Unit – II

Lesson – 4

Different Classes of Audit

Context of the lesson:

The lesson deals the different classes of audit, viz., Private audit, Public audit, Government audit, Internal audit, External audit, Cost audit and Balance audit.

Objective:

The objective of this lesson is to know the-

1. Types of audit
2. Uses or application of these audits
3. Advantages of these audit

Introduction

An audit examination may be performed in many ways, depending on the needs and convenience of the concern. Thus, it may be once in a year after the financial statements have been prepared or continuously round the year at regular or irregular intervals. According, an audit may be classified as follows-

1. Statutory Audit
2. Private Audit
3. Government Audit
4. Continuous Audit
5. Final Audit
6. Interim Audit
7. Internal Audit
8. Environmental Audit
9. Cost Audit
10. Special Audit
11. Management Audit
12. Balance Sheet Audit
13. Social Audit

Statuory Audit

Where audit in the case of an organization is made compulsory by law, it is called statutory audit. Statutory audit has been prescribed in the case of the following-

1. By the Companies Act, 1956 (For Private and Public Companies)
2. By the Banking Regulation Act, 1949, For the
   - Public Banks
   - Private Banks
   - Commercial Banks
3. By the Electricity Supply Act (For the Electricity supply Companies)
4. By the Co-operative Societies Act (For Co-operative Societies registered under this Act)
5. By the General Insurance Act, 1938 (IRDA)
6. By the Life Insurance Corporate Act, 1956
7. By the Societies Registration Act, 1860 (For the Societies)

Statutory audit is compulsory under an statute or law (mentioned above). It can be conducted only by a qualified chartered accountant, whose rights, duties and liabilities are determined by the concerned statute or law. Statutory audit can never be partial audit. It always has to be a complete audit. Appointment of the auditor is made according to rules or norms of the relevant Act.

Essential elements of a Statutory Audit:

(i) It is mandatory by nature
(ii) The auditor must be C.A.
(iii) Appointment of the auditor is made as per rules or relevant Acts.
(iv) Rights and duties are decided by the Act.

Private Audit

Where audit in the case of an organization is not made compulsory by law, it is called private audit. It is known as voluntary audit and can be conducted by the respective organization for the taking the several benefits from it. In India Sole Trader, Partnership Firms, Hindu Family business, etc. are not obliged under the law to get their financial statements audited, though according to a recent amendment to the Income tax Act, 1961, Audit by a professional auditor has been made compulsory in the case of all businesses whose gross turnover exceeds Rs. 90 lakhs and all professional persons whose gross receipts exceed Rs. 10 lakhs.

Advantages of Private audit –

1. Checking of frauds and errors is possible.

2. Raising of loans becomes easy.
3. It helps in settling accounts between Partners themselves and there by avoids the possibility of future disputes.
4. The audited accounts may be accepted by concerned authorities for income tax, Sales tax, VAT and other relevant tax assessments.
5. The partners can avail themselves of the benefits of the expertise of audit for the purpose of taxation or better management, etc.

Private Audit is conducted by –

1. Sole Traders
2. Partnership Firm
3. Individuals
4. Rent Collectors
5. Estate Managers
6. Clubs
7. Hospitals
8. Libraries
9. Colleges and
10. Schools.

Government Audit

The Government audit is conducted by the government departments. The Government maintains a separate department in the name of Accounts and Audit Department which performs the audit of its departments and offices. This department is headed by the Comptroller and Auditor General of India who is assisted by different officials at various levels.

The duties and powers of the Comptroller and Auditor General of India have been specified under the Comptroller and Auditor General (Duties, Power and Conditions of service) Act, 1971.

The report of the Comptroller and Auditor General relating to the accounts of the Union shall be submitted to the President of India, who shall cause them to be laid before house of Parliament. The reports relating to the accounts of the states are to be submitted to the Governors of the respective States who shall cause these to be laid before the state legislature.

Government audit can be divided as follows –

(i) Audit of government offices.
(ii) Audit of government departments.
(iii) Audit of government undertakings.
(iv) Audit of government companies.

(v) Audit of government aided/Granted Companies.

Final Audit

Final audit is done at the close of the financial or trading period when final accounts are prepared. In such a case the auditors visits his client only once a year and check the accounts in one visit till he is not in a position to cover the accounts pertaining to the whole of the period.

Final audit is less expensive and more useful for a small business concern than continuous audit. In such audit the work of auditor can be finished quickly and within a reasonable time.

