are not companies and foreign companies are also not to be included.

AUDIT OF BRANCH OFFICE\ACCOUNTS

The accounts of the branch office of a company are required to be audited either by the company's auditor appointed under Section 139 or by a person qualified for appointment as contemplated by Section 141 or, where the branch office is situated in a foreign country, either by the company's auditor or by a person qualified as aforementioned or by an accountant duly qualified to act as an auditor in accordance with the laws of that foreign country [Section 143].

In case they are audited by a person other than the company's auditor, the latter would have a right to visit branch office, if necessary, and also to have access at all times to the books and accounts and vouchers maintained at the branch office except in the case of a banking company having foreign branch office, in which case it would be sufficient if the auditor of the company is allowed access to such copies of and extracts from the books and accounts of the branch as have been transmitted to the head office in India [Section 143) and proviso therein].

A company may at general meeting decide whether it shall have accounts of its branch office audited by a person other than the company's auditor. Upon such a decision being taken, the company may either appoint a person who may be a person qualified under section 141 or, in the case of a foreign branch a person qualified according to the laws of that country to audit the accounts of the branch or authorise the Board of Directors to appoint such an auditor in consultation with the company's auditor. The auditor so appointed in either case will have the same powers and duties as the statutory auditor and will be paid such remuneration as the company in general meeting or the Board may fix. It will be the duty of the branch auditor to prepare a report on the accounts of the branch office examined by him and to forward the same to the company's auditor who shall, while preparing his report deal with the same in such manner as he considers necessary [Section 143].

JOINT AUDIT

When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India have dealt with these issues in SA-299 on using the work of another Auditor the Statement on Responsibility of Joint Auditors.

To prevent any hardship, the Central Government has been empowered to make rules so as to exempt branch offices from audit to extent as is specified in the Rules [Section 143].

These rules are summarised below:

1. Exemption based on quantum of activity: If a company, carrying on any manufacturing, processing or trading activity, has a branch office whose average; of the, 'quantum of activity' i.e., (i) the aggregate value of the goods and articles produced, manufactured or processed, or (ii) the aggregate value of the goods or articles sold and of service rendered, or (iii) the amount of the expenditure, whether of a revenue or capital nature, incurred by a branch office of a company during a financial year, (i.e., the financial year of the company in respect of which exemption 'from branch audit is to be determined) does not exceed ₹ 2 lakhs or 2% of the average pf the total turnover of the company including all its branches and other offices and the earnings from services rendered and from

any source during the same period, whichever is higher, the branch office shall be exempted from the provisions of section 143, It may be noted that in any such case, the auditors of the company shall have the rights referred to in section 145 relating to the audit of accounts of the branch office. For this exemption, there is no necessity to make any application,

2. Grant of exemption in certain other cases: When an application for exemption is made to the Central Government, it may, after making the necessary inquiry, exempt the branch office from the provisions of audit in section 143 on anyone of the following grounds, viz.

- (i) that the company carrying on activities other than those of manufacturing or processing, or trading, has made satisfactory arrangements for the security and check, at regular intervals, of the accounts of the branch office by a responsible person competent to scrutinise and check the accounts;
- (ii) that the company has made arrangements for the audit of the accounts of the branch office by a person otherwise qualified for appointment as branch auditors, even though such a person is an employee of the company;
- (iii) that having regard to the nature and the quantum of activity carried on at the branch office or for any other reason a branch auditor is not likely to be available at a reasonable cost; and
- (iv) that, for any other reason, the Central Government is satisfied that exemption may be granted.

A copy of the Central Government's order or exemption is required to be forwarded to the company which shall forthwith send a copy thereof to the auditor of the company and shall also cause it to be read before the next general meeting (Rule 4).

3. Condition of exemption in certain cases: In every case in which an exemption is granted on the ground referred to in clause (ii) of the foregoing paragraph, the company shall afford such a person access, at all the times, to the books, accounts and vouchers maintained at the branch office and also shall furnish him with such information and explanation as he may require. Such a person, during the period of exemption, is required to prepare in respect of each financial year, a report on the accounts of the branch office examined by him, as well as, to forward the same to the company's auditor. A certificate to the effect that no material change had taken place in the arrangements made for the audit of the accounts of the branch office shall have to be attached to the balance sheet for each financial year. Such a certificate shall be signed by the manager or secretary of the company and by two directors, one of whom shall be managing director where there is one (Rule 6).

SPECIAL AUDIT

Section 147 empowers the Central Government, in certain cases, to call for a 'special audit'. Such an audit may be required where the Central Government has reasons to believe:

- (i) that the affairs of the company are not being managed on sound business principles or according to prudent commercial practices; or
- (ii) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
- (iii) that the financial position of the company is such as might endanger its solvency.

Such an audit aims at providing the Government with a critical appreciation of the company and its financial position.

The audit may be conducted either by the company's auditor or another chartered accountant who may or may not be engaged in a practice, appointed by the Central Government [Section 147].

The auditor so appointed has the same powers and duties in the matter of special audit as the statutory auditor of a company has under section 143, except for the fact that he must report to the Central Government in place of the members of the company.

The special auditor's report must include, as far as may be practicable, all the matters required to be included in a normal auditor's report under section 143 and where the Central Government so directs, also a statement on any matters which may be referred to him by that Government.

With a view to facilitating the work of the auditor the Central Government may serve an order to furnish to him all such information as he may be in need of non-compliance with such an order of the government subsection (12) shall render the defaulter punishable with a fine which shall not be less than one lakh rupees and may extend to 25 lakhs.

On receipt of the report, the Central Government may take such action as circumstances might warrant, according to the provisions of the Act or any other law for the time being in force. In case, the Central Government does not take any action within four months from the receipt of the report, It must send the report to the company either to circulate the copy or the extracts among the members or to get it read before the company at its next general meeting.

The expenses of or incidental to a special audit, including the remuneration of the special auditor as fixed by the Central Government (and its decision in this regard is final), must be paid by the company. If the company defaults in making the payment, the amount can be recovered from the company as arrears of land revenue.

ADDITIONAL OBJECTIVE QUESTIONS

A. State whether following statements are True or False

1. If the Auditor is not satisfied with the records he can call for the explanation on any accounting matters.
2. Auditor has no lien on working papers.
3. Auditor has right to take legal and technical advice.
4. Auditor has to sign Audit Report.
5. Auditor is liable for negligence.
6. Auditor is liable for misstatement in the prospectus.
7. Educational institutions are governed by Co. Op. Societies Act, 1960.
8. Governing body of educational institutional institutions take decisions about the day to day functioning.
9. Bills raised for fees should tally with the fee collection register.
10. Donations can be verified on the basis of counterfoils of receipts.

11. Security deposits received from the students can be verified on the basis of collection register.
12. In the case of hotels, room sales collection can be verified with the guest register.
13. Service tax collected by hotels has to be verified with the copies of challans and Bank Statement.
14. Restaurant bills can be verified from the KOT.
15. Cost of renovation to be considered as deferred revenue expenditure as per AS26.
16. Patients attendance records should be verified with reference to bills prepared.
17. Entrance to Cinema Hall during show is through the printed tickets only.
18. Separate series of tickets need not be maintained for advance booking.
19. Stock of tickets need not be in the custody of the responsible officer.
20. Free passes need not be recorded as they are free.
21. Entertainment tax collected need not be deposited with the Government.
22. Expenditure on advertising should not be capitalized.
23. Donations received by the hospital should be verified from donation register.+
24. Section 44 AB provides for compulsory tax audit.
25. Any person can be appointed as a Tax Auditor.
26. Tax Auditor has to be a Chartered Accountant.
27. Letter of appointment must be obtained from the assessee.
28. Tax Audit Report is to be submitted to the shareholders.
29. Turnover limit for tax audit is ₹ 40 lakhs.
30. A professional whose gross receipts are less than ₹ 10,00,000 must go for tax audit.
31. Selective tax audit can be directed by the AO.
32. The Tax Audit Report should be submitted in Form 6B.

True: 1, 3, 4, 5, 6, 8, 9, 10, 11, 12, 13, 14, 16, 17, 23, 24, 26, 27, 29, 31, 32

False: 2, 7, 15, 18, 19, 20, 21, 22, 25, 28, 30

B. Match the following

	Group A		Group B
a	Audit report	i.	To receive remuneration
b	Right	ii.	Submitted to shareholders
c	Audit report	iii.	Shareholders
d	Removal of subsequent auditor	iv.	Fixed by shareholders
e	Remuneration	v.	Submitted to shareholders

Ans: a (v), b (i), c (ii), d (iii), e (iv)

	Group A		Group B
a	Trust deed	i.	Lease deed
b	Bills raised for fees	ii.	Utilisation certificate
c	Donations	iii.	Collection register
d	Receipt of rent	iv.	Prize fund
e	Utilisation of grants	v.	Counterfoils foils of receipts
f	Refund of security deposits	vi.	Fees collection register
		vii.	Educational institutions

Ans: a (vii), b (vi), c (v), d (i), e (ii), f (iii)

	Group A		Group B
a	Room Sales	i.	Cost of renovation not treated as deferred revenue expenditure
b	Daily occupancy reports	ii.	FEMA Act
c	Luxury Tax	iii.	KOT
d	Restaurant Bills	iv.	Tax Challan
e	AS 26	v.	Guest Bill
f	Foreign currencies	vi.	Guest Register

Ans: a (vi), b (v), c (iv), d (iii), e (i), f (ii)

	Group A		Group B
a	Entrance to Cinema Hall	i.	Reconciled with tickets sold
b	Advance booking	ii.	AS-26
c	Free passes	iii.	Issued under proper authority
d	Expenditure on redecoration	iv.	A separate series of tickets
e	Entertainment tax collected	v.	Printed tickets
		vi.	Deposited with the Government

Ans: a (v), b (iv), c (iii), d (ii), e (vi)

	Group A		Group B
a	Accountant	i.	A chartered Accountant
b	Tax Audit has to be	ii.	Section 44 AB
c	Compulsory tax audit	iii.	₹ 40,00,000
d	Turnover Limit	iv.	₹ 10,00,000
e	Gross Receipts	v.	Chartered Accountant

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

C. Fill in the blanks with proper word

1. The audit working papers are the property of _____.
2. The audit report should be signed by _____.

3. Retiring auditor can make _____ representation.
4. Audit fees should be disclosed in _____ A/c.
5. Rights & duties of an auditor of a _____ company are governed by Companies Act, 1956.
6. Auditor has right to receive _____ remuneration.
7. Auditor has right to receive _____ of the general meeting.
8. Remuneration for services other than the _____ can be given to the auditor.
9. The details of audit fees should be given in the _____ A/c.
10. The auditor has a right to receive _____ of the general meeting of the company.
11. The duty of the auditor is not restricted to verify the _____ of accounts.
12. The duty of the auditor is to make audit report and submit it to the _____.
13. Auditor should carry out the work as per the _____ standard.
14. _____ is application for educational institutions.
15. _____ contains rules and regulations of educational institutions.
16. Bills raised for fees are compared with _____.
17. Donations are verified from _____ of receipts.
18. Receipt of rent is verified from _____ deed.
19. Corpus is verified with the _____.
20. Refund of security, deposit from students is verified from _____.
21. Room sales collection is verified from _____.
22. Restaurant bills are required with reference to _____.
23. A hotel has to deposit _____ tax with the respective authorities.
24. Cost of renovation is not treated as _____.
25. As _____ governs redecoration cost of a hotel.
26. Conversion of foreign currencies to Indian rupees is governed by _____.
27. Bills to patients are verified from _____ register.
28. Subscriptions are visited from _____ register.
29. Physical existence of assets is verified from _____.
30. Entrance to Cinema Hall is given through _____.
31. _____ are issued under proper authority.
32. A Cinema House has to collect _____.
33. Collection from advertising charges is verified from the register of _____.
34. Payment to distributors is verified from _____.
35. Annexure – I is divided into part _____ and part _____.
36. Part B of annexure gives information about _____ parameters.
37. Annexure – II is relating to _____.

