SECTION:1 AUDITING

Unit 1: Introduction Principles of Auditing and Audit Process.

Synopsis

- **Auditing**: Meaning, Objectives, Principles, Scope
- **Errors and Frauds in Auditing**: Types of error, Location of error, Types of Fraud, Difference between Fraud and error
- **Advantages of Auditing**
- **Limitation of Auditing**
- **Types of Audit.**
- **Audit Process.**
- **Internal control, Internal check and Internal Audit.**

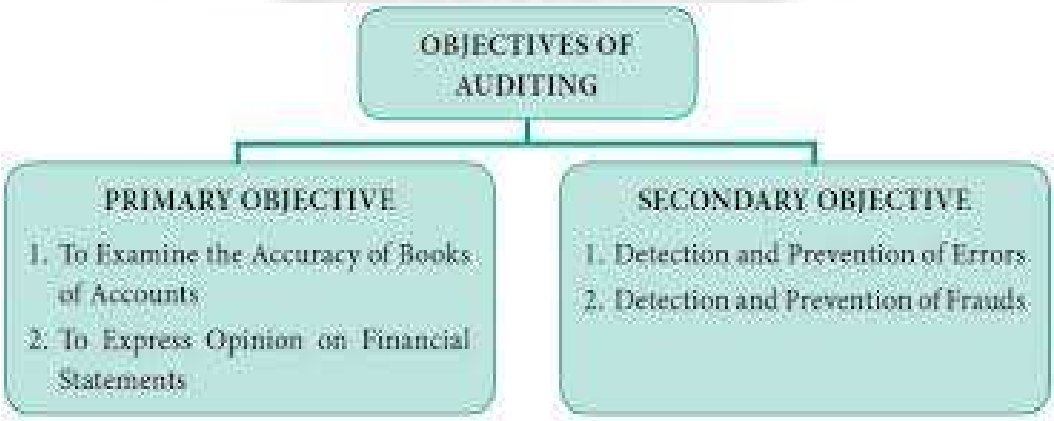
Auditing: Meaning

Auditing is a systematic examination of the books of records of business.

Meaning of Audit is a thorough inspection of the books of accounts of the organization. The person who carries out an audit is the auditor

Audit is the examination or inspection of various books of accounts by an auditor followed by physical checking of inventory to make sure that all departments are following documented system of recording transactions. It is done to ascertain the accuracy of financial statements provided by the organization.

Objectives



Principles

1. Principles of competency.
2. Principles of Independence
3. Principles of Integrity.
4. Principles of Confidentiality.
5. Principles of Objectivity.
6. Principles of Documentation.
7. Principles of Planning.
8. Principles of Audit Evidence.
9. Principles of Accounting system and Internal control.
10. Audit conclusions and Report.

Scope

The amount of time and documents which are involved in an audit, is an important factor in all auditing. The audit scope, ultimately, establishes how deeply an audit is performed. It can range from simple to complete, including all company documents

Errors and Frauds in Auditing

Types of error

TYPES OF ERRORS

- **Clerical Errors**
  - Errors of Commission
  - Errors of Omission
  - Partial Omission
  - Complete Omission
- **Errors of Principle**
- **Compensating Errors**
- **Errors of Duplication**

Location of errors

The location of errors will be easier if the following steps are systematically taken.

* Check the total of the trial balance
* Compare the ledger account balances carried to the trial balance
* Check the total of debtors' and creditors' accounts and compare with the balance of debtors' and creditors' amounts shown in the trial balance
* Verify the total of subsidiary books and their posting to ledgers
* Compare the items of trial balance of the current year with the items of trial balance of the previous year to see if any balancing figure is omitted.
* Verify that all journal entries are posted into ledgers.

Types of Fraud

- Employee Fraud
  - Embezzlement of cash
  - Misappropriation of Goods
- Management Fraud
  - Manipulation of Accounts
  - Omission of Events
  - Misapplication of accounting policies
  - Internal control System overridden

Advantages of Auditing

- Audit Helps to Detect and Prevent Errors and Frauds.
- Audit Helps to Maintain Account Regularly.
- Audit Helps to Get Compensation.
- Audit Helps to Obtain Loan.
- Audit Facilitates the Sale of Business.
- Audit Helps to Assess Tax.
- Audit Facilitates to Compare.
- Audit Helps to Adjust Account of Deceased Partner.

Limitation of Auditing

- **Rely on Experts** – An Auditor has to rely on experts like engineers, valuers and lawyers for estimation and valuation of fixed assets and estimation of contingent liabilities.

- **Efficiency of Management** − An Auditor does not comment on the efficiency of management working in client organization; no comments on future performance of an organization can be made through audited financial statements.
- **Checking of All Transactions** − It is not possible for an Auditor to check all business transactions especially in big organizations where the number of transactions is very high. An Auditor has to rely on sampling and test checking.
- **Additional Financial burden** − An organization has to bear additional financial burden on account of any fees and other such expenses for conducting an audit.
- **Not Easy to Detect Some Frauds** − It is not easy for an Auditor to detect deeply laid frauds like forgery, misstatements and non-recording of transactions.