Advantage of final Audit:

(i) It is economical and suitable particularly for small sized business units.

(ii) There is less possibility in periodical audit of the work becoming mechanical or boring.

Interim Audit

Interim audit is conducted for a part of the accounting year with some interim purpose, such as declaration of interim dividend by an incorporated company. If may also be needed in the case of a Partnership firm at the time of admission or retirement of the partners. It is conducted between two Periodical audits.

Advantages of Interim Audit:

1. Publication of interim result is made possible.
2. With the interim audit, it becomes easy to complete the final audit soon.
3. Errors and frauds may be detected during the period itself.
4. In case of such audit, it become easy to complete the annual soon.
5. Interim audit helpful when the publication of interim figures becomes necessary.

Why Interim Audit?

An Interim audit is done for the –

(i) Declaration of interim dividend.

(ii) Admitting new partner

(iii) Outgoing an old partner

(iv) Purchasing of existing business

(v) Selling the existing units.

Internal Audit

According to L.R. Howard, Internal audit may be defined as, “A review of operation and records, sometimes continuous, undertaken within a business by specially assigned staff.” It is done by the employees of the business undertaking who are not necessarily qualified person (having C.A. degree).

Thus internal audit is conducted by the staff of the business itself. It serves primarily the needs of management. The main concern of an internal audit is with the prevention and detection of fraud.

An internal auditor is independent accountant but is not independent of management. He is appointed by the management of the business and as such, he reports to the management.

Objectives:

1. To ensure the management that the internal check and the accounting systems are effective in design and operation.
2. To ascertain that there has been proper authority for transactions of the business.
3. To prevent and detect the errors and frauds.
4. To facilitate and expedite the annual audit conducted by an independent auditor.

Self check Questions

Short Question:

1. What is Private audit?
2. What is Statutory audit?
3. What is the main objective of Internal audit?
4. Who is the appointing authority of Internal auditor?

Objective Questions:

1. Which is the compulsory Audit?
   (a) Private audit (b) Statutory audit
   (c) Interim audit (d) All of these
2. Statutory audit is conducted by –
   (a) Banking Companies (b) Sole traders
   (c) Partners (d) All of these
3. Which type of audit is suitable for sole trader?
   (a) Private audit (b) Government audit
   (c) Statutory audit (d) All of these
4. Which is not a type of audit?
   (a) Self audit (b) Government audit

(c) Statutory audit (d) All of these

5. Government audit is conducted by –
   (a) Partnership firm (b) sole trader
   (c) Government department (d) All of these
6. Final Audit is known as –
   (a) Periodical audit (b) Annual audit
   (c) Completed audit (d) All of these
7. Which audit is done between a financial year?
   (a) Final audit (b) Complete audit
   (c) Interim audit (d) All of these

Environmental Audit

The International Chamber of Commerce defines "Environmental auditing as a basic management tool comprising a systematic documented, periodic and equipment are performing with the aim to safeguard the environment by –

(I) Facilitating management control of environment practices,

(II) Assessing compliance with company policies, which would include meeting regulatory requirements.

Objectives:

The objectives of Environmental Audit are –

1. To examine the compliance of environmental norms of the regulatory bodies.
2. To assess and verify the environmental compliance with the corporate requirements.
3. Ensuring quality improvement in every spheres of corporate life.
4. Evaluation and reporting of key environmental performance, like pollution control measures, waste management etc.
5. To minimise wastage, losses and thereby resulting in cost reduction.
6. To generate awareness and consciousness about environmental issues amongst all level of employees in the organization.

Subject matter Environmental Audit:

The following are the subject matters of Environmental audit –

(i) Noise Pollution

(ii) Air pollution

(iii) Water Pollution

(iv) Pollution Control

(v) Pollution abetment

(vi) Pollution management

(vii) Environmental management
(viii) Green management
(ix) Comparison between standards and actual figures.

Environmental audit is applicable in case of the following industries or companies –

1. Oil industries
2. Oil refineries
3. Cement industries
4. Sugar industries
5. Motor car industries
6. Vanaspati ghee industries
7. Iron industries
8. Steel industries
9. Marbel industries
10. Chemical industries.

Cost Audit

Cost audit may be defined as the verification of the correctness of cost accounts and a check on the adherence to the cost accounting plan. It is the audit process for verification of the cost of manufacturing or production of any article on the basis of accounts relating to utilization of material, labour and overheads.

According to Smith and Day, the term “ Cost audit refers to the detailed checking of the costing system, technique and accounts to verify their correctness and to ensure adherence to the objective of cost accounting.”