38. Annexure – II does not require _____ signature of the tax auditor.
39. Annexure – II is divided into _____ sub-columns.
40. Tax Audit is compulsory for a professional whose gross receipts are exceeding _____ in any previous year.
41. Deduction under section 80 HHS is _____.
42. The assessee has to submit the Audit Report within _____ days from the date of receipts of direction.
43. Section has prescribed the form of Tax Audit Report.

Ans: 1. The Auditor, 2. The Auditor, 3. Written, 4. P & L A/c, 5. Limited, 6. Reasonable, 7. Notice, 8. Audit work, 9. P & L A/c, 10. Notice, 11. Accuracy, 12. Shareholders, 13. Professional, 14. Societies Registrations Act, 1860, 15. Trust Deed, 16. Collection Register, 17. Counterfoil of Receipts, 18. Lease, 19. Audited Statement, 20. Collection Register, 21. Guest Register, 22. KOT, 23. Entertainment Tax, 24. Deferred Revenue Expenditure, 25. AS 26, 26. FEMA, 27. Patient Attendance Record, 28. Subscription, 29. Inspection, 30. Printed Tickets, 31. Free Passes, 32. Entertainment Tax, 33. Slides, 34. Agreement with Distributors, 35. A, B, 36. 16, 37. Fringe benefits, 38. Separate, 39. Five, 40. ₹ 10,00,000, 41. 50%, 42. 180 days, 43. 44B.

Multiple Choice questions

D. Select the most appropriate answer from the following:

1. The audit working papers are the property of

(a) Board directors	(b) Shareholders
(c) Auditor	(d) CEO
2. The auditor has to inform the register about his acceptance within

(a) 30 days	(b) 10 days,
(c) 21 days	(d) 20 days
3. CAG stands for

(a) Controller & Auditor General	(b) Control Audit General
(c) Control of AGM	(d) None of the above
4. First duty of the auditor is to

(a) Verify	(b) Investigate,
(c) To detect fraud,	(d) None of the above
5. The person to act as a watchdog is

(a) Auditor	(b) Accountant,
(c) Shareholder	(d) None of the above
6. Branch auditor can be

(a) Shareholder	(b) Board of Director
(c) Auditor u/s 224	(d) Any one

7. The auditor must be a
 - (a) Director
 - (b) CA,
 - (c) ICWAI,
 - (d) ICS
8. The right of the auditor is to
 - (a) Access books of accounts
 - (b) Attend general meeting,
 - (c) A & B
 - (d) None
9. The persons responsible for appointment of statutory auditor are
 - (a) Directors
 - (b) Shareholders,
 - (c) Government of Maharashtra
 - (d) None of the above
10. The auditor has a right to
 - (a) obtain information & explanation
 - (b) obtain information from employees
 - (c) obtain information & explanation from employees and officers of the company
 - (d) None of the above
11. Statutory auditor can be
 - (a) A chartered accountant
 - (b) A firm of chartered Accountants,
 - (c) A company of chartered accountants
 - (d) A & B
12. The Act governing the educational institutions is
 - (a) Societies Registrations Act, 1860
 - (b) Co. Op. Societies Act, 1960
 - (c) Companies Act, 1956
 - (d) Banking Companies Act, 1949
13. The Rules & Regulations of educational institutions are given in
 - (a) Trust deed
 - (b) Partnership deed
 - (c) Sale deed
 - (d) Purchase deed
14. Bills raised for fees are compared with
 - (a) Students Collection Register
 - (b) Students Attendance Register
 - (c) Grants Register
 - (d) Donation Register
15. Donations are verified from
 - (a) Donation Register
 - (b) Counterfoils of Receipts
 - (c) Grants Register
 - (d) Scholarship Register
16. Rent is verified from
 - (a) Rent Register
 - (b) Lease Deed
 - (c) Occupation Register
 - (d) None of the above
17. Corpus of educational institutions is verified on the basis of
 - (a) Bank Statement
 - (b) Audited statement
 - (c) Balance Sheet
 - (d) P & L A/c.
18. Refund of Security Deposit from students is verified from
 - (a) Acknowledgment from students
 - (b) Collection Register
 - (c) Fees Register
 - (d) Attendance Register

-
19. Room Sales collection is verified from
- (a) Room Register
 - (b) Guest Register
 - (c) Restaurant Register
 - (d) Donation Register
20. Restaurant bills are verified from
- (a) Restaurant Register
 - (b) Visitors Register
 - (c) Kitchen order tickets
 - (d) Room Register
21. A Hotel has to deposit with respective authorities
- (a) Luxury tax
 - (b) Sales tax
 - (c) Income tax
 - (d) Wealth tax
22. Cost of renovation by a hotel is not treated as
- (a) Revenues Expenditure
 - (b) Deferred Revenue Expenditure
 - (c) Capital Expenditure
 - (d) None of the above
23. The AS which governs re-decoration cost of a hotel is
- (a) AS 3
 - (b) AS 4
 - (c) AS 26
 - (d) AS 29
24. Conversion of foreign currency to Indian rupee is governed by
- (a) Competition Act
 - (b) FEMA Act
 - (c) Companies Act
 - (d) Income Tax Act
25. Bills to patients are verified from
- (a) Patients Attendance Records
 - (b) Bills Register
 - (c) General Ledger
 - (d) Journal
26. Subscriptions are verified from
- (a) Donation Register
 - (b) Subscription Register
 - (c) Sales Register
 - (d) Grants Register
27. Physical existence of assets is verified from
- (a) Documentation
 - (b) Personal inspection
 - (c) Certificate from the management
 - (d) Asset Register
28. Entrance to Cinema Hall is given through
- (a) Gate passes
 - (b) Printed ticket
 - (c) Letter from the manager
 - (d) pan cards
29. Under authority the Cinema house issues.
- (a) Free passes
 - (b) Paid passes
 - (c) Gate passes
 - (d) Free coupons
30. A Cinema house has to collect
- (a) Income tax
 - (b) Sales tax
 - (c) Entertainment tax
 - (d) VAT

31. Collection for advertising charge is verified from
 (a) Register of clients (b) Register of slides
 (c) Advertisement Register (d) None of the above
32. Payment to Distributors is verified from
 (a) Sales register (b) Agreement with distributors
 (c) Distribution register (d) None of the above
33. An Accountant means a
 (a) CA (b) M. Com.,
 (c) ICWA (d) CS
34. The Chartered Accountant's Act was passed in
 (a) 1948 (b) 1949
 (c) 1935 (d) 1985
35. A Tax Auditor has to be
 (a) a C.S., (b) CA,
 (c) ICWA (d) M. Com
36. Letter of appointment must be obtained by the tax auditor from
 (a) MD (b) Government
 (c) Assessee (d) Individual
37. The tax auditor has to submit the report to
 (a) The shareholders (b) Board of directors
 (c) the assessee (d) Chairman of the company
38. Tax Audit is made compulsory under section
 (a) 44 DD (b) 44AB
 (c) 45 (d) 49 of the Income Tax Act.
39. The limit of gross receipt for audit of a professional is
 (a) ₹ 15,00,000, (b) ₹ 20,00,000,
 (c) ₹ 10,00,000, (d) ₹ 25,00,000
40. The limit of turnover for tax audit for a person carrying business is
 (a) ₹ 45 lakhs (b) ₹ 40 lakhs
 (c) ₹ 20 lakhs (d) ₹ 50 lakhs.
41. Selective tax audit is provided by section.
 (a) 142 (b) 142 (2A)
 (c) 145 (d) 146

Ans: 1. (c), 2. (a), 3. (a), 4. (a), 5. (a), 6. (c), 7. (b), 8. (c), 9. (b), 10. (c), 11. (d), 12. (a), 13. (a), 14. (a), 15. (b), 16. (b), 17. (b), 18. (a), 19. (b), 20. (c), 21. (a), 22. (b), 23. (c), 24. (b), 25. (a), 26. (b), 27. (b), 28. (b), 29. (a), 30. (c), 31. (b), 32. (b), 33. (a), 34. (d), 35. (b), 36. (c), 37. (c), 38. (b), 39. (c), 40. (b), 41. (b).

Theory Questions:

Explain the following:

1. Duty of auditors
2. Right of auditors
3. Liabilities of auditor.
4. How would you conduct audit of hospitals?
5. How would you conduct audit of hotels?
6. How would you conduct audit of schools?
7. How would you conduct audit of cinema theater?
8. Explain Tax Audit under section 44 AB?



Audit Report

SA 700 (AAS 28) THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Introduction

1. The purpose of this Standard on Auditing (SA) is to establish standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity.
2. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements.
3. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements.
4. The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole.
5. The auditor's report includes the following basic elements, ordinarily, in the following layout:
 - (a) Title;
 - (b) Addressee;
 - (c) Opening or introductory paragraph
 - (i) identification of the financial statements audited;
 - (ii) a statement of the responsibility of the entity's management and the responsibility of the auditor;
 - (d) Scope paragraph (describing the nature of an audit)
 - (i) a reference to the auditing standards generally accepted in India;
 - (ii) a description of the work performed by the auditor;
 - (e) Opinion paragraph containing
 - (i) a reference to the financial reporting framework used to prepare the financial statements; and
 - (ii) an expression of opinion on the financial statements;

- (f) Date of the report;
- (g) Place of signature; and
- (h) Auditor's signature.

A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur.

6. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report. In such a case, the auditor should incorporate in his audit report, the matters specified by the statute or regulator and/or report in the form prescribed by them in addition to the requirements of this SA.
7. The auditor's report should have an appropriate title. It may be appropriate to use the term "Auditor's Report" in the title to distinguish the auditor's report from reports that might be issued by others, such as by the officers of the entity, the board of directors, or from the reports of others.
8. The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the auditor's report is addressed to the authority appointing the auditor.
9. The report should include a statement that the financial statements are the responsibility of the entity's management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.
10. Financial statements are the representations of management. The preparation of such statements requires management to make significant accounting estimates and judgments, as well as to determine the appropriate accounting principles and methods used in preparation of the financial statements. In contrast, the auditor's responsibility is to audit these financial statements in order to express an opinion thereon.
11. An illustration of these matters in an opening (introductory) paragraph is: "We have audited the attached Balance Sheet of.....(Name of the entity) as at 31st March 2XXX and also the Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these financial statements based on our audit."
12. "Scope" refers to the auditor's ability to perform audit procedures deemed necessary in the circumstances. Standard on Auditing (SA) 200A, "Objective and Scope of the Audit of Financial Statements", with regard to the determination of the "scope" states.
"The scope of an audit of financial statements will be determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute."
13. The Auditing and Assurance Standards issued by the Institute of Chartered Accountants of India establish the auditing standards generally accepted in India.