Types of Audit

Types of Audit

Ownership	Periodicity	Objectives	Scope of audit	Employer of Auditor	Manner of Checking
Privat Audit	Continuous	Financial	Complete	Internal	Standard
Government Audit	Annual	Operational	Partial	External	Balance sheet
Statutory Audit	Interim	Cash Audit			Post and vouch Audit
	Occasional	Management			
	Concurrent	Tax			
		Social			
		Environment			

Audit Process

The Audit process is a well-defined methodology for organizing an audit and is adopted to accomplish audit objectives.

An audit process may consist of the following steps:

1. **Define Audit Objectives**
2. **Audit Announcement**
3. **Planning**
4. **Fieldwork**
5. **Reporting**

Audit program

1.Audit program is nothing but a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed

2.An audit program consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements

3.An audit program covers various steps of auditing in an audit program like the assessment of internal control, ascertaining accuracy and reliability of books of accounts, inspection, vouching and verification, valuation of assets and liabilities, scrutiny of accounts, presentation of financial statements.

The following points should be kept in view:

(1) Stay within the scope and limitation of the assignment.

(2) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.

(3) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.

(4) Consider all possibilities of error.

(5) Co-ordinate the procedures to be applied to related items.

Working paper

1.The audit working papers constitute the link between the auditor's report and the client's records.

2.The objects of an auditor's working papers are to record and demonstrate the audit work from one year to another

3. Working papers are varied in nature. They may be recorded on paper or on electronic or other media. Examples include:

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.

Internal control, Internal check and Internal Audit.

Internal control: Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud. Besides complying with laws and regulations and preventing employees from stealing assets or committing fraud, internal controls can help improve operational efficiency by improving the accuracy and timeliness of financial reporting.

Internal check: Internal Check is an integral function of the internal control system. It is an arrangement of duties of the staff members in such a way that the work performed by one person is automatically and independently checked by the other

Features of Internal check

1. This technique is an integrate part of the complete system of internal control.
2. This technique is related to the division of work among the people maintaining the accounts.
3. In this technique, no single employee records any transaction from the beginning to the end.
4. In this technique, the work done by every employee is examined independently by another employee.
5. In this technique, the work done by one employee is complementary to the work done by another employee.

The aim of this technique is to develop an automatic system for detection of frauds and errors.

In this technique, the work of book-keeping and accountancy is mechanised to the maximum possible extent.

Internal Audit: Internal Audit is a department or an organization of people within a company that is tasked with providing unbiased, independent reviews of systems, business organizations, and processes

Distinguish between 'Internal check and Internal Audit

1. Meaning: Internal Check is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.
Internal Audit is an independent appraisal of the operations and records of the company.

2. Object: The purpose of **Internal Audit** is to detect the errors and frauds which have already been committed.
The purpose of **Internal Check** is to prevent or minimize he possibilities of errors, frauds or irregularities.

3. Need for separate staff: for Internal Audit, a separate staff of employees is engaged for the purpose.
For internal check, no new appointment is made. It, in fact represents only the arrangement of duties of the staff in a particular way.

4. Nature of work: The work involved in the **Internal Audit** is just like that of a watch man. Internal auditor has to report, from time to time, to the management about the various in efficiencies and suggest improvements. It is also his duty to see that the internal check system does not become static.
Internal Check, on the other hand, represents a process under which the work goes on uninterruptedly and the checking too is more or less automatic.

5. Timing of work: Internal Audit starts when the accounting process of different transactions is finished.
Internal Check is an operation during the course of transaction.

6. Internal audit: It is a device for checking the work, whereas **internal check** is a device for doing the work.

7. Scope of work: The scope of **Internal Check** is very limited. The scope of **Internal Audit** is comparatively board.

8. Involvement: A large number of employees are needed for the implementation of **Internal Check** System.
Whereas, a much smaller number of persons are needed for implementing **Internal Audit** implementation.

Unit 2: Checking, Vouching and Audit report

Synopsis

- **Test Checking**
- **Voucher**
- **Vouching**
- **Vouching of cash book.**
- **Audit report**
- **Audit certificate**
- **Auditing and Assurance standard**

Test Checking

It is the examination of few transaction of business, instead of checking all transaction.

Voucher

It is a documentary evidence supporting a business transaction. It may include:

- A receipt.
- An invoice.
- Bank Paying slip.
- Debit note.
- Credit note.
- Gatekeeper's books of entry.
- Wage book.
- Order book.

Type of Voucher

Primary	Secondary
Cash memo. Rent Receipts. Wage Sheets.	Carbon copy of cash memo counter foli of paying-slip

Vouching

Vouching can be described as the essence or backbone of auditing. Vouching is defined as the "verification of entries in the books of account by examination of documentary evidence or vouchers, such as invoices, debit and credit notes, statements, receipts, etc.