According to Harpar, “ Cost audit is the verification of the correctness of the cost accounts and of the adherence to proper cost accounting procedures.”

According to ICWA, London –

Cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan.

Hence, Cost audit is a systematic and accurate recording of detailed transactions and operations of manufacturing, contracting, extracting, transporting, supplying, etc. so as to show the actual cost of each individual piece of work, service or separate process comprised in the operations of the business.

Objectives of Cost Audit:

(I) To verify the cost accountancy records made in the books of accounts are accurate.

(II) To certify that the principles of Cost Accountancy have been fully applied in maintaining cost accounts properly.

(III) To find out that the management is adhering to the procedures and processes of cost accounting which are predetermined.

(IV) To detect and prevent errors and frauds in preparing cost records.

(V) To ensure the integration of cost accounting system and technique into the total system of the organization.

Nature of the cost Audit

1. The cost audit is not compulsory for all the companies.
2. The cost audit has to examine the cost records in detail.
3. The cost audit is concerned with those aspects of the account which are mainly related to the cost.
4. The cost auditor submits his report to the Central Government.

Special Audit

Under Section 233 A (i) the Central Government is empowered to direct special audit in certain cases. The provisions are as under.

(I) The Central Government may at any time by order direct that a special audit of the company's accounts for such a period as may be specified in the order, shall be conducted and may by the same or different order, shall be conducted and may by the same or different order appoint a Chartered Accountant as defined in clause (b) of sub-section (i) of section 2 of the Chartered Accountant Act, 1949 or the company's auditor himself to conduct such special audit.

(II) The person who conduct a special audit will be known as special auditor.

Self check Questions:

1. What is environmental audit?
2. What are the objectives of the environmental audit?
3. What is Cost Audit?
4. Explain any two objects of Cost Audit.

Management Audit

A Management audit is an attempt to evaluate the performance of various management processes and functions. It is an audit to examine, review and appraise the various policies and plans of management on the basis of targets.

Management audit can be defined as follows –

As per T.G. Tokhe, "The Management Audit has been defined as a comprehensive critical review of all aspects of the process of management."

As per Taylor and Perry, "Management auditing is a method to evaluate the efficiency of management at all levels throughout the organisation, or more specifically, it comprises the investigation of business by an independent body from the highest executive level downwards in order to ascertain whether sound management prevails throughout and to report as to its efficiency or other wise with recommendations to ensure in effectiveness where such is not the case."

As per L.R. Howard, "Management audit is an investigation of a business from the highest level downwards in order to ascertain whether sound management prevails throughout thus facilitating the most effective relationship with the outside world and the most efficient organization and smooth running internally."

Nature of Management Audit

1. Management audit is not prescribed by the law.
2. There is no limitation as to the period to be covered.
3. There is no legal compulsion as regards the management audit.
4. A management audit is required to submit his audit report to the company and no time limit is fixed for the submission of such a report.

Objects of Management Audit:

Main Object: The management auditor investigates the aims and objects of the concern.

Secondary Object: The management audit helps in forming a good relationship between the staff and the management. Through the management audit a review of the performance of the various managers can also be made.

Advantages of management Audit:

1. It critically assesses the performance of different levels of management and different process and functions of management.
2. It attempts to make internal control system more effective and move objective.

Balance Sheet Audit

In Balance Sheet audit, the auditor checks capital, reserve, surplus, loan, current liabilities, provision, assets and stocks, etc. given in the Balance Sheet. He checks only those documents which are related to the item given in the Balance Sheet.

Items of Balance Sheet Audit –

Assets Side

1. Cash in hand
2. Cash at Bank
3. Goodwill
4. Patents
5. Trademark
6. Plant and Machinery
7. Building
8. Land
9. Stock
10. B/R
11. Investment
12. Motor Car
13. Furniture

Liabilities Side

1. Share Capital
2. Reserve
3. Surplus
4. Creditors
5. Debentures
6. Bank loan
7. B/P
8. Bank Overdraft
9. Provision

Continuous Audit

Continuous audit implies that there is a continuous visit of the auditor. The company auditory examines the books of accounts regularly during the year by visiting the client’s office throughout the year periodically. He may visit weekly or monthly, or daily; and so on. When the auditor visits the client’s office he checks up all the transactions up to date where possible. The work, therefore is conducted throughout the financial year.