14. The report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement.
15. The auditor's report should describe the audit as including:
 - (a) examining, on a test basis, evidence to support the amounts and disclosures in financial statements;
 - (b) assessing the accounting principles used in the preparation of the financial statements;
 - (c) assessing the significant estimates made by management in the preparation of the financial statements; and
 - (d) Evaluating the overall financial statement presentation.
16. The report should include a statement by the auditor that the audit provides a reasonable basis for his opinion.
17. An illustration of these matters in a scope paragraph is:

We conducted our audit in accordance with the auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.”
18. The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and, where appropriate, whether the financial statements comply with the statutory requirements.
19. An illustration of these matters in an opinion paragraph is: “In our opinion and to the best of our information and according to the explanations given to us, the financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:
 - (a) in the case of the Balance Sheet, of the state of affairs of the (name of the entity) as at 31st March 2XXX; and
 - (b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date.”
20. In addition to an opinion on the true and fair view, the auditor's report may need to include an opinion as to whether the financial statements comply with other requirements specified by relevant statutes or law. For example, in the case of companies incorporated under the Companies Act, 1956, Section 227(2) of the said Act requires that the auditor's report should state in his audit report, whether in the auditor's opinion and to the best of his information and according to the explanations given to the auditor, the financial statements give the information required by the Companies Act, 1956, in the manner so required.
21. The date of an auditor's report on the financial statements is the date on which the auditor signs the report expressing an opinion on the financial statements. The date of report

informs the reader that the auditor has considered the effect on the financial statements and on the report of the events and transactions of which the auditor became aware and that occurred up to that dated.

22. Since the auditor's responsibility is to report on the financial statements as prepared and presented by management, the auditor should not date the report earlier than the date on which the financial statements are signed or approved by management.
23. The report should name specific location, which is ordinarily the city where the audit report is signed.
24. The report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report should be signed in the personal name of the auditor and in the name of the audit firm.

The partner/proprietor signing the audit report should also mention the membership number assigned by the Institute of Chartered Accountants of India.

25. *An unqualified opinion* should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements. An unqualified opinion also indicates that:
 - (a) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
 - (b) the financial statements comply with relevant statutory requirements and regulations; and
 - (c) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.
26. An auditor may not be able to express an unqualified opinion when either of the following circumstances exists and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:
 - (a) there is a limitation on the scope of the auditor's work; or
 - (b) there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.
27. *A qualified opinion* should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the matter to which the qualification relates.
28. *A disclaimer of opinion* should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the financial statements.

29. *An adverse opinion* should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.
30. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates.
31. A limitation on the scope of the auditor's work may sometimes be imposed by the entity, for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary. However, when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists; the auditor should ordinarily not accept such a limited engagement as an audit engagement, unless required by statute. Also, a statutory auditor should not accept such an audit engagement when the limitation infringes on the auditor's statutory duties.
32. A scope limitation may be imposed by circumstances, for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories. It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.
33. When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.
34. The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements. If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.
35. This Standard on Auditing becomes operative for all audits relating to accounting periods beginning on or after 1st April 2003.

QUALIFICATION IN AUDITORS REPORT

The Statement on qualification in Auditors Report issued by the Institute of Chartered Accounts of India (ICAI), deals with various aspects of a qualified report. 1. When the quality: Audit Report is qualified in the following cases:

1. **Unable to obtain information:** Auditor qualifies his report when he has not been able to obtain information or explanation regarding any material item necessary for the audit.
2. **Non-proper book:** Auditor may qualify his report when the books of account are not maintained properly.
3. **Not agreeing with books:** Auditor may qualify his report when the final accounts do not tally with the books of account e.g., when the trial balance does not tally.
4. **Non-disclosure of Prescribed Information:** Auditor may qualify his report when an item required to be disclosed in the account, by law is not disclosed e.g., director's remuneration.
5. **Wrong Accounting Policies:** Auditor should qualify his report, if the accounts are based on wrong accounting policies and practices. Most qualifications belong to this category for examples:
 - (a) Wrong method of depreciation
 - (b) Wrong method of stock valuation
 - (c) Wrong method of converting foreign exchange transactions in rupees.
 - (d) Debiting goodwill to profit and loss account.
 - (e) Wrong method of valuation of investments.
 - (f) Wrong method of taking credit for income from contacts.
 - (g) Wrong method of valuation of fixed assets.
 - (h) Treatment of contingent liabilities as actual liabilities or *vice versa* and so on.
6. **Breach of Companies Act:** Auditor should qualify his report, if the company has violated any provision of the Companies Act. For example if...
 - (a) Investments of the company are not held in its own name (Section 49)
 - (b) Tax free payments are made (Section 200)
 - (c) Dividend is paid without complying with the provision of section 205
 - (d) Unpaid dividend is not transferred to a special bank account.
 - (e) Restrictions regarding political contributions are disregarded
 - (f) Loans/investments exceed the prescribed percentages.
 - (g) Remuneration to directors is in violation provisions.

Contravention of Memorandum/Articles of Company

Auditor should qualify his report if the transactions do not conform to the provisions of the Memorandum and Articles of Association of the company. E.g., if investments are not sanctioned by the object clause of the memorandum.

Even in the above cases, a qualified report may not be normally necessary, unless the matter involved are material. Thus, if the difference in trial balance is only ₹ 1,000 in a ₹ 10 crore turnover company, auditor need not qualify his report on the ground that the books do not tally.

However, in case in item required to be specifically disclosed in accounts, for example remuneration to directors, is not disclosed auditor should qualify even if the item is not material.

However on the other hand the matter should not be so material as to affect the true and fair view. Thus, if the auditor is unable to obtain any information since all the records are destroyed in a fire, he should give a "No Opinion" Report rather than a qualified report. When to qualify and when to give a negative opinion is a matter of judgement and experience.

Where to Mention Qualification

1. **Qualification not in notes to accounts:** The qualification should appear in the audit report itself, and not in the notes to accounts. Notes to account contain explanations of items appearing, in the final accounts. Notes are given by the company and should not contain auditor's should opinion. However, if any note to accounts contains a qualification, auditor should reproduce the note his audit report. This enables the reader of the audit report to know the importance of the qualification.
2. **Qualification not in separate report to directors:** Similarly, the qualifications should appear in the auditors report to the share holder, and not in a separate report sent only to the directors. He cannot, in his report to the shareholder, state that the report should be read subject to the qualifications contained in his separate report to the directors. It is wrong since, the shareholders do not have access to his report to the directors containing the qualification. Auditors report to the shareholders should be self-contained and include call qualifications.
3. **No Referring Back to previous Reports:** Further, auditor should not qualify by reference to a report made in an earlier made in an earlier year. The current years report should be self contained, because not all the shareholders may have access to old reports. Thus, auditor should not state- "the position in respect of loan to XYZ remains the same, as explained in our report for the last year". He should reproduce in the current year's report the exact qualification made in the last year's report.

How to Qualify

1. **Reasons for qualification to be given:** Sec. 227(4) of the Companies Act states that a qualified report must state the reasons for such qualification. Thus auditor cannot just qualify his report with out giving reasons to justify the qualifications.
2. **Clear and precise:** Auditor must state the qualifications in a clear and precise manner. They should be made in an unambiguous manner so as not leave any room for doubt. Auditor must give all the information. In the "London and General Bank" case it has been laid down that auditor should provided information and not "means to information". He should not create more grounds for subscription and expert the readers to make further inquires. Thus a qualification that debtors are subject to realized merely creates grounds for suspicion that they may be some bad debts and expects the reader to make future inquires instead, auditor should clearly state that "Debt amounting to ₹... are doubtful because..." In case of a company, the qualification should be printed in italics or bold font as laid down in Sec. 227 (3) (e) of the companies Act.
3. **Standard Terms:** Auditor should, while making a qualification, use standard terms which clearly imply a qualification. Qualification is always made by using terms such as "Subject to" or "except that". Auditor should not use terms like "read with notes thereon" or together with notes thereto." These terms are explanatory and do not indicate any qualification. The

use of subject to indicate that auditor has reservations about the matters stated. It implies that auditor objects to certain items in the accounts.

4. **Computer effects on profits:** Auditor should compute, in terms of rupees, the effect of the qualification on the profit or loss for the year. Thus, if the report is qualified for providing excess depreciation, auditor should state – “Depreciation debited to the profit and loss account exceeds the amount of depreciation computed according to the provision of Companies Act and Schedule XIV thereto by ₹ 1,00,000. This has resulted in profit being understated by ₹ 1,00,000. Subject to the above, we report that the accounts give a true and fair view...” In case it is not possible to make exact computations the auditor should check the estimates made by the management and give as much information as possible.

Examples:

It is not possible to give an exhaustive list of all types of Qualifications which may be made.

Following are the some qualifications normally made in an audit report:

1. **Unable to obtain information:**

“Due to destruction of old fixed assets registers, it is possible to ascertain precisely the opening written down value of and the profit on some items of assets sold during the current year. Subject to the above, we report that...”

2. **No Proper books:**

“Due to seizure of the stock book by the Excise department, the stock entries have been checked with the photocopy of the stock register certified as true by the excise department and the management. Subject to the above, we report that...”

3. **Not Agreeing with books:**

“The balance of Delhi Branch in the Head Office Books does not agree with the corresponding balance in the books of Delhi Branch to the extent of ₹ 1,00,000 subject to the above, we report that...”

4. **Non-disclosure of Prescribed information:**

“The fees paid to directors, required to be disclosed separately vide Schedule VI to the companies Act. Have been ground under “Miscellaneous Expenses” in the profit and loss account. Subject to the above, we report that...”

5. **Wrong Accounting Policies:**

- (a) “Goods on consignment have been treated as outright sales by the company, and contrary to recognized accounting practice, the entire profit on such sales has been credited to the profit and loss account. The profit as a result as been overstated by ₹... subject to the above, we report that...”

- (b) “Preliminary Expenses incurred during the year have been entirely debited to the profit and loss account. This is contrary to recognized accounting practices. This has resulted in profit being understand by ₹... subject to the above, we report that...”

6. **Breach of Companies Act:**

“Donations have been made to a charitable trust in excess of the limits prescribed in section 293(1) (c) of the Companies Act, to the extent ₹...”

7. Contravention of Memorandum/Articles of Company:

“Investment made by the company are ultra virus of its memorandum of association, as there is no specific power therein to make such investment and such power cannot be implied from the objects contained in its objects clause. Subject to the above, we report that...”