Vouching of cash book

In a business concern, cash book is maintained to account for receipts and payments of cash. It is an important financial book for a business concern. Hence the auditor should see whether all receipts have been recorded in cash book and no fictitious payment appears on the payment side of cash book. To ensure this an auditor should check debit side of cash book which represents as receipts and credit side which contains payment details

Vouching of Cash Receipts (Debit Side of Cash Book)

- Opening Balance of Cash Book
- Cash Received from Debtors
- Repayment of Loan by Others
- Rent Received
- Sale of Investments
- Sale of Fixed Assets
- Interest and Dividend Received
- Commission Received
- Installments Received on Hire-Purchase Sale

Vouching of Cash Payments (Credit Side of Cash Book)

- Opening Balance
- Payment to Creditors
- Payment of Salaries
- Payment of Wages
- Purchase of Plant and Machinery
- Purchase of Land & Building
- Rent Paid
- Insurance Premium
- Income Tax
- Commission on Sale
- Director's Fees
- Internal Control System for Cash Transactions.

Valuation of Assets and Liabilities.

Verification of assets and liabilities. Verification means 'proving the truth' or 'confirmation of the truth'. Verification of assets and liabilities means proving the truth about the existence and the correctness of the money value of the assets and liabilities appearing in the balance sheet of the business

Verification of assets and liabilities are done to confirm the following −

- Existence
- Ownership
- Proper valuation
- Possession
- Freedom from encumbrances
- Proper recording

Objectives of Verification

Following are the objectives of Verification −

- Confirmation about the existence of assets through physical verification.
- Legal and official documents relating to assets are checked to confirm the ownership of assets.
- It is confirmed that assets are free from any charge of lien.
- Proof regarding proper valuation of assets.
- To confirm that assets are properly accounted for in the books of accounts.

Vouching and Verification

Both are considered to be same thing but there are lots of difference between vouching and verification.

Vouching relates to confirmation of the correctness and authenticity of accounting entries as appeared in the books of accounts whereas verification confirms the existence, ownership and valuation of assets as appears in the balance sheet. The Auditor's duty is not only vouching the entries appearing in the books because vouching cannot prove the existence of the related asset or liabilities at the balance sheet date.

Verification of Liabilities

Following are the objectives of verification of liabilities −

- Creditors reflect a true position as to liabilities of the business.
- All liabilities are disclosed in the balance sheet whether recorded in the books or not.
- Value of liabilities is according to the generally accepted accounting principles.
- Liabilities are properly classified and disclosed in the balance sheet.

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Confirmation and Verification

Let us now understand what confirmation and verification is required by the auditor.

Auditor requires confirmation from third party and management about any fact or figure. Few of the examples in which the Auditor requires confirmations are as follows

- Confirmation from debtors about balances.
- Confirmation from creditors about balances.
- Confirmation from banks about bank balances, fixed deposits, interest accrued, overdraft or cash credit limit balance, etc.
- Confirmation from financial institutions about loan and interests.
- Confirmation from management about contingent liabilities, etc.

Verification

Verification means inspection of assets by the Auditor and it includes identification, weighing and counting of assets. Following items require physical verification −

- Land and Building
- Plant and Machinery
- Stock-in-hand
- Stores and consumables
- Investments
- Securities
- Cash-in-hand
- Bills receivable

Thus, confirmation and verification are altogether different processes of audit and both are equally important too.

Valuation of Assets and Liabilities

Valuation means estimation of various assets and liabilities. It is the duty of Auditor to confirm that assets and liabilities are appearing in the balance sheet exhibiting their proper and correct value. In the absence of proper valuation of assets and liabilities, they will exhibit either overvalued or under-valued.

It is therefore required for an Auditor to exercise reasonable care and skill to analyze the basis of valuation from technical experts and satisfy himself that assets shown in Balance-sheet are properly valued accordance with the generally accepted conventions and accounting principles.

Components of Valuation

Methods of valuation of assets are as hereunder −

- **Cost Price** − This is the cost price paid at the time of acquisition of assets plus the freight charges, octroi charges, and commissioning and installation charges, etc. to bring that asset in usable condition.
- **Book Value** − This is the value as appearing in the books of accounts; the cost price less depreciation.
- **Realizable Value** − A Value which can be realized from the sale of assets.
- **Market Value** − A value which the asset can fetch at the time of sale.
- **Replacement Value** − A value on which an asset can be replaced.
- **Conventional Value** − It means the cost price less depreciation written off ignoring any kind of fluctuation in the price.
- **Scrap Value** − If the asset is not in working condition and sold as scrap, then the sale value of asset is scrap value.

Audit report

An audit report should be clear, specific and complete, in order that anyone who has an occasion to read it may know exactly what is wrong with the company. 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. This review and assessment involve 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.

The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole.