According to Spicer and Pegler, "A Continuous audit is one where the auditor's staff is occupied continuously on the accounts the whole year round or where the auditor attends at intervals, fixed or otherwise, during the currency of the financial year and performs an interim audit, such audits are adopted where the work involved is considerable and have many points in their favor although. They are subject to certain disadvantage."

According to R.C. Williams, "A Continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends at regular or irregular intervals during the period."

Application of continuous Audit

1. Bank
2. Insurance Companies
3. Railways
4. Hotel
5. Cinema
6. Road Transport

Conditions for the Application of Continuous Audit:

1. When preparation of final accounts is necessary at the closure of financial year.
2. When the scope of business is wide.
3. When the system of internal check is not satisfactory.

Advantages of continues Audit

1. It would be easier to detect errors and frauds quickly before they assume advanced from.
2. As the auditor pays surprise visits to the client's office it has a considerable moral check on them.
3. As the auditor visits the client's office at regular intervals, a detailed, close and exhaustive checking can be possible.
4. In big business concerns where monthly statements one prepared and the management is not smooth, continuous audit has proved to be very useful.

Disadvantages of continuous Audit

1. It is a more expensive form of audit

2. The frequent visits made by the auditor may dislocate the work of his client and cause inconvenience to him.
3. As the auditor comes at regular intervals to check the accounts the link between the post and present work cannot be maintained.

Techniques of Auditing

These are -

1. **Vouching:** An auditor examines documentary evidences relating to records or books.
2. **Confirming:** An audit conform the information from the respondents of the vouchers or information.
3. **Reconciling:** to find out differences in figures.
4. **Analysing:** The device or Process of segregating any accounting facts or figures is known as analysing.
5. **Testing:** Sample checking
6. **Physical Examination:** To examine actual or physical existence of an item or assets apposed in the books of accounts.
7. **Verification:** To find the correct position
8. **Scanning:** This implies a critical study or appraisal of the characteristics of data.
9. **Computation:** computation consists of checking the arithmetical accuracy of source documents and accounting, records or performing independent calculations.
10. **Analytical Review:** Analytical review consists of studying significant ratios and trends and investigating unusual fluctuation and item.

Preparation before Audit

The following preparation should be done before starting of an audit work:

1. Scope of work to be determined
2. To acquire full knowledge of business and its affairs, like-
   (i) Rules and regulation
   (ii) Type of business
   (iii) Nature of business
   (iv) Object of the business
   (v) Accounting nature
   (vi) Accounting system
   (vii) Books of Accounts
   (viii) Internal check system

3. Instruction to client.

4. The auditor should distribute the work and assign duties among his staff according to their qualifications, experience and training.
5. Preparation audit program.

Lesson – 5

General Audit

Context of the lesson:

This lesson deals Audit Program, Audit file and audit note book, Audit working papers, Test Check System and Routine Check System.

Objectives:

After studying this lesson you should be able to understand about –

- Meaning of Audit Program
- Form of Audit Program
- Audit note book
- Audit Working Paper
- Test Check System
- Routine Check System

Audit program

An audit program is the auditor's plan of action. It presents an out line of procedures to be followed to support on opinion on the financial statements.

As per Prof. Meigs, "An audit program is a detailed plan of the audit work to be performed, specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required."

As per Montgomery, "An audit program is a list generally in detail of steps to be performed in the course of an examination. It controls the nature and extent of examination aids in arranging, timing and distributing the work, guard against possible omissions and duplications and provides part of evidence of work done."

Audit programme is a written documents setting forth, in details, the various aspects of the proposed audit. Such programme is prepared before commencing the audit and it is updated with the progress of the audit.

Without a written and predetermined programme work is necessarily, to be carried out on the basis of some, mental plan. In such a situation, there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger insignificantly less and the audit can proceed systematically.

It serves as a guide to be carried out in the succeeding year. A properly drawn up audit programme serve as evidence in the event of any charge of negliance being brought against auditor. Audit programme normally provide for the following:

(i) Audit procedure to be applied
(ii) Extent of check
(iii) Timing of check
(iv) Allocation of work amongst the audit team members.

From the above definition of an audit program, we can say that an audit program is necessary for adequate planning and supervision of an engagement under the first standard of field work.

Advantages of Audit Program:

1. Identification of the work to be done
2. Distribution of work as per requirements
3. Base work for audit work
4. Identification of the audit work progress.
5. Evidence against charge of negligence
6. Increasing the efficiency of audit staff.

Disadvantages of the use of a Audit Programme:

(i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

(ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.

(iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.