DISTINCTION BETWEEN AUDIT REPORT AND CERTIFICATE

We have so far discussed that the auditor has to submit report to the company. But it is essential to know the term REPORT. It is used where an expression of opinion is involved. While the term CERTIFICATE is preferred where the auditor *comments* on or *verifies* facts such as verification of investment by inspection or the checking of ballot papers on a poll in a company meeting under the Companies Act, 2013 a number of situations are there, where an auditor is required to issue a certificate rather than a report. As per section 26(b) matters to be specified in prospectus and reports to be set out therein of the Companies Act, 2013, an auditor is required to certify the statements of accounts for that part of the five years ending on a date immediately preceding the financial year of the issue of prospectus. However, the report under section 143 of the Companies Act is an OPINION based Report and is *not a certificate*.

There are various certificates are required to be given by a Chartered Accountant as below:

1. **Certificate of duty exemption entitlement:** The requirement of this certificate lies in the need of an assurance of a correct and complete disclosure of the *exports* and *imports* made by the exporter
2. **Promoter's contribution certificate:** A certificate from the CA/company secretary in practice, to that effect that the promoter's contribution including premium in its entirety has been brought in advance before the public issue opens should be forwarded to SEBI at least one day prior to the date of opening of the issue.
3. **Certificate towards application:** For grant of Export/Trading Star/Trading House as per Export-Import Handbook.
4. **Audit certificate by statutory auditor:** On the cash flow statement for requirement of listing with stock exchange.
5. Auditor's certificate regarding profit forecast.
6. Special purpose audit certificates.
7. Auditor's certificate pursuant to Companies (Acceptance of Deposits) Rules 2014.
8. Certificate on unaudited accounts.

ADDITIONAL OBJECTIVE QUESTIONS

A. State whether following statements are True or False

1. Auditors is an expert in Accounts.
2. Audit Report must be factual.
3. Audit Report should be biased.

4. There is no difference in Audit Report and Audit Certificate.
5. As 28 provides for audit report.
6. Audit Report is qualified when important books are maintained.
7. Audit Report need not be qualified even if wrong method of depreciation is followed.
8. A company limited by shares has to hold a Statutory Meeting.
9. The Auditor has to express his opinion about the books of accounts.

True: 1, 2, 5, 8, 9

False: 3, 4, 6, 7.

B. Match the following

	Group A		Group B
a	Audit Report	i.	Whether financial statements comply with legal requirements
b	Section 227 (2)	ii.	Modified Report
c	Opinion Paragraph	iii.	Report to the members
d	SA 700	iv.	Qualified opinion
e	Qualified Report	v.	Addressed to the members

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

C. Fill in the blanks with proper word

1. _____ is a statement of collected and considered facts about the accounts.
2. _____ is an instrument through which the auditor express his opinion.
3. Audit Report should not be _____.
4. Audit Report is in the nature of _____.
5. The scope of Audit Report is _____ than the scope of Audit Certificate.
6. _____ provides for Audit Report.
7. Audit Report is addressed to the _____.
8. The Report must be _____ by the Auditor.
9. The report which says that financial statements company with GAAP is an _____ Report.

Ans: 1. Audit Report, 2. Audit Report, 3. biased, 4. Verification, 5. wide, 6. As 28, 7. members, 8. signed, 9. unqualified.

Multiple Choice questions

D. Select the most appropriate answer from the following:

1. Scope of audit is communicated to the client in

(a) Audit Report	(b) Engagement letter
(c) Representation letter	(d) Annual Report

2. The auditor has to give a statement of fact u/s 227 (3) on
 - (a) Proper book of accounts
 - (b) Accounting standards
 - (c) Less payable
 - (d) None of the above.
3. The date of Audit Report should not be
 - (a) Date of AGM
 - (b) Date of approval of accounts,
 - (c) Both (a) & (b)
 - (d) None of the above
4. The client changed the method of depreciation. It is disclosed as a note. It has immaterial effect on current financial statement. Which opinion should the auditor express?
 - (a) Unqualified opinion
 - (b) Qualified opinion
 - (c) Disclaimer of opinion
 - (d) Adverse opinion
5. Under CARO 2003, the auditor is not required to report on
 - (a) Arrears of preference dividend
 - (b) Preferential allotment of shares to related party
 - (c) Disposal fixed assets
 - (d) Unsecured loans granted to related party.
6. Auditor Report is given in prescribed format as per
 - (a) AAS 28
 - (b) AAS 27
 - (c) AAS 21
 - (d) None of the above.
7. A good report must be
 - (a) Factual
 - (b) Unbiased
 - (c) Convincing
 - (d) All of the above
8. The Report which expresses that financial statements are as per GAAP is
 - (a) Qualified
 - (b) Unqualified
 - (c) Modified
 - (d) Adverse.
9. Audit Report is qualified when
 - (a) Wrong method of depreciation is followed
 - (b) Company law is violated,
 - (c) The auditor is unable to obtain information
 - (d) All of the above.

Ans: 1. (b), 2. (c), 3. (b), 4. (a), 5. (a), 6. (a), 7. (d), 8. (b), 9. (d).

Theory Questions

Explain the following

1. Audit report.
2. Types of audit opinion.
3. Qualifications in audit report.
4. Report v/s Certificate.



Audit under Computerized Information System Environment

SPECIAL ASPECTS OF CIS AUDIT ENVIRONMENT

The overall objective and scope of an audit does not change in a CIS environment. However, the use of a computer changes the processing, storage, retrieval and communication of financial information and may affect the accounting and internal control systems employed by the entity.

Accordingly, a CIS environment may affect:

- the procedures followed by the auditor in obtaining a sufficient understanding of the accounting and internal control system.
- the auditor's evaluation of inherent risk and control risk through which the auditor assesses the audit risk.
- the auditor's design and performance of tests of control and substantive procedures appropriate to meet the audit objective.

The auditor should consider the effect of a CIS environment on the audit.

The auditor should evaluate, inter alia, the following factors to determine the effect of CIS environment on the audit:

- (a) the extent to which the CIS environment is used to record, compile and analyse accounting information;
- (b) the system of internal control in existence in the entity with regard to:
 - (i) flow of authorised, correct and complete data to the processing center;
 - (ii) processing, analysis and reporting tasks undertaken in the installation; and
- (c) the impact of computer-based accounting system on the audit trail that could otherwise be expected to exist in an entirely manual system

AUDIT SKILL AND COMPETENCY

Skill and Competence

Auditor should have sufficient knowledge of CIS to plan, direct, supervise and review work performed. The auditor needs:

1. Obtain sufficient understanding of the accounting and internal control affected by the CIS environment

2. Determine the effect of CIS on the procedures to assess the audit risk
3. Able to design and perform appropriate test of control and substantive test
4. If required, auditor may seek for assistance of the expert.

In addition, according to The IIA's International Standards for the Professional Practice of Internal Auditing (Standards) — specifically Standards 1220 and 1210.A3 — internal auditors need to apply the care and skill of a reasonably prudent and competent auditor, as well as have the necessary knowledge of key IT risks, controls, and audit techniques to perform their assigned work, although not all internal auditors are expected to have the expertise of an auditor whose primary responsibility is IT.

NEED FOR REVIEW OF INTERNAL CONTROL ESPECIALLY PROCEDURE CONTROLS AND FACILITY CONTROLS

Internal controls in a computer environment

The two main categories are application controls and general controls.

Application controls

These are manual or automated procedures that typically operate at a business process level and apply to the processing of transactions by individual applications. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records.

Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data. These controls help ensure that transactions occurred, are authorised and are completely and accurately recorded and processed (ISA 315 (Redrafted)).

Application controls apply to data processing tasks such as sales, purchases and wages procedures and are normally divided into the following categories:

(i) Input controls

Examples include batch control totals and document counts, as well as manual scrutiny of documents to ensure they have been authorised. An example of the operation of batch controls using accounting software would be the checking of a manually produced figure for the total gross value of purchase invoices against that produced on screen when the batch-processing option is used to input the invoices. This total could also be printed out to confirm the totals agree.

The most common example of programmed controls over the accuracy and completeness of input are edit (data validation) checks when the software checks that data fields included on transactions by performing:

- reasonableness check, eg net wage to gross wage
- existence check, eg that a supplier account exists
- character check, eg that there are no alphabetical characters in a sales invoice number field
- range check, eg no employee's weekly wage is more than \$2,000
- check digit, eg an extra character added to the account reference field on a purchase invoice to detect mistakes such as transposition errors during input.

When data is input via a keyboard, the software will often display a screen message if any of the above checks reveal an anomaly, eg 'Supplier account number does not exist'.

(ii) Processing controls

An example of a programmed control over processing is a run-to-run control. The totals from one processing run, plus the input totals from the second processing, should equal the result from the second processing run. For instance, the beginning balances on the receivables ledger plus the sales invoices (processing run 1) less the cheques received (processing run 2) should equal the closing balances on the receivable ledger.

(iii) Output controls

Batch processing matches input to output, and is therefore also a control over processing and output. Other examples of output controls include the controlled resubmission of rejected transactions, or the review of exception reports (eg the wages exception report showing employees being paid more than \$1,000).

(iv) Master files and standing data controls

Examples include one-for-one checking of changes to master files, eg customer price changes are checked to an authorised list. A regular printout of master files such as the wages master file could be forwarded monthly to the personnel department to ensure employees listed have personnel records.

General controls

These are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, mini-frame and end-user environments. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:

- data centre and network operations
- system software acquisition, change and maintenance
- program change
- access security
- application system acquisition, development, and maintenance (ISA 315 (Redrafted))

'End-user environment' refers to the situation in which the users of the computer systems are involved in all stages of the development of the system.

(i) Administrative controls

Controls over 'data centre and network operations' and 'access security' include those that:

- prevent or detect errors during program execution, eg procedure manuals, job scheduling, training and supervision; all these prevent errors such as using wrong data files or wrong versions of production programs
- prevent unauthorised amendments to data files, eg authorisation of jobs prior to processing, back up and physical protection of files and access controls such as passwords

- ensure the continuity of operations, eg testing of back - up procedures, protection against fire and floods.

(ii) System development controls

The other general controls referred to in ISA 315 cover the areas of system software acquisition development and maintenance; program change; and application system acquisition, development and maintenance.

‘System software’ refers to the operating system, database management systems and other software that increases the efficiency of processing. Application software refers to particular applications such as sales or wages. The controls over the development and maintenance of both types of software are similar and include:

- Controls over application development, such as good standards over the system design and program writing, good documentation, testing procedures (eg use of test data to identify program code errors, pilot running and parallel running of old and new systems), as well as segregation of duties so that operators are not involved in program development
- Controls over program changes – to ensure no unauthorised amendments and that changes are adequately tested, eg password protection of programs, comparison of production programs to controlled copies and approval of changes by users
- Controls over installation and maintenance of system software – many of the controls mentioned above are relevant, eg authorisation of changes, good documentation, access controls and segregation of duties.

APPROACH TO AUDIT IN CIS ENVIRONMENT

An audit trail allows auditors to investigate errors that they have discovered in more detail. Ideally the audit trail should make it possible to trace all the reports and other information terms that have been affected by the error, and to trace the cause of the error.