Basic Elements of the Auditor's Report:

1. Title
2. Addressee
3. Introductory Paragraph:
4. Management's Responsibility for the Financial Statements:
5. Auditor's Responsibility
6. Auditor's Opinion:
7. Other Reporting Responsibilities:
8. Signature of the Auditor
9. Date of the Auditor's Report
10. Place of Signature

Types of Audit report

Unqualified report | Qualified report | Disclaimer report | Adverse report

Unqualified report: An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in REPORT 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

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Qualified report: The auditor shall express a qualified opinion when:

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements

(ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Disclaimer report: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion

the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, disclaimer report is issued when there is insufficient evidence to form an opinion

Adverse report: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that financial statement do not give a true and fair view, and the matter od disagreement with management is material and pervasive.

Audit certificate

An Auditor's certificate is a written confirmation of the accuracy of the facts relating to the accounts for a particular time or to a specific matter.

Auditor is called for issuing certificate for the following:

(a) Import and Export certificate.
(b) Bonus computation certificate.
(c) Deposit Return certificate.
(d) Newspaper circulation certificate

considered while preparing a certificate:

1. Limitations of the examination should be stated.
2. Indicate the specific record covered by the auditor.
3. Fundamental assumption made for certifying.
4. Manner of the conduct of audit.
5. The information and explanations obtained.
6. Title of the certificate should be mentioned.

7. Certificate should be a self-contained document.
8. If figures from audited statements are made, then it should be mentioned in the
9. certificate.
10. Auditor should a*d*dress the certificate to the client or the public authority, or person
11. *r*equiring it as the case may be.

Auditing and Assurance standard

Auditing and Assurance standard1 (SA200)

This SA explains basic rules for auditing of any organization. These rules are very simple but it is needed for all type of examination of accounts. This standard classifies these rules in 10 points.

1. **Integrity, objectivity and independence:** auditor should do his auditing work independently. He should not be affected due to the any approach. Whether

he is auditing of his relative or any other person, he should be impartial all the time. Only then, his examination will be useful.

2. **Confidentiality**: Businessman shares many confidential information to the auditor. It is the rule for auditor; he should not share it with other. He may only share if as per any law, it is compulsory.
3. **Skill and Competence:** For solving auditing problem, auditor should use his skills and competence.
4. **Work Performed by Others**: Sometime auditor has to depend on other auditors and employees for completing his audit work. So, it is the duty of auditor, he should appoint them as per their qualification and skill.
5. **Documentation:** Auditor should collect all the documents which is needed for his audit. All document should be classified and keep in a direction that it can easily be found when it is needed.
6. **Planning:** Auditor should make the plan of audit. He should complete the audit on the time. Auditor will also make the plan about "How to audit ledger accounts and financial statements?"
7. **Audit Evidence:** Audit evidence is the base of better audit. These evidence are relating to financial information. If he has to give his opinion on the financial information, he should obtain its all proofs.
8. **Accounting System and Internal Control:** Auditor should check both accounting system and internal control system before accepting it as it is. If there is the need of improvement in it, he can bring it in the notice.

9.Audit Conclusions and Reporting: Auditor should conclude in his reports:

- Financial information follows all statutory requirements.
- Financial information are prepared on the basis of accounting policies.
- Audit report must be in written and a clear opinion on the financial information.

10.Effective Date: All the auditing and assurance standard apply on or after 1st April 1985

Audit Evidence under AAS – 5 (SA500)

As per AAS - 5, audit evidence means the collection of important information for checking of accounting reports. You know, this world is working on the basis of proofs.

Following are the Main Ways for Collecting Audit Evidences:-

- **Inspection**
- **Observation**
- **Inquiries and Confirmation**
- **Computation.**
- **Analytical Reviews**

1. Inspection

Inspection is the main method of audit evidence. If any auditor says that accounting reports are not showing true and fair views, then interested parities will demand its proofs. At that time, he will explain that he did inspection and lots of transactions which are recorded in the accounting records are without sources. We also examined the records and found unreliable. So, auditor should come physically to the office of company and check accounts one by one and write it in inspection notes which will become his audit proof. He should also check the assets physically.

2. Observation

In the observation way of collecting audit evidence, auditor will observe the process of accounting records which are done by others. For example, there are large quantities of stock in the store which were counted by store keeper. Auditor can take sample and ask the quantity. Now, store keeper will count it. Auditor will observe whether he is counting correctly or not. On this basis, he will make his observation report and it will be his audit evidence for telling counting process is wrong or correct.

3. Inquiries and Confirmation

Inquiries are the set of questions which are asked by auditor from inside personnel and outside persons for knowing useful information regarding accounting records of company. This inquiries may be written or oral. If it is oral, auditor will write the responses of his inquiries when he will free in same day. Confirmation is also response of auditor's query.

4. Computation

Computation is the calculation of figures which are showing in the accounting records. Auditor can fix the duty of his assistant to calculate the total of bills and

ledger balances and then he see whether there is difference or not in his calculation. This audit evidence will be helpful for knowing arithmetical accuracy in the books of accounts.

5. Analytical Reviews

In analytically reviews, auditor calculates different accounting ratios and analyse the past financial statements for checking the variations in the figures of financial statements.