(iv) A hard and fast programme may kill the initiative and innovation of efficient and enterprising assistants.

<u>Specimen of Audit Program</u>

Name of co. ----------------

Address ---------------------

Year……	Nature of works do be done during the Year					
Moths	Cash Book	sales Book	Purchase Book	Journal	Trial Balance	Balance checked
Jan.						
Feb.						
Mar.						
Apr.						
May						
Jun.						
Jul.						
Aug.						
Sep.						
Oct.						
Nov.						
Dec.						

Name of the Auditor --------------------

Audit File

The audit work is a repetitive nature. Since, it is undertaken period by period, it is customary to maintain current audit files. It is also permanent as the auditor usually remains in office and covers and conducts a number of separate audit. The maintenance of audit file it very important for the office of the auditor so as to enable him to keep them for easy and ready reference.

The auditor normally maintains two types of audit files for the company-

Audit File

Permanent File Current File

1. Permanent Audit File: Document is one of the basic principles governing an audit. SAP – 3 on 'Documentation' requires that an auditor should maintain working papers in connection with performance of the audit. The extent and form of documentation is a matter of professional judgment but working papers should be sufficiently complete and detailed for an auditor to obtain an overall understanding of the audit.

In the case of recurring audits, some working paper files may be classified as permanent audit files which are updated currently with information of continuing importance to succeeding audits, as distinct from current audit files which contain information relating primarily to the audit of a single period.

A permanent audit file normally includes:

(i) Information concerning the legal and organizational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
(ii) Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
(iii) A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
(iv) Copies of audited financial statements for previous years .
(v) Analysis of significant ratios and trends.
(vi) Copies of management letters issued by the auditor, if any.
(vii) Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
(viii) Notes regarding significant accounting policies.
(ix) Significant audit observations of earlier years.

Permanent audit file contains all the papers and documents which have a long term use. They can be referred to a repetitive engagement from year to year. Such file contains the following matters –

(i) Rules and Regulations
(ii) Copy of the various Law
(iii) Articles of Association
(iv) Memorandum of Association
(v) Partnership Deed
(vi) Copies of minutes
(vii) Copies of agreement
(viii) A brief details of the business or their staff
(ix) Nature of the work
(x) List of books and Registers
(xi) Financial Account's copy
(xii) Official manuals

2. **Current Audit File:** The current file contains the all the papers which pertain to the year, like –

(i) Audit Program
(ii) Internal Control system's questionnaire
(iii) Audit Note Books
(iv) Audit notes

(v) Bank Reconciliation Statement
(vi) The working Trial Balance
(vii) Adjustment entries
(viii) Flow chart

According to SAP-3 'Documentation' the permanent audit file would generally the following-

(i) Client's name, address and telephone numbers
(ii) Brief description of the business and its operations
(iii) A plan of the client's office lay-out.

Advantages of Audit file:

1. An audit file assists in the preparation of audit plan.
2. An audit file maximizes efficiency in auditing procedures.
3. It provides desired informations to the auditor.
4. It assists in the preparation of audit report.

Tax File: It contains all the documents relating to preparation and filing of the tax returns. The other item included there in are:

(i) Duplicates of tax returns as filed.
(ii) Record of payments.
(iii) Records of receipts.
(iv) Working papers relating to determination of tax liability and reconciliation of book and tax figures.
(v) Correspondence with the client and tax authorities.
(vi) Assessment orders
(vii) Evidence of tax payments
(viii) Refund claims
(ix) Refund orders
(x) Tax orders
(xi) Tax return
(xii) Tax policies
(xiii) Tax procedures
(xiv) Tax information
(xv) Records of tax books
(xvi) Vouchers relating to tax
(xvii) Tax cover notes

Self Check Question

Short Question:

1. What is Audit Program?

2. Write the advantages of Audit Program.
3. What is Audit File?
4. Define current Audit File.

Objective Questions:

1. Which is the technique of auditing?
   (a) Vouching (b) Confirming
   (c) Reconciling (d) All of these
2. Which is the type of audit file?
   (a) Permanent Audit file (b) Deemed file
   (c) Score file (d) All of these
3. Current Audit file includes
   (a) Audit Notes (b) Audit Notes Books
   (c) Flow Chart (d) All of these
4. Articles of Association is a Part of
   (a) Permanent Audit file (b) Current Audit file
   (c) Tax file (d) All of these

Audit Note Book

The audit not book is an vital book for the auditor. It is maintained by the audit clerk or other staff of the auditor. He keeps therein a record of his of observations during the course of any audit work and also the points to be discussed with the auditor. It is also a written record of the queries made by him to the various level of management and the replies there to.