1. Audit around the computer

- (a) performed by examining and reconciling the input to the computer with the output from it.
- (b) concept means that auditors bypasses the computer and treat it as a giant bookkeeping machine.
- (c) This technique is used when the audit trail is complete, computer processing operations are straightforward and system documentation is complete and readily available.
- (d) The disadvantages
 - (i) auditor cannot determine how all transactions will be handed by computer programs
 - (ii) costly and time consuming to provide printouts for audit purposes where no ready audit trail exists
 - (iii) not adequate for use in advanced and sophisticated computer system

2. Audit through the computer

- (a) focuses on the computer and its programs directly in the audit. E.g. submits data for processing and analyse results to determine the processing reliability and accuracy of the computer program.
- (b) on-line data entry, system designed with elimination or reduction of printouts and real-time updating.
- (c) forced to adopted if there is an inability to locate the source documents or printouts.

3. Auditing with the computer

- (a) use the computer and its programs as a tool of the auditor, e.g. putting computers to work footing subsidiary ledgers on magnetic tape or disk, calculating amounts such as depreciation, comparing the contents of two files and computing the required ratios for analysis purpose.
- (b) Some public accounting firms have developed generalized audit software to perform the tasks.

COMPUTER ASSISTED AUDIT TECHNIQUES (CAAT)

CAAT's are computer programs and data that the auditor uses as part of the audit procedures to process data of audit significance contained in a client computer information system (CIS)

Types of CAAT

1. **Audit software:** comprises computer programs used for audit purposes to process data audit significance from the client accounting system.

It is used by the auditor to examine the entity computer files and may be used during both test of control and substantive testing of transactions and balances as the program can scrutinize large volume of data and extract information, leaving skilled manual resources to concentrate upon the investigation of the results.

Types of audit programs are

- Generalized packaged programs: however they need to be tailored to each specific case by defining the format of the files to be interrogated by specifying the parameters required and the form of that output.
- Purpose written programs: these are specially written programs where it is not possible to adapt a package program because of the type of machine, processing or file organization used.
- Utility programs used by the client: used by the entity to perform data processing functions such as sorting and printing of files e.g. excel.

The uses of audit software are

- **Calculation checks:** e.g. program gives the total amount of individual entries in purchases day book in a particular period. Auditor then agree this total amount to the amount posted in purchases ledger control a/c.
- **Detecting system violation rule:** e.g. program checks that no customer has balance above specified credit limit.
- **Detecting unreasonable items:** programs checks that no customer has discount of 50% or sales ledger balance (i.e. debtors balance) is more than the amount of sales made to that customer.
- **New calculation and analysis:** e.g. statistical analysis of inventory movements to identify slow moving items.
- **Selecting items for audit testing:** e.g. obtaining a stratified sample of sales ledger balances to be used as a basis for a circularization of debtors.

Test data

Audit test data is data submitted by the auditor for processing by the clients computer based accounting system in order to test the operation of the enterprise's computer programs.

It may be processed during a normal production run (running test data live) or during a special run at a point in time outside the normal cycle (running the test data dead).

Test data could be held in the form of a batch of documents that is captured into the system to test both the manual and computer controls (applications and programmed controls).

There are three main approaches to the use of test data:

- Using live data: process client real live data and then check that the controls and processing are OK.
- Dummy data in a normal production run: however output of dummy data processing should not be released in the live database general ledger.
- Dummy data in a special run: dummy data is run back up/ image copy of database.

Difficulties in using audit test data

- **Cost:** for constructing test data, predetermine the results manually and ascertaining which controls to be tested.
- **Confined to test of control only.**
- **Live testing is dangerous** as it may affect live database is used for special run.
- **No visible evidence of audit work performed:** need to record in the working papers of work done.

Advantages of CAAT to the auditor

- Test programmed controls: in a computer based accounting system, there are large volume of transactions which the auditor will have to audit. The auditor will have to check if the

programmed controls are functioning correctly. The only effective way of testing programmed controls is through CAAT.

- Test on large volume of data: CAAT enable auditors to test large amount of data quickly and accurately and therefore increase the confidence they have in their opinion.
- Test on source location of data: CAAT enables auditors to test the accounting systems and its records (e.g. disk files) at its source location rather than testing the printouts of what they believe to be a copy of those records.
- Cost effective: once set up CAAT are likely to be cost effective way of obtaining audit evidence year after year provided that the client does not change the accounting system regularly.
- Comparison: allows results from using CAAT to be compared to traditional testing. Where the two results agree this increase the overall audit confidence.
- Completeness checks: e.g. checking continuity of sales invoices to ensure that they are all accounted for.

USE OF COMPUTER FOR INTERNAL AND MANAGEMENT AUDIT PURPOSES

The whole internal control environment may change from those in a manual setting. The nature of the audit evidence changes when information is a manual setting. The nature of the audit evidence changes when information is readable only by electronic means. The use of computer assisted audit techniques may result in the performance of audit tests by the computer which were previously done manually. In addition, these techniques may enable the auditor to carry out audit procedures that were hitherto impracticable. As new systems are acquired or developed he can determine whether data can be accumulated and stored in a manner that will facilitate later audit. Through maximum utilization of computer assisted audit techniques, the internal auditor may not only improve the quality of audits, but also sharpen his capabilities to perform special reviews for management thus provide better service.

Requirements for a computer audit program system

Prior to selecting a computer audit package, a review should be made of the generalized computer audit program systems that have been developed by other organizations. No single software package may satisfy all the requirements of every audit group or assignment. The following are some characteristics of an effective system.

1. Simplicity
2. Understandability
3. Adaptability
4. Vendor technical support
5. Statistical sampling capability
6. Acceptability
7. Processing Capabilities
8. Report writing.

Mechanics of Use: If data of audit interest are processed on a computer, the auditor should be on the lookout for methods of using the computer to audit such data. The capabilities of most computer audit packages open up new opportunities to use the computer to fulfill audit responsibilities. The use of the computer is especially desirable when there is a large volume of data and the data are readily available from the computer files. The auditor determines the identity and content of all potentially useful files early to his audit, and obtains a copy of the data layout for each record written on those files.

Once the auditor has recognized the availability of computer file of interest in the audit, he considers methods for using a computer audit package, it is important to understand how the computers audit package work. Basically, the package has the capability of listing those records which match other records in the same file or in different files. One or more data fields designated by the auditor are compared. Record layouts of the two files can be different, except for the fields to be matched. The computer audit package can also print account details and totals for records defined by the auditor.

In addition, the audit package is capable of performing various calculations and solution of formulae. Special programs can be used for any computational task required. Sampling plans can be developed and the results of sampling tests evaluated and projected. In addition, the computer using its comparison capability, can select all or a sample of records having the characteristics stated by the auditor. Multiple sets of characteristics can be designated for a single application. For each stratum, statistics are provided on the number of records on the input file, the number of records selected, and the sum of designated fields. Each stratum may be sampled or printed in its entirety.

Applications: There are various areas in internal auditing for use of audit software packages. Once the techniques are mastered, the applications to computer files are performed manually and determine the feasibility of applying computer techniques. Another approach is to include special computer routines in the normal, everyday processing. An example is in the review of cheques disbursements. As transactions are processed, the computer can automatically select a sample, or print out expenditures in excess of a specified amount by classification. The following are some application for potential use by internal auditors.

1. **Inventories:** The use of computer software packages in reviews of inventories results in significant savings of audit staff time and elimination of detailed checking of voluminous data manually. In testing a perpetual inventory, a statistical sample can be taken by the computer of inventory parts, stratified as to high and low values. Counts summarized and tabulated by quantity, rupees and percentages. In addition, tests of pricing can be made by comparison of perpetual inventory records with a master cost tape showing the costs of all parts. Other application include tests for meeting standards for filling requisitions, printouts of stocks with recurring shortages or averages, and summaries of trends in losses through pilferage.
2. **Payrolls:** There are operational as well as financial areas relating to payrolls that lend themselves to the use of audit software packages. Printouts can be made to review labour utilization – amount of overtime, labour charged to jobs in excess of standards, and downtime. Comparisons can be made with prior performance as well as with standards to indicate performance needing improvement. In addition, the programs can identify new and

terminated employees, as well as changes, for checking against payroll authorization file in the personnel department.

3. **Maintenance:** Overruns in excess of specified percentage can be pin pointed for analysis of causes. Backlogs of maintenance request can be aged and printed out for review.
4. **Energy:** Plants or departments with excessive use of gas and electricity are identified for monitoring under the energy program.
5. **Travel and Telephone:** Excessive charges by employee or departments can be identified for follow up and possible reductions.
6. **Sales:** Data can be accumulated as to sales by salesperson, territory, or product in relation to quotas and performance by others.

Test pack

AUDIT TOOLS, TEST PACKS, COMPUTERIZED AUDIT PROGRAMMES

Computer-aided audit tools

CAATTs, not CAATs, addresses these problems. CAATTs, as it is commonly used, is the practice of analyzing large volumes of data looking for anomalies. A well designed CAATTs audit will not be a sample, but rather a complete review of all transactions. Using CAATTs the auditor will extract every transaction the business unit performed during the period reviewed. The auditor will then test that data to determine if there are any problems in the data

Specialized software

In the most general terms, CAATTs can refer to any computer program utilized to improve the audit process. Generally, however, it is used to refer to any data extraction and analysis software. This would include programs such as data analysis and extraction tools, spreadsheets (e.g. Excel), databases (e.g. Access), statistical analysis (e.g. SAS), business intelligence (e.g. Crystal Reports and Business Objects), etc.

Benefits of audit software include:

- They are independent of the system being audited and will use a read-only copy of the file to avoid any corruption of an organization's data.
- Many audit-specific routines are used such as sampling.
- Provides documentation of each test performed in the software that can be used as documentation in the auditor's work papers.

Audit specialized software may perform the following functions:

- Data queries.
- Data stratification.
- Sample extractions.
- Missing sequence identification.
- Statistical analysis.

- Calculations.
- Duplicate transaction identification.
- Pivot table creation.
- Cross tabulation.