Following Audit Evidence is Must :-

1. Existence of Asset : Whether an asset is exist in the company or not. Evidence can get after physical checking only.

2. Right and Obligations on the Assets and Liabilities : Whether asset is of company or not. Its proof shows its original buying bill. Whether an liability is the obligation of company or not. Its proof will be the loan agreement document.

3. Correct Valuation: Whether valuation is correct or not, for confirming this, just go to market and know the correct value of specific asset of company

4. Correct Measurement: Whether quantity is measure correctly or not depends on the person who is responsible for this. Through above observation way, you can check whether person is measuring correct or not.

5. Correct Presentation and Disclosure: To check whether all financial statements are presented and disclosure on the basis of statutory requirement or not.

Unit 3: Company Auditor.

Synopsis

- **Auditors Qualification.**
- **Disqualification.**
- **Appointment of auditor**
- **Removal of an auditor.**
- **Rights and duties of a company auditor**
- **Liabilities of a** company auditor

Auditors Qualification.

Qualification of a Company Auditor:
According to Section 226(1) and 226(2) of the Companies Act, the prescribed qualifications of an auditor are as follows:

Qualification [sec226 (1)]:
1. The auditor of a co. may be either, an individual or a firm
2. In the case of an individual, he should be a Chartered Accountant within the meaning of Chartered Accountants Act 1949 i.e. he should be holding certificate of practice.
3. In the case of firm of auditor's all the partners of a firm shall be chartered accountants practicing in India within chartered accountants Act1949.

Qualification [Sec 226(2)]:
A person holding a certificate issued by central govt. under restricted state auditors rules prior to the enactment of part B state laws 1951 can also be auditor of the co.
The central government in empowered to frame rules relating to granting renewals, suspension or cancellation of such certificates.

Disqualification of a Company Auditor

According to section 226(3) of the Companies Act, the following persons shall not be appointed as auditors of a company:

1. A body corporate. A company cannot audit any other company,
2. An officer or employee of the company.

3. A person who is either a partner or employee of an officer or employee of the company.
4. A person who has taken debt from the company for amount exceeding Rs. 1,000.
5. A person who has taken guarantee of another person who has taken a loan exceeding Rs. 1,000 from the company.
6. A person who holds shares or debentures of the company cannot audit that company.

Appointment of auditor

Particulars	Non-Government co	Listed/Specified co	Government Company co
1. Application for 1st Auditor post Incorporation	-Appointed by the Board Of Directors. -This has to be done within 30 days from the date of Registration. -Appointment can also be done by Members at Extraordinary General Meeting within 90 days of information.	-Appointed by Board Of Directors. -This has to be done within 30 days from the date of Registration. -Appointment can also be done by Members at Extraordinary General Meeting within 90 days of the information	-Appointed by the Comptroller and Auditor General of India. -This has to be done within 60 days from the date of Registration. -Appointment can also be done by Board of Directors within 30 days of incorporation
2. Auditor at First AGM. The written consent and a certificate.	-The appointment is done by the members	-The appointment is done by the members for a maximum term of 5/10 consecutive years	-The appointment is done by the Comptroller and Auditor General of India -He should be appointed within 180 days from the 1st of April
3. Appointment of Subsequent Auditor	-The appointment is done by the members	-The appointment is done by the members for a Maximum term of 5/10 consecutive years	-The appointment is done by the Comptroller and Auditor General of India within 180 days from the 1st of April
4. Casual Vacancy due to resignation and other reasons	-The appointment is by the members within 3 months of the recommendations of Board and he will hold office till the next AGM		The appointment is done by the : -CAG (Comptroller and Auditor General) within 30 days OR -BOD within the next 30 days

Removal of an auditor.

Removal of first auditor: The company can remove the first auditor appointed by the directors, in a general meeting. The central government's approval is not needed for the removal of first auditor's .

Removal of subsequent auditor: Any subsequent auditor can be removed from the office before the expiry of his term only by the company in its general meeting , after obtaining the prior approval of the central government and following the same procedure as laid down for appointment of an auditor in the place of a retiring auditor.

Rights and duties of a company auditor

Rights:

- **Rights to access the books and records**: Company auditor has rights to access the books and records of the company. He can refer to any book..
- **Right to get explanations from company staff:** Company auditor has right to get explanations from company staff. If such explanations are not received he qualifies his report.
- **Right to receive notice of general meetings:** Company auditor has right to receive notice of general meetings. He can attend the general meetings.
- **Right to visit branches:** Company auditor has right to visit branches. But there should be no separate auditors to those branches and it should be a home branch
- **Right to seek legal and technical advises:** Company auditor has right to seek legal and technical advises. But, in his report, he should express his own opinion but not that of experts concern.
- **Right to claim remuneration:** Company auditor has right to claim remuneration. His remuneration will be fixed by appointing authority and it will be paid by company.
- **Right to refuse to commence the audit:** Company auditor has right to refuse to commence the audit. Till making the records up to date, he cannot start his work.
- **Right to question the board:** Company auditor has right to question the board. Board also should give explanation to him.
- **Right to qualify his report:** Company auditor has right to qualify his report. If he comes across any dis-satisfactory point, he can mention the same in his report.
- **Right of indemnity:** Company auditor has right of indemnity. He can reimburse expenses incurred by him in connection with conduction of audit work.