Contents of an Audit Note Book

(i) Audit Program
(ii) Details or items are to be included in the audit report
(iii) Frauds and errors found in the books during the course of audit
(iv) Details about the organization
(v) Progress of audit work
(vi) Any queries for which explanations and information have to demanded
(vii) List of missing vouchers
(viii) Notes
(ix) Totals of important ledger accounts
(x) Record of all important correspondence.

Audit Working Papers

Auditing working papers are those papers which are prepared by the auditor or audit staff during the audit work. Such papers are competent records of pertinent information about the material under audit. Skill and care in their preparation is evident from the various purposes which they serve.

Working papers in the case of an audit consist of –

(i) Evidence obtained during the audit examination.

(ii) Details of the methods and procedures followed by the audit during such an examination.

(iii) Conclusions reached by the auditor as regards the objects of the audit. They are thus the records concerning an audit examination.

Audit working papers constitute the basic records for the auditor in respect of the audit carried out by him. They constitute the link between the auditor's report and client's record. These include retention of record in the nature or a document to show the actual audit work executed, the nature of the work the extent of the work and important points, facts, dates and decisions having bearing on the audit of the accounts audited. The working papers, if properly maintained, can be used as defence in case of need to establish that audit was conducted in accordance with basic principle governing an audit. The audit working papers are found very useful in the following aspects as they:

(i) Aid in the planning performance of the audit work;

(ii) Aid in the supervision and review of the audit work;

(iii) Provide evidence of the audit work performed to support the auditor's option; and

(iv) Act as evidence in the Court of law when a charge of negligence is brought against the auditor.

Items of the Audit Working Papers

1. Audit Program
2. Audit Note Books
3. Letters
4. Rules and Regulation
5. Contact Letters from the Client
6. List of Debtors
7. List of Creditors
8. List of Fixed Assets
9. List of Investment
10. Correspondence matters
11. Particulars of Depreciation
12. Details of the question made by the Auditor
13. Calculation

14. Rough Trial Balance
15. Rough Final Account
16. Closing Stock Schedule
17. Certificate collected from the outsider
18. Information
19. Copies of the resolutions passed in the meeting of shareholders of Board of directors
20. Copies of the documents which the auditor has taken.

<u>Self Check Question</u>

Short Question:

1. What do you mean by Audit Note Book?
2. What is a Permanent Audit File?
3. Write any six contents of Audit Note Book.
4. What is Audit Program?
5. What are the objectives of Audit Working Papers?

Objective Questions:

1. Which is helpful in notes down the important point and enquires?
   (a) Audit Note Book (b) Audit file
   (c) Tax file (d) All of these
2. Audit note book is useful for –
   (a) Organization (b) Customer
   (c) Staff (d) Auditor
3. Audit's note book is prepared by –
   (a) Auditor's staff or himself (b) Customer
   (c) Organization (d) All of these
4. Which is the contents of an Audit note book?
   (a) Audit Programme (b) Missing Voucher
   (c) Progress of audit work (d) All of these
5. Audit working paper includes –
   (a) Auditor (b) Staff
   (c) Customer (d) All of these
6. Audit working paper includes –
   (a) Schedules of Debtors (b) Schedules of creditors
   (c) Rough trial balance (d) All of these

<u>Routine Check System</u>

Routine checking is the checking of common records and books. It is carried on by the auditor as a matter of routine. It can verify the arithmetical accuracy of the entries made in the books of accounts.

The checking of books of records and registers which is carried on by the auditor as a matter of routine is known as routine checking in auditing.

Thus routine checking involves –

(i) Checking of casting in the books of original entry.
(ii) Checking of sub casting in the books of original entry.
(iii) Checking of carry forward in the books of original entry.
(iv) Checking of calculations in the books of original entry.
(v) Checking of Posting in the ledgers.
(vi) Checking of casting in the ledger.
(vii) Checking of balances in the ledger.
(viii) Checking of transfer of balances from the ledgers to the trial Balance.

Objectives of Routine Check System

(i) To check the arithmetical accuracy of the books of accounts.
(ii) To detect errors
(iii) To detect frauds
(iv) To verify the postings made by the accountant.