SPECIAL ASPECTS IN AUDIT OF E-COMMERCE TRANSACTION

E-commerce, or e-business, via the internet is now bringing fundamental changes to the way business is conducted. The continued evolution of technology, the economics of the internet, and the growth of e-commerce are significantly affecting the traditional business environment. E-commerce is changing the competitive market and making international trading viable for a much larger number of businesses. However, in the midst of these changes in the business environment, the auditor's responsibility to provide an opinion on the financial report has remained unchanged. Although communication and transactions over networks and through computers are not new features of the business environment, the increasing use of the internet for e-commerce introduces new variables of risk and control requiring audit consideration. E-commerce is not clearly defined or constrained, but comes with 'open boundaries' in terms of scope. The auditor requires appropriate skills to understand how an entity's e-commerce strategy addresses the business risks that arise. Audit risk assessment for e-commerce requires a paradigm shift in the way auditors consider client entities and the way auditors plan audit procedures to reduce audit risk to an acceptable level. When a business engages in e-commerce, it runs many new risks. The internet provides every entity with the opportunity to trade in a global market. But when transactions are initiated by unknown parties on the internet, there are risks relating to the authenticity and integrity of trading partners and e-commerce transactions. Usually, management will identify e-commerce business risks, and address those risks with appropriate security and control measures. In contrast, the auditor will consider e-commerce business risks only in so far as they affect audit risk. Audit risk relates to the risk that the entity's financial report (on which the auditor provides an audit report) is materially misstated. A business may be faced with a number of constraints when developing e-commerce, including the availability of appropriate technical and marketing expertise, the need for continuing investment, and the identification and resolution of security issues. Although these issues may remain unresolved, many entities are continuing to develop e-commerce on a 'risk-reward' basis. As a result, the e-commerce market is growing rapidly, particularly the use of e-commerce on a business-to-business (B2B) basis to shorten supply lines and reduce costs. Such growth, without due attention to the risks in an electronic trading environment, impacts on both business risk and audit risk. AGS 1056 identifies specific matters that the auditor considers to determine the significance of e-commerce to the entity's business activities, to monitor the impact of e-commerce on the auditor's assessment of risk and to develop audit strategies to respond to different risks arising from e-commerce. E-commerce business risks include those arising from: the identity and nature of relationships with e-commerce trading partners; the integrity of transactions; electronic processing of transactions; systems' reliability; privacy issues; return of goods and product warranties; taxation and regulatory issues. AGS 1056 includes discussion of how an entity's e-commerce strategy and business model identifies and addresses these business risks. This understanding enables the auditor to determine how the entity has applied its control framework to its e-commerce activity. It also helps him or her to assess whether the entity's development processes are defined, understandable and transparent. The security issues arising from transactions over the internet

are considered, emphasising in particular that the entity's security infrastructure is fundamental to ensuring the effectiveness of other security measures.

How to audit your Ecommerce site

Have you taken a look at your ecommerce accessible website lately? With people in the UK spending nearly £1,100 a year on average for online purchases, you need to be certain that your setup is running the right way and is not letting you or your customers down. Much of managing your setup involves ensuring you have a smooth running website that is easy to administrate from your end, and user friendly to your customers. Testing it as a user alongside gathering statistics on how it runs should be done regularly so that you know what your customer experiences when ordering from you.

How is Your Shopping Cart Experience?

Your ecommerce responsive site needs to work with a control setup that allows you to adjust the shopping cart features that your site might work with. In simple terms, the site might need to be adjusted based on any promotional codes you want to offer and if you wish to add any new payment options. Make sure you adjust your setup regularly, and test your checkout regularly to make sure it works well for your customers.

Keep Tabs On History

You must also work hard on getting your ecommerce admin program to keep track of the history of your site and how it is being run. Make sure you gather information on things like how often people come onto your site and what types of items they often buy the most off of your accessible website.

Mass Editors Work

A mass editor is a program that allows you to adjust different topics and points on your ecommerce setup in real time. You can edit data on hundreds of products at once by adjusting the parameters of whatever you are reporting on, thus improving your chances of getting more people to take advantage of your services at a given time while being fully aware of what you have to offer.

Design Themes

Don't forget web design when it comes to your audit. Take a long hard look at the site and see if it still looks as fresh as it did when you first started it. If anything needs adjusting, or pictures need updating this should be done straight away.

Looking at these four things regularly will ensure that you constantly strive to improve the user experience for your customers, which is something you'll reap rewards from. If your website is not performing and you need assistance with a web design Sussex company, choosing a professional outfit with the skills to talk you through maintenance, or who will perform regular audits of your site and fix any errors is a must.

ADDITIONAL OBJECTIVE QUESTIONS

A. State whether following statements are True or False

1. The overall objective and scope of an audit does not change in a CIS environment
2. There are three main categories of Internal controls in a computer environment
3. Batch control totals and document counts are the examples of Input control.
4. Audit around the computer performed by examining and reconciling the input to the computer with the output from it.
5. Audit through computer use the computer and its programs as a tool of the auditor
6. Audit through computer forced to adopted if there is an inability to locate the source documents or printouts.
7. In audit around the computer the auditor cannot determine how all transactions will be handed by computer programs
8. In audit around the computer on-line data entry, system designed with elimination or reduction of printouts and real-time updating.
9. CAAT means computer aid audit techniques.
10. There are two types of audit programme
11. Purpose written programs are specially written programs where it is not possible to adapt a package program
12. CAATs means Computer-aided audit tools

True: 3, 4, 6, 7, 11, 12.

False: 1, 2, 5, 8, 9, 10

B. Match the following

	Group A		Group B
a		i.	
b		ii.	
c		iii.	
d		iv.	
e		v.	

Ans:

C. Fill in the blanks with proper word

1. CIS environment is used to record, _____ and analyse accounting information;
2. The two main categories of internal controls are _____ and general controls.
3. Batch control totals and document counts are the examples of _____ control.
4. Resubmission of rejected transactions or the review of exception reports is the example of _____ control.

5. _____ refers to the situation in which the users of the computer systems are involved in all stages of the development of the system.
6. _____ refers to the operating system, database management systems and other software that increases the efficiency of processing.
7. _____ concept means that auditors bypasses the computer and treat it as a giant bookkeeping machine.
8. _____ use the computer and its programs as a tool of the auditor.
9. In _____ concept means that auditors bypasses the computer and treat it as a giant bookkeeping machine.
10. CAAT means _____.
11. _____ comprises computer programs used for audit purposes to process data audit significance from the client accounting system.
12. Excel is the example of _____.
13. CAATs means _____.

Ans: 1 compile, 2. application controls, 3. Input control, 4. Output control, 5. End-user, 6. System software, 7. Audit around the computer, 8. Auditing with the computer, 9. Audit around the computer, 10. computer assisted audit techniques, 11. Audit software, 12. Utility programs, 13. Computer-aided audit tools.

Multiple Choice questions

D. Select the most appropriate answer from the following:

1. The two main categories of internal controls are _____ and general controls
 - (a) Application control
 - (b) Output control
 - (c) Processing control
 - (d) none of the above
2. Batch control totals and document counts are the examples of _____ control.
 - (a) Application control
 - (b) Output control
 - (c) Processing control
 - (d) none of the above
3. _____ refers to the operating system, database management systems and other software that increases the efficiency of processing.
 - (a) System software
 - (b) Administrative controls
 - (c) General controls
 - (d) None of the above
4. _____ focuses on the computer and its programs directly in the audit.
 - (a) Audit around the computer
 - (b) Auditing with the computer
 - (c) Audit through the computer
 - (d) none of the above
5. In _____ on-line data entry, system designed with elimination or reduction of printouts and real-time updating.
 - (a) Audit around the computer
 - (b) Auditing with the computer
 - (c) Audit through the computer
 - (d) none of the above

6. _____ is costly and time consuming to provide printouts for audit purposes where no ready audit trail exists
- (a) Audit around the computer (b) Auditing with the computer
(c) Audit through the computer (d) none of the above
7. CAAT means _____
- (a) computer aid audit techniques (b) computer assisted audit techniques
(c) computer audit assisted techniques (d) none of the above
8. There are _____ types of audit programs
- (a) One (b) Two
(c) three (d) four
9. _____ programs however they need to be tailored to each specific case by defining the format of the files.
- (a) Purpose written (b) Utility
(c) Generalized packaged (d) None of the above
10. _____ programs are specially written programs where it is not possible to adapt a package program.
- (a) Purpose written (b) Utility
(c) Generalized packaged (d) None of the above
11. CAATs means
- (a) Computer-aided audit tools (b) Computer- audit aided tools
(c) computer assisted audit techniques (d) none of the above

Ans: 1. (a), 2. (b), 3. (a), 4. (c), 5. (c), 6. (a), 7. (b), 8. (c), 9. (c), 10. (a), 11. (a).

Theory Questions

Explain the following



Professional Ethics

WHY ETHICS

One may doubt as to why ethics, when there is law?

Ethics is required to encourage people to maintain rightful 'professional conduct, though law is mainly to punish non – compliance of conduct prescribed. Ethics is thus more positive in character. Ethics encompasses public conscience, and surpasses' expectations as posed from law. Ethics often forms the basis of law. 'A distinguishing mark of the accountancy profession is its' acceptance of the responsibility to act in the public interest

CODE OF ETHICS FOR CHARTERED ACCOUNTANTS

- For the success of the profession of accountancy a self-imposed Code of Ethics is essential to command the respect and confidence of the general public. Chartered Accountants in the service of the affairs of others have responsibilities and obligations to those who rely on their work.
- A client, before engaging the services of a professional requires to be assured, (i) that he has the required competence and (ii) that he is a person of character and integrity. As regards the first, evidence is available to the client in the form of a certificate that the Chartered Accountant has undergone the training and passed the appropriate examination in accountancy and as regards the second, he would have an assurance only if the professional body to which he belongs has adopted a code of professional ethics for its members.
- The International Federation of Accountants (IFAC), in its guidelines on Professional Ethics for the Accountancy Profession, has stated: "Persons who pursue a vocation in which they offer their knowledge and skills in the service of the affairs of others have responsibilities and obligations to those who rely on their work. An essential pre-requisite for any group of such persons is the acceptance and observance of professional ethical standards regulating their relationship with clients, employers, employees, fellow members of the group and the public generally." The accountancy profession's public consists of clients, credit grantors, governments, employers, employees, investors, the business and financial community and others who rely on the objectivity and integrity of professional accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on the accountancy profession.

- Internal auditors provide assurance about a sound internal control system which enhances the reliability of the external financial information of the employer; - Tax experts help to establish confidence and efficiency in, and the fair application of, the tax system; and - Management consultants have a responsibility towards the public interest in advocating sound management decision making. Professional accountants have an important role in society. Investors, creditors, employers and other sections of the business community, as well as the government and the public at large rely on professional accountants for sound financial accounting and reporting, effective financial management and competent advice on a variety of business and taxation matters. The attitude and behaviour of professional accountants in providing such services have an impact on the economic well-being of their community and country. Professional accountants can remain in this advantageous position only by continuing to provide the public with these unique services at a level which demonstrates that the public confidence is firmly founded. It is in the best interest of the worldwide accountancy profession to make known to users of the services provided by professional accountants that they are executed at the highest level of performance and in accordance with ethical requirements that strive to ensure such performance.
- The fundamental principles are: * Integrity A professional accountant should be straightforward and honest in performing professional services. * Objectivity A professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity. * Professional Competence and Due Care: A professional accountant should perform professional services with due care, competence and diligence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques. * Confidentiality A professional accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose. * Professional Behaviour A professional accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession. The obligation to refrain from any conduct which might bring discredit to the profession requires IFAC member bodies to consider, when developing ethical requirements, the responsibilities of a professional accountant to clients, third parties, other members of the accountancy profession, staff, employers and the general public. * Technical Standards A professional accountant should carry out professional services in accordance with the relevant technical and professional standards.
- Independence: When in public practice, an accountant should both be, and appear to be, free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity. The over-riding motto has been 'pride of service in preference to personal gain'.
- This Act is being administered through the Institute of Chartered Accountants of India; which functions and discharges its duty through a 'Council'. To ensure discipline in the profession, The Chartered Accountants Act along with its schedules sets out different forms

of behaviour, which constitute misconduct under the law. The definition of misconduct in the Act is only an inclusive one and is not exhaustive. Over and above this, the council of the Institution (ICAI) has also been given powers under the law to enquire into the conduct of any member of the Institute other than those specified in the Act, which may in the view of the COUNCIL be not desirable and/or expected of a Chartered Accountant. This kind of misconduct is known as 'other misconduct'. The 'other misconduct' may not necessarily arise out of professional work. With a view to bring harmony in presentation of the financial statements and an identical treatment in a particular situation, the ICAI has brought out various Statements, Auditing and Assurance Standards, Accounting Standards and Guidance Notes, which are mandatory for a practicing Chartered Accountant to be adhered to while discharging his professional duty of attestation of financial statements.