Duties:

Duties towards the shareholders:

1. Report shareholders about true and fair state of affairs of the company
2. State that balance sheet and profit and loss a/c give all information required by law
3. State that balance sheet and profit and loss a/c agree with the books of account
4. State that balance sheet and profit and loss a/c agree with accounting standards
5. State that he has obtained all the necessary information
6. State whether the company has maintained all books as required by law;
7. State the reasons of qualification in his report
8. State that he has received the audit report on the branch accounts audited by other auditor and how he has dealt with the same in preparing his report
9. Auditor shall state in his report whether:

a) The loans taken are properly secured and the terms of loans are not against the interests of the company

b) Loans given are shown as fixed deposits and the terms of loans are not against the interests of the company

10. Transactions recorded as book entry are not against the interests of the company
11. Personal expenses of directors have not been charged to revenue a/c of company;
12. The company fulfils the requirements of CARO 2003.

Duties towards Company:

1. Prospectus: According to Sec 56, the auditor is required to certify profits or losses, assets & Liabilities and dividend paid etc in the prospectus.

2. Statutory Report: Section 165 requires that the auditor has to certify the statutory report.

3. Public Deposits: Section 58AA requires the auditor to report about whether the company has followed all rules and guideline of RBI in regard to public deposits or not.

4. Signature on Audit Report: Section 229: It is duty of auditor to sign on his report.

5. Insolvency (Section 488): If the company wants itself to be declared insolvent, it is duty of auditor to prepare profit and loss a/c for the current period.

Duties towards Government:
1. CARO-2003: The auditor has to report para-wise that the company has fulfilled all the requirements of CARO-2003.

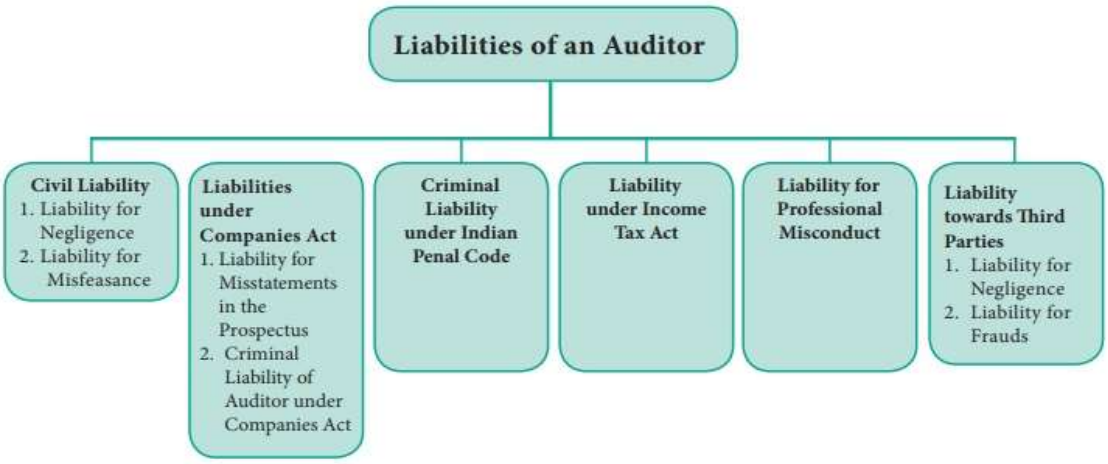
2. Assist the Investigation u/s 237: It is duty of auditor to assist the investigation ordered by the CG u/s 237.

Duties towards General Public:
1.His office is of confidence and faith. He must be reliable in all respects.

2. He should reveal all material information regarding the state of affairs of the company to the company as well as to the general public.

3. While issuing prospectus u/s 56, he should see that the prospectus does not include any misleading information or material.

Liabilities of a company auditor



Liability for Negligence: While conducting the work of audit, auditor should take proper care and should show proper skills. Otherwise it amounts to negligence.

- *For example:* Mr. X is a sole trader and Mr. A is his auditor. A has conducted audit work so negligently and therefore he could not find misappropriation of cash,

amounting to Rs. 10000/-. Now A is liable to pay such amount to X, it is called liability for negligence.

Contractual Liability: In case of optional audits rights, duties, liabilities etc of auditor will be of contractual nature. So there may be terms between auditor and client according to which auditor has to become liable on certain agreed occasions. Contractual liability is agreed liability.

Unit 4: Tax Audit

Synopsis

- **Meaning.**
- **Scope of auditor's role under the income tax act.**
- **Certificate of claiming exemptions.**
- **Selective tax audit.**

Meaning.