Advantages of Routine Checking

1. To check the arithmetical accuracy of the books of accounts
2. To detect errors
3. To detect frauds
4. No possibility of alteration

Test Check System

In test check system or test checking the auditor does not check all the records made into the books of accounts but selects a few items through a process of sampling and if they are found correct, he presumes that the remaining entries would also be correct likewise. Thus, test check system is based on a sample checking's principle in other words, if a representative number of transaction selected at random by the auditor for test checking is found to be correct, the remaining ones would also be correct.

As per Meig, " Testing and test checking means to select and examine a representative sample from a large number of similar items.

Test Checking and Routine Checking: Test checking is an accepted auditing procedure where instead of checking all transactions only a part of it is checked to form an opinion. The extent of examination of individual transactions would depend upon the auditor's appraisal of internal control and its operation including the security and other measures taken by management for the protection of the assets of the concern. If this appraisal proves satisfactory, the auditor employs test examination of the records. The examination of the records. The examination of the transaction selected should be sufficient, detailed and it is recommended that the auditor might usefully employ for this purpose the technique of 'statistical sampling' and 'auditing in depth'. such a procedure ensures that the errors noticed in the test check are more or less in the same proportion as the whole record required to be checked. Routine checking is the checking of casts, sub-casts, carry-forward, extensions and calculations etc., in subsidiary books, checking of postings into the ledgers, casting of ledger accounts and extraction of their balances etc. Routine Checking being more or less of mechanical nature is monotonous but it is most essential that it should be done thoroughly and intelligently as upon it will depend the discovery of many errors of postings, wrong total and the like which too plays no less important part in the scheme of an audit. The main objects of routine checking are –

(a) to verify the arithmetical accuracy of entries,

(b) to verify the accuracy of postings to ledgers,

(c) to check that the ledger accounts have been correctly balanced, and

(d) to ensure that no figures have been altered after checking.

Therefore, test checking involves all elements of routine checking restricted to limited number of transactions but the extent of checking is quite wide.

Advantages of Test Check System

(i) It saves time and energy because in a test checking all the books and transactions are not checked fully.
(ii) The volume of work is reduced. The time saved can be utilised for other audits.
(iii) If the selection of transactions is done intelligently test check system is useful and purposive.

(iv) It helps in reducing the cost of audit.

Disadvantages of Test Check System

(i) Since test check system is based on the selection of representative transactions, it is possible that all the errors and fraud may not be detected.
(ii) It is suitable only for big organization.
(iii) An auditor can easily cover up his negligence under the shadow of this system of test checking.

Self Check Question

1. What is an Internal Audit?
2. Explain the different kinds of Audit? Give the merits and demerits of each.
3. What is an Audit Program? State its features.
4. Write short notes on –
   (i) Audit techniques
   (ii) Audit Note Book
   (iii) Audit Working Paper
5. What is routine checking? State its steps.
6. What is a test check system? State its advantages and disadvantages.
7. Distinguish difference between Routine check system and test check system.
8. What is Routine check system? State its objectives and advantages..
9. What is the audit file? State its types.
10. what is Audit note books? Explain its contents.
11. State the items of permanent audit file.
12. State the contents of Audit working paper.

Lesson – 6

Appointment of Auditor

Context:

This lesson deals Appointment of Auditor.

Objectives:

After studying of this lesson you should be able to understand –

- Qualification of the Auditor
- Disqualification of the Auditor
- Appointment of the Auditor
- Removal of the Auditor

Appointment of Auditor

Qualification of the Auditor:

Section 226 of the Companies Act, 1956, lays down the qualification of auditors of a limited company-

(I) A person is qualified for appointment as the auditor of a company only if he is a chartered accountant within the meaning of the Chartered Accountant Act, 1949. Nationality is not important. A firm where of all the partners practising in India are qualified for appointment, all being chartered accountants, may be appointed by its firm name, in such a case any partners so practising may act in the name of the firm.

(II) The holder of a certificate under the Restricted Auditors Certificate (Part B States) Rules, 1956 shall be entitled to be appointed to act as an auditor of companies.

Disqualification of the Auditor

Under sub-section (3) of Section 226 of the companies Act, 1956. The following persons are not qualified for appointment as auditors of a company –

(i) a body corporate;

(ii) an officer or the employee of the company;

(iii) a person who is a partner, or who is in the employment, of an officer or employee of the company.

(iv) A person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for more than Rs. 1,000.

The aim of the aforesaid provisions is to ensure that the auditors are independent of the companies they audit.

Self Check Question

Short Question:

1. Who can be appoint as a auditor?
2. What are the qualification of the Auditor?
3. What is the disqualification of the Auditor?
4. What is section 226.