- A Chartered Accountant who does not follow these sets of documents in discharging his professional duty of attestation, is guilty of professional misconduct, and thereby liable for disciplinary action and punishment under the Act, which may be; (i) Reprimanding the member or (ii) Removing his name from the Register of members for such period not exceeding five years, or (iii) Forwarding the case to the High Court with its recommendations where the council opines for removal of name for a period exceeding five years, or (iv) If the misconduct is of a nature, which as per the Chartered Accountants Act requires action by the High Court, reference to the High Court with recommendations of the council.
- The procedure of enquiry in respect of disciplinary action against a Chartered Accountant is not only lengthy but rigorous also. Barring a few exceptions, the Chartered Accountant, who has to face action would feel so humiliated that his enthusiasm and working capacity comes to the lowest level. Removal of name as a punishment further nails him with a severe economic blow.
- Still there are instances when it is noticed that the report of Chartered Accountants either misses vital information which must be there, or gives incomplete information or gives an information in a misleading manner or at times gives a completely wrong information. It is pertinently noticed by bank officials in dispensation of credit and monitoring of some financed cases, that information in the financial statements does not help in taking a right and judicious decision. Though it is difficult to substantiate by tangible evidences, but circumstantial evidences in certain cases, do point out that the intention of all concerned has not been bonafide, rather it is malafide and is done with some ulterior motive.
- Some of the common points where reports of Chartered Accountants have not been of desirable level are: - Valuation of stocks including work in progress. - Transactions with related parties. - Valuation of investments - Valuation and status of other assets. - Status of Sundry Debtors - Status of Creditors - Status of loans - Provision in respect of all the known liabilities. All these issues have a considerable impact on profit and the real financial health of an enterprise, failure of which would prevent taking of a well informed, correct decision by banks and financial institutions.
- Here it may not be out of place to mention that banks and financial institutions are heavily relying on Chartered Accountants in discharging their work in judicious manner. For this the banks get various type of reports and certificates which the banks have devised after much

deliberations. If these certificates give the required information in the right perspective, the loan assets of the banks to a large extent may be saved from becoming bad.

- These certificates and reports in general are:
 - Annual Audit Report on the Accounts of Borrower- CAs have to be transparent and absolutely honest while certifying the following items: (a) Valuation of inventory – stock, work in progress, finished goods, etc. (It may be observed that variations in the sale of the stocks declared by the companies in their stock statement for the year ending position in March and the value of stocks declared in the annual accounts subsequently are on account of this.) (b) Dealing with group accounts – Normally this is where diversion of funds take place. CAs also should comment whether transactions are at par with commercial transactions done with other parties. CAs also should comment whether investments in group companies are safe and sound. (c) It should also be commented whether any bad debt is included under Sundry Debtors, whether loans and advances to group companies are camouflaged under sundry debtors to avail book debt finance, whether any fictitious debt is created to avail finance from banks (like fertilizer subsidy financed against by banks). (d) Whether any fictitious sales are booked to inflate sales/profit.
 - Stock Audit of Borrowal accounts: CAs should bear in mind that based on their certificate, the banks value the security. Any false certificate will affect the security of the bank and jeopardize their funds. The valuation of stocks should be judged correctly. The valuation of especially work-in-progress should be studied in depth. The sundry creditors position should be analyzed to see whether paid for stocks is adequate.

What is 'professional or other misconduct'?

A. 'Professional or other misconduct' refers to an action or omission listed out in the two schedules of the CA Act, 1949.

Meaning of professional Misconduct

A Chartered accountant will be held responsible if he commits any act or misconduct specified (prescribed) by the schedule I & schedule II of C.A. Act. 1949. Any professional negligence whether intentional or non intentional is termed as professional misconduct. However, this does not purport to be a comprehensive definition as the scope of this term is expanding in view of the power conferred under the Act on the Director (Discipline) to enquire into the conduct of members under any other circumstances.

The chartered accountants Act contains two schedule:

1. Schedule I
2. Schedule II
3. Schedule I contains part 1, 2, 3 & 4 & Schedule II contains Part I & Part II

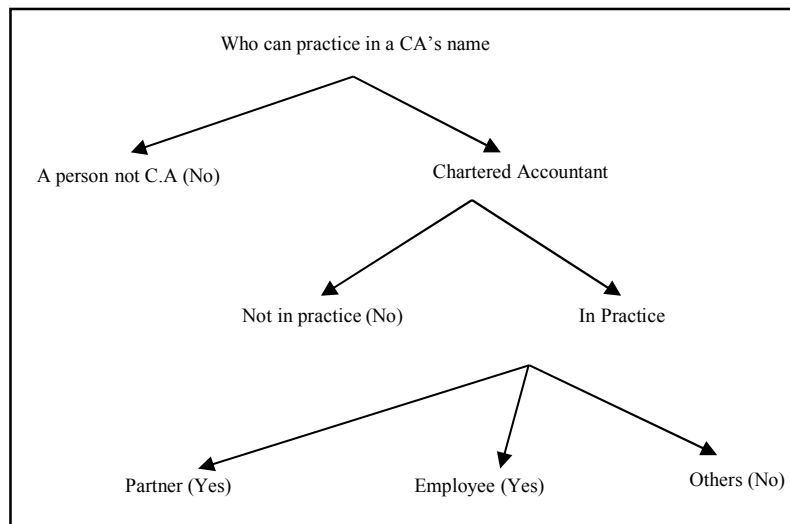
Schedule I : (By Board of Discipline)

The council of ICAI will pass an order for removing the name of the member from the register of members, if he has done something mentioned in Part I, II & III. The name can be removed for a maximum period of 5 years, but if the order is passed by, the high court then this period can be exceeded.

Part I:

This part contains professional misconduct in relation to Chartered Accountants in practice and he will be held guilty if he:

Clause 1: If he allows any person to practice in his name as Chartered Accountant in practice, unless he is also a C.A. in practice & is in partnership or employed



Clause 2: If he pays/allows or agrees to pay/allow any share, commission or brokerage in fee/profits of his professional business to any person other than a CA or a partner or retired partner or legal representative of deceased partner or member of any other professional bodies or with such persons with prescribed qualifications, for the purpose of rendering such professional services from time to time in or outside India

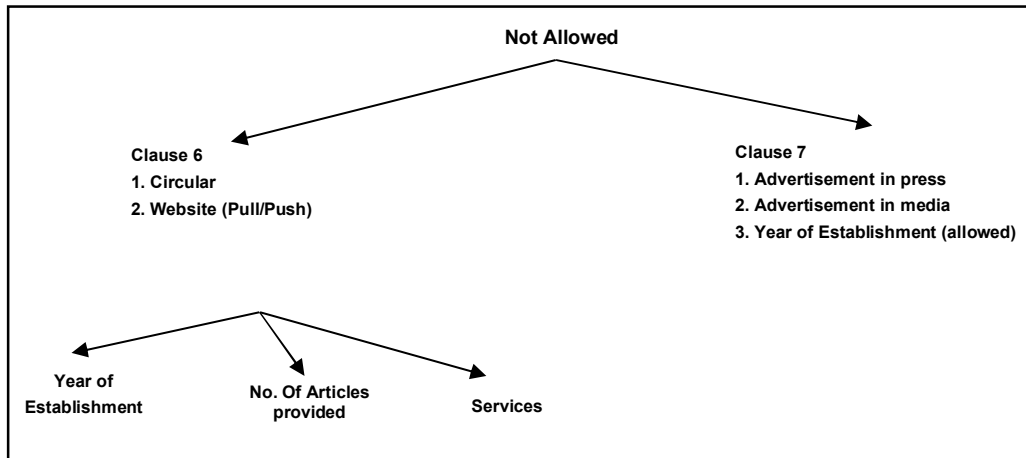
Clause 3: If he accepts/agrees to accepts any part of profits of professional work from a non-member (exception- member of any other professional bodies or with such persons with prescribed qualifications, for the purpose of rendering such professional services from time to time in or outside India)

Clause 4: If he enters into a partnership with a person who is not a C.A. in practice or member of any other professional bodies

Clause 5: If he secures any professional business through any agency.

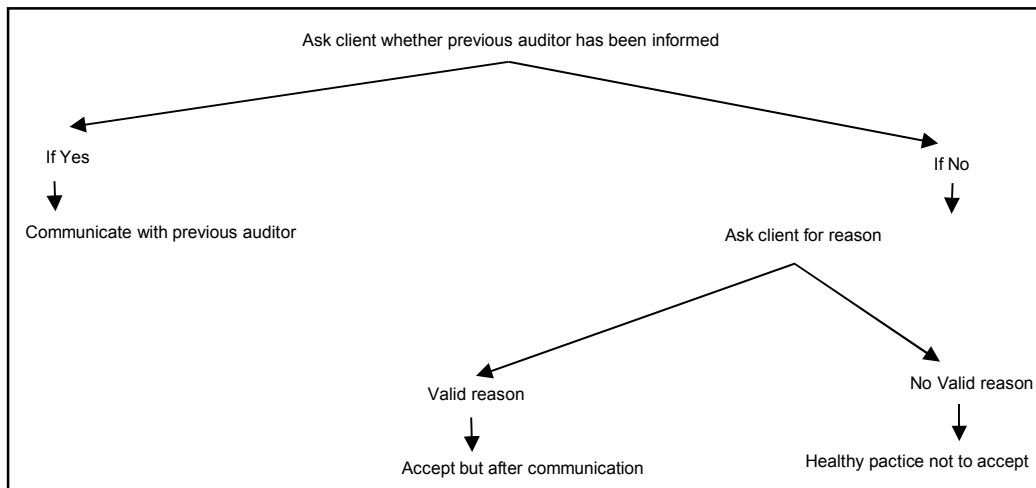
Clause 6: If he solicits clients, directly or indirectly through circulars or advertisements or personal communication or interviews etc.

Clause 7: If he advertises his professional attainments or services or if he uses any designation other then C.A. on visiting cards, letter heads or sign boards.



Clause 8: If he accepts his appointment as an auditor which was previously held by another C.A. without first communicating to him in writing.

Ask client whether previous auditor has been informed



Clause 9: If he accepts appointment as an auditor of a company without a ascertaining whether the requirements of section 224, 224 (a) & 225 have been complied with.

Clause 10: If he agrees a professional employment which his based on certain percentage of profits or contingent upon finding/result of such work.