A tax audit is a formal examination conducted by the IRS to verify information or uncover fraud and inaccurate tax returns. The IRS selects tax returns to examine both randomly and intentionally. If the audit is selected randomly, the IRS will simply take a closer look to make sure all information are accurate. The IRS will intentionally audit certain tax returns if there are issues, errors, or possible frauds in reporting the tax return. Tax audits can be broken down into four different types:

1. **Correspondence Audit**: This is the least serious type of tax audit. A correspondence audit refers to the IRS request of additional information to verify the accuracy or details of your tax return.
2. **Office Audit:** An office audit refers to the in-person interview with an IRS manager to process your audit. To avoid making statements that can be used against you, it's highly advisable to consult with an attorney or a tax professional before you attend the interview.
3. **Field Audit**: This is the most serious type of audit because the IRS agents will visit you at home or business. They may ask to see things that are related to the tax you've reported.
4. **Random Audit:** As mentioned above, tax returns can be randomly selected for an audit. A random audit is made without any particular reason. The IRS auditor will review the entire tax return to make sure the information was entered correctly.

Scope of auditor's role under the income tax act.

Category of person	Threshold
Business	
Carrying on business (not opting for presumptive taxation scheme*)	Total sales, turnover or gross receipts exceed Rs 1 crore in the FY
Carrying on business eligible for presumptive taxation under Section 44AE, 44BB or 44BBB	Claims profits or gains lower than the prescribed limit under presumptive taxation scheme
Carrying on business eligible for presumptive taxation under Section 44AD	Declares taxable income below the limits prescribed under the presumptive tax scheme and has income exceeding the basic threshold limit
Carrying on the business and is not eligible to claim presumptive taxation under Section 44AD due to opting out for presumptive taxation in any one financial year of the lock-in period i.e. 5 consecutive years from when the presumptive tax scheme was opted	If income exceeds the maximum amount not chargeable to tax in the subsequent 5 consecutive tax years from the financial year when the presumptive taxation was not opted for
Carrying on business which is declaring profits as per presumptive taxation scheme under Section 44AD	If the total sales, turnover or gross receipts does not exceed Rs 2 crore in the financial year, then tax audit will **not** apply to such businesses.
Profession	
Carrying on profession	Total gross receipts exceed Rs 50 lakh in the FY
Carrying on the profession eligible for presumptive taxation under Section 44ADA	1. Claims profits or gains lower than the prescribed limit under the presumptive taxation scheme 2. Income exceeds the maximum amount not chargeable to income tax

Certificate of claiming exemptions

CA certificate in case of exemption or deduction claim by the assesse. CBDT Should make it mandatory to obtain the CA certificate in case of exemption or deduction claim by the assessees is in excess of certain amount for other than audit and salaried assessees for verifying the correctness and genuineness of claim.

Unit 5: Audit of computerized system
Synopsis

- **Meaning.**
- **Types of EDP accounting system.**
- **Problems of EDP environment.**
- **Controls in an EDP environment.**
- **Audit approach in an EDP environment**
- **Computer Assisted Audit techniques.**

Meaning

It is the audit of all information system assets, to ensure that they are adequately safeguarded against vulneraries of natural and manmade disasters. The type is identified with reference to the risk exposure. It is performed by qualified information system auditors. The detection of frauds and errors are by ensuring various safeguards prescribed by the systems men, internal and external auditors qualified to perform systems audit.

EDP Audit is an analysis of an organization's computer and information systems in order to evaluate the integrity

Types of EDP accounting system

There are various methods of data processing but there are some very popular methods when it comes to “electronic data processing”. These methods are widely adopted in almost every industry. Depending on the nature of requirement of data processing, some of the most popular methods of electronic data processing are explained below:
Time-sharing
Real-time processing
Online processing
Multiprocessing
Multitasking
Interactive processing
Batch processing
Distributed processing

Problems of EDP environment.

1.Theft of Computer Time: Information created by one person may be easily copied by another person who can claim that the data is his own and he is the actual creator. In computers there is nothing like original copy and duplicate copy.

2. Manipulation of Programs: An intruder, rival or competitor can manipulate, modify or delete one or more programs of a company making the complete software unusable

3.Theft of Data: Data stored in a computer can be copied into floppies and could be delivered to competitors. With modern communication networks available, insiders of the company may send confidential information of a company to another. Hackers can connect to network and steal data.

4. Stealing Software: An intruder, rival or competitor can manipulate, modify or delete one or more programs of a company making the complete software unusable.

5. Controlling Access: Controlling of hardware and software should be the first system security. The system should be under lock and key to prevent hardware theft. Physical and electronic access control techniques including keyboard locks, automatic logs, restricted access to systems and limited after-hour use.

6. Passwords: Passwords should be provided at all levels of system. They should be changed frequently or as and when needed so that unauthorized users cannot enter into the system.

7. Backup Copies: It is necessary to take frequent backups of all software and keep them separate from the usual media. Backups are often taken on tapes and are used to restore data when the primary data from the system fails. Software programs should also be taken if necessary.

8. Security for Backup: Backups should be kept in secure place. Loss of backups means disaster for the company. Protection of backups includes fireproof containers and away from the computer installation site to avoid any natural disaster.