Objective Questions:

1. Who can be appoint as a Auditor?
   (a) C.A. Degree holder (b) M.Com.
   (c) BCA (d) All of these
2. What is the qualification for an auditor?
   (a) C.A. (b) MBA
   (c) Manager of the Company (d) All of these
3. C.A. stands for –
   (a) Chartered Accountant (b) Company Accountant
   (c) Cost Accountant (d) All of these

Appointment of the Auditor

(a) Appointment of First Auditors:

Section 224(5) of the Companies Act. 1956 lays down that "The first auditor or auditors of a company shall be appointed by the board of directors within one month of the date of registration of the company." The law further provides that if the auditors, the company at a general meeting may do so. In the instant

(b) Subsequent Auditors:

Except in the case of the first auditor every company shall at each annual general meeting, appoint the auditor at conclusion of that meeting until the conclusion of the next annual general meeting.

(c) Appointments by the Central Government:

Where at an annual general meeting no auditors are appointed within seven days of such a meeting, the company shall intimate this information to the Central Government who appoint a person to fill the vacancy.

(d) Casual Vacancy:

Where a vacancy, is caused by the resignation of an auditor the vacancy shall only be filled by the company in a general meeting. The Board of Directors may fill any other casual vacancy in the office of an auditor.

An auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

(e) Appointment of Auditor by Passing a Special Resolution:

Section 224A of the Companies Act, 1956. provides that in case of a company in which not less than 25% of the subscribed share capital is held whether singly or in any combination, amongst other, by a public financial institution or government or nationalized bank or an insurance company carrying on general insurance business, the appointment or re-appointment of an auditor or auditors at each annual general meeting shall be made by a special resolution only.

Reappointment of Auditor

Generally, at any annual general meeting, the retiring auditor shall automatically be reappointed; Neither the Board nor the shareholders can refuse to reappoint him. However, in the following cases, the retiring auditor shall not be reappointed –

(i) If retiring auditor is not qualified for reappointment.

(ii) If retiring auditor has given the company a notice in writing of his unwillingness to be reappointed.

(iii) If a resolution has been passed at the meeting –

(a) To appoint somebody other than him, or

(b) To provide expressly that he shall not be reappointed, or

(iv) If a notice has been given of an resolution proposing the appointment of some other person in the place of the retiring auditor.

Removal of Auditor

The first auditor of a company appointed by the directors prior to the first annual general meeting may be removed by the members in the general meeting. Any auditor may be removed from office before the expiry of his term. But this can be done only by the general meeting after obtaining the prior approval of the Central Government to this effect.

With a view to safeguarding the auditor's independence, the law provides very stringent provisions so far as removal of an auditor before the expiry of the term is concerned. Section 224(7) of the Companies Act, 1956. provides that an auditor may be removed before the expiry of his term by the company in a general meeting only after obtaining the prior approval of the Central Government. An exception to this rule is that no such approval is required for the removal of the first auditor appointed by the Board of Directors under section 224(5) of the Companies Act, 1956.

Refusal by Auditors to Accept the Reappointment:

Section 224(3) of the Companies Act, 1956 empowers the Central Government to fill a vacancy in case no auditors are appointed or reappointed at an annual general meeting. Since the appointment of an auditor is complete only on the acceptance of the office by the auditor. It can be deemed that case no auditor has been appointed and the Central Government may appoint a person to fill the vacancy as provided in section 224(3). Thus, the non-acceptance of appointment by the auditor does not result in any casual vacancy. Moreover even if the auditor is existing one would not make any difference since the appointment has to be made at each AGM and the auditor must accept the same. As a general principle, the shareholder has to exercise this power in all cases, except in the case of filling a casual vacancy or appointing the first auditors. Thus, the Board of Directors are not authorized to fill up the vacancy in case the existing auditors appointed at the AGM refuse to accept the appointment since no casual vacancy is arising.

Removal of auditors before expiry of their term:

The auditors appointed by whatsoever authority called Auditors appointed by the Board of Directors can be removed before the expiry of their term by the company at a general meeting without obtaining the pervious approval of the Central Government. However, a special notice of at least 14 days is required for the appointment of any other person in his place. However, to remove an existing auditor other than first auditor before the expiry of their term is quite a serious matter and affects the independence of an auditors. Therefore, Section 224(7) provides that the auditor of a company other than the first auditors, can also be removed before the expiry of their term by the company only at a general meeting but after obtaining