Clause 11: If he engages in any business or occupation other than profession of C.A. without taking profession permission of the council of ICAI.

Clause 12: If he allows any non-member to sign on his/firms's behalf any balance sheet, profit & loss account or a audit report.

Part II

Part II deals with professional misconduct to members whether he is in service of an individual, firm or company & he will be held guilty if he:

Clause 1: Pays/allows to pay directly or indirectly any share in professional fees/emoluments of employment to a non-members.

Clause 2: Accepts/agrees to accept any part of profits/fees or gains from lawyer, a C.A., broker, customer of such employer by way of commission or gratification.

Part III

It deals with professional misconduct in relation of members of ICAI, generally & he will be held guilty if he, it consist of various clauses .:

Clause 1: If he is not an FCA but designates himself as FCA:

(Follow Chartered Accountant, a person who is a practicing C.A. for 5 years becomes an F.C.A.)

Clause 2: If he does not supply information called by the council of ICAI.

Part IV

A member whether in practice or not if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months or in the opinion of the council, brings disrepute to the profession or the Institute

Schedule II (Case is to be referred to disciplinary committee)

Part I- C.A. in practice & he will be held guilty if he

The schedule consist of various clauses:

Clause 1: If he discloses any client information to any other person, without the consent of client or permitted by law .

Clause 2: Without examination of financial statements, he Certifies an audit report or any report of an examination of financial statements

Clause 3: Permits his name to be used in connection with an Estimate of earnings contingent upon future transactions.

Clause 4: If he is substantially interested in a company & submits his opinion of financial statement without disclosing his interest.

Clause 5: If he fails to report a material fact known do him which is not disclosed in financial statement but disclosure of which is necessary.

Clause 6: If he fails to report on a material misstatement appearing in a financial statement.

Clause 7: If he has not performed his professional duties with due diligence, care & great skill.

Clause 8: If he expressed his opinion without collecting adequate audit evidence.

Clause 9: If he fails to invite attention to any material departure from generally accepted procedures of audit

Clause 10: If he fails to keep money of his client in a separate bank account.

Part II- C.A. Generally & he will be held guilty if he

Clause 1: Contravenes any of provisions of this Act or regulations or guidelines issued by Council.

Clause 2: being an employee of discloses information acquired in course of employment except when required by law or permitted by employer

Clause 3: Includes in any information/statement/ return/form to be submitted to ICAI particulars knowing to be false

Part III

A member whether in practice or not shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence with imprisonment for a term exceeding six months

Grant of Certificate of Practice (Section 6, Regulation 9)

Eligibility (1) As Associate/Fellow member of the Institute can apply for grant of Certificate of Practice in the prescribed Form '6' together with requisite fee

(2) A member engaged in the categories of business/occupation as defined in Appendix (9) under Regulation 190A is eligible to apply for Certificate of Practice. Requirements (1) The member is required to apply for Certificate of Practice in Form 6. The Form complete in all respect and signed is required to be submitted. (2) An account payee Cheque (for local members only)/Demand Draft along with annual membership fee of the relevant year should be submitted. (3) If the member is engaged in other business/occupation, he is required to apply for permission of the Council, by submitting application in the prescribed Form.

General (1) An acknowledgment will be issued by the Decentralised Office on receipt of Form 6 and fees. (2) A letter granting Certificate of Practice will be issued by the concerned Decentralised Offices. (3) The date of grant of Certificate of Practice will be the date on which all the requirements are complied with. The Certificate of Practice is generally granted from the date of application in Form 6 provided the Demand Draft/Cheque is issued on or before the date of application and such application is received by the Institute's office within 10 days from the date of the application. (4) The permission for other engagement will be granted provided the engagement is permissible. (5) The script of Certificate of Practice will be issued to a member within 3 to 4 months time from the date of issue of letter granting COP and will be sent by Registered/Speed Post.

DISCIPLINARY PROCEDURE

Printed Notes

Q.1 What is the distinction between the two Schedules?

Ans: The two Schedules are distinguished on the basis of gravity of misconduct described therein. The misconduct listed in the Second Schedule is understood to be grave and serious prescribing higher punishment.

Q.2 Can a chartered accountant undertake practice after getting the CA final pass certificate?

Ans: No, a chartered Accountant requires the Certificate of Practice (CoP) issued by the Institute after getting the final pass certificate to practice as a chartered accountant.

Q.3 Whether Code of Ethics is applicable outside India?

Ans: The Code of Ethics of the Institute is applicable to all the members, even outside India.

Q.4 Can a chartered accountant in practice allow any person to practice in his name as a chartered accountant?

Ans: No, a chartered accountant in practice is prohibited to allow any person to practice in his name as unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

Q.5 Can a chartered accountant in practice secure any professional business through the services of a person who is not his employee or partner?

Ans: No, the CA Act, 1949 does not permit a practicing chartered accountant from securing, either through the services of a person who is not an employee of such chartered accountant or who is not his partner, any professional business.

Q.6 Whether a member in practice is permitted to respond to announcement for empanelment for allotment of audit and other professional work and quote fees on enquiries being received?

Ans: It has been clarified by the Council that if announcements are made for empanelment by Government, Corporations, Courts, Cooperative Societies, Banks and other similar Institutions, the members may respond to such announcements provided the existence of panel is within their knowledge. The Council has further clarified that the quotations of fees can be sent if enquiries are received by the members in this regard.

Q.7 Whether a member in practice is permitted to have his name published in Telephone Directory?

Ans: Yes, a member in practice is permitted to have his name published in the Telephone Directory subject to certain conditions: The entry should appear in the section/category of "Chartered Accountants". The member/firm should belong to the town/city in respect of which the directory is being published. The entry should be in normal type of letters. Entry in bolder type or abnormal type of letters or in a box is not permissible. The order of the entries should be alphabetical and logical. The entry should not appear in a manner giving the impression of publicity/advertisement. Entry should not be given in a manner which gives prominence to it as compared to other entries. The payment, if any, for the entry should not be unreasonable. The entries should not be restricted and should be open to all the chartered accountants/firms of chartered accountants in the particular city/town in respect whereof the directory is published. Subject to the above conditions, the members can also include their names in trade directories which are published and/or otherwise available such as electronic media e.g. Internet, telephone services like "Ask Me Services" etc.

Q.8 Can a member in practice indicate in a book or an article, authored/contributed/published by him, his association with any firm of Chartered Accountants?

Ans: No, as per CA Act, 1949, a member is not permitted to indicate in a book or an article, authored/contributed/published by him, his association with any firm of Chartered Accountants.

Q.9 Can a Chartered Accountant in practice seek professional work from his professional colleagues?

Ans: Yes, as per CA Act, 1949 a member is permitted to apply or request for, or to invite, or to secure professional work from another Chartered Accountant in practice.

Q.10 Can a Chartered Accountant in practice accept original professional work emanating from the client introduced to him by another member?

Ans: No, a Chartered Accountant in practice should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

Q.11 Can a member in practice solicit clients or professional work by advertisement?

Ans: No. The CA Act prohibits a member in practice from soliciting clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. However, there are following exceptions to it: A member can respond to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence. A member may advertise changes in partnerships or dissolution of a firm, or of any change in the address of practice and telephone numbers, the advertisement being limited to a bare statement of facts and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions. A member is permitted to issue a classified advertisement in the Journal/Newsletter of the Institute intended to give information for sharing professional work on assignment basis or for seeking professional work on partnership basis or salaried employment in the field of accounting profession provided it only contains the accountant's name, address, telephone, fax number and E-mail address.

Q.12 Whether sponsorship or prizes can be instituted in the name of Chartered Accountants firm?

Ans: Yes, as per the CA Act it is not objectionable to institute prizes in the name of the individual Chartered Accountant and also in the firm's name provided the designation "Chartered Accountant", is not indicated in the prize and the clause relating to advertisements and publicity are complied with.

Q.13 Can a Chartered Accountant in practice/firm of Chartered Accountants post the particulars of himself/itself on a website?

Ans: Yes, the Council has approved the detailed guidelines for posting the particulars on Website by Chartered Accountants in practice and firm(s) of Chartered Accountants in practice.

Q.14 Whether a Chartered Accountant in practice can give public interviews and also whether he can furnish details about himself or his firm in such interviews?

Ans: Chartered accountant in practice can give public interviews. While doing so, due care should be taken to ensure that such interviews or details about the members or their firms are not given in a manner highlighting their professional attainments, which may hit clauses (6) and (7) of the First Schedule of the CA Act.

Q.15 Whether the information contained in the website of the Chartered Accountants and/or Chartered Accountants' firms can be circulated on their own or through E-mail or by any other mode or technique?

Ans: The Code of Ethics provides that the Chartered Accountants and/or Chartered Accountants' firms should ensure that none of the information contained in the website be circulated on

their own or through E-mail or by any other mode or technique except on a specific “pull” request. The Chartered Accountants and/or Chartered Accountants' Firms would ensure that their Websites are run on a “pull” model and not a “push” model of the technology to ensure that any person who wishes to locate the Chartered Accountants or Chartered Accountants' firms would only have access to the information and the information should be provided only on the basis of specific “pull” request.

Q.16 Can a member put up his photograph on the website?

Ans: Yes, as per the website guidelines , display of Passport size photograph by a member on the website is permitted.

ADDITIONAL OBJECTIVE QUESTIONS

A. State whether following statements are True or False

1. Professional ethics is a sign of maturity.
2. Professional ethics guide the members in performing their jobs.
3. Internal auditors does not provide assurance about a sound internal control system which enhances the reliability of the external financial information of the employer.
4. Integrity means a professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.
5. Confidentiality means a professional accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

True: 1, 2, 5.

False: 3, 4.

B. Match the following

	Group A		Group B
a		i.	
b		ii.	
c		iii.	
d		iv.	
e		v.	

Ans: .

C. Fill in the blanks with proper word

1. _____ ethics is a sign of professional pride.
2. The auditor must have necessary skills & _____ to determine audit risk.
3. Part 1 of Schedule I of Chartered Accountant Act contains professional misconduct in relation to Chartered Accountants in _____

4. Part 2 of Schedule I of Chartered Accountant Act contains professional misconduct in relation to Chartered Accountants in _____.

Ans: 1. Professional, 2. Competence, 3. Practice, 4. Service.

Multiple Choice questions

D. Select the most appropriate answer from the following:

1. Professional ethics are established by
 - (a) Professional business unit
 - (b) SEBI
2. The benefits of internal control include
 - (a) Transactions are complete
 - (b) Transactions are supported by documents
 - (c) Transactions are authorized
 - (d) All of the above
3. A professional accountant should be straightforward and honest in performing professional services means _____
 - (a) Objectivity
 - (b) Skill
 - (c) Integrity
 - (d) None of the above
4. A Chartered accountant will be held responsible if he commits any act or misconduct specified (prescribed) by the schedule I & schedule II of
 - (a) The Chartered Accountants Act, 1949
 - (b) Companies Act
 - (c) None of the above

Ans: 1. (a), 2. (d), 3. (c), 4. (a).

Theory Questions

Explain the following