9. Network Control: Most companies may have computers that exchange data with each other using a networking architecture. In such cases, PC users can connect with another person/users and access files or services from the machine.
Since outsiders [competitors] can also get connected to our network, special interest should be shown on security of systems and data located on the internet

10. Data Encryption: It refers to the means of converting data into an unrecognizable form, transmitting it over a network and decrypting it back so that the original contents

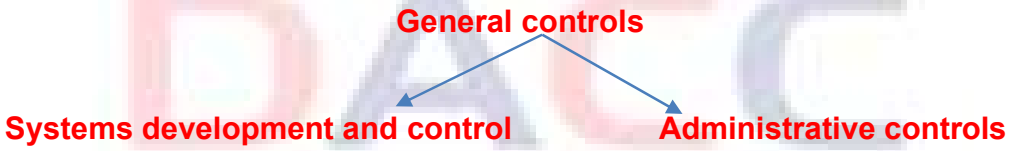
can be revealed. If an unauthorized person taps into the file, could not go through its contents.

Controls in an EDP environment

Internal Control in an Electronic Data Processing system
Internal controls in computer-based accounting system are of two basic types:

1) General controls or organization controls
2) Application or procedural controls

2)



This control covers the environment in which computer processing is conducted. Some of the objectives of general control include:
a) To ensure adequate segregation of duties, that is, division of functional responsibilities
b) To protect information contained in computer records etc.

Systems development and control

This covers the following areas:
Standards: There should be standard procedures to be followed anytime an application is introduced. This will include adequate feasibility studies covering investigation, fact recording and analysis of gathered facts. It also covers the design of new systems, implementation and most importantly systems change over procedure.
Documentation: There should be proper documentation using flow charts, decision tables, structured English etc and all these should be incorporated in a manual for use. Testing: The new system should be fully tested before being used operationally. Programs should be checked with test and live data while the whole system should be tested using parallel running or pilot operation technique.

File conversion: Before the new system becomes operational, master files should be set up completely and accurately. This can be achieved by a complete print out of the contents of master files and crosschecking the results with manually maintained records. This process is referred to as conversion checks.

Authorization: Each system development stage should be reviewed by a responsible officer in the EDP department and it must be approved by the steering committee or board of directors but most importantly, it must be acceptable to user department.

Conclusion.
It is important to consult with auditors because they would want to ensure that sufficient control is present in the new system to maintain reliable accounting records.

Administrative Controls

a) **Division or segregation of duties:** Data processing staff should not initiate transactions or authorize normal transactions while users should not operate the computer by self to process transactions.

b) Control over computer operators: There should be control over computer operators using manual with details of standard procedures to be followed always. There should be frequent and independent review of computer usage by references to clerical and machine logs.
There should be rotation of operators' duty and a minimum of two operators per shift.

c) File control:

- File storage procedure
- File identification procedures:
- Protection
- File reconstruction procedures:

d) General security:

Application or procedural control This includes:
Input, processing, output and master file controls. These controls are to ensure the completeness and accurate processing of data.

Input controls: There should be segregation of duties between users and EDP functionals. For example, input should be originated by users only, and amendments should be done by authorized personnel
Processing control: This relates to all arithmetic and logic operations or input carried out by programmed procedures such as edit controls or data vet.
Output control: There should be reconciliation or matching of input totals established prior to processing to computer generated output totals

Computer Assisted Audit techniques.

Computer Assisted Audit Techniques (CAATs) is the tool which is used by the auditors. This tool facilitates them to make search from the irregularities from the given data. With the help of this tool, the internal accounting department of any firm will be able to provide more analytical results

There are two broad categories of CAAT:

Audit software: Audit software is used to interrogate a client's system. It can be either packaged, off-the-shelf software or it can be purpose written to work on a client's system. The main advantage of these programs is that they can be used to scrutinize large volumes of data, which it would be inefficient to do manually. The programs can then present the results so that they can be investigated further

Test data: Test data involves the auditor submitting 'dummy' data into the client's system to ensure that the system correctly processes it and that it prevents or detects and corrects misstatements. The objective of this is to test the operation of application controls within the system

Advantages of CAATs

CAATs allow the auditor to:

- Independently access the data stored on a computer system without dependence on the client;
- Test the reliability of client software, i.e. the IT application controls (the results of which can then be used to assess control risk and design further audit procedures);
- Increase the accuracy of audit tests; and
- Perform audit tests more efficiently, which in the long-term will result in a more cost effective audit.

Disadvantages of CAATs

- CAATs can be expensive and time consuming to set up, the software must either be purchased or designed (in which case specialist IT staff will be needed);
- Client permission and cooperation may be difficult to obtain;
- Potential incompatibility with the client's computer system;
- The audit team may not have sufficient IT skills and knowledge to create the complex data extracts and programming required;
- The audit team may not have the knowledge or training needed to understand the results of the CAATs; and
- Data may be corrupted or lost during the application of CAATs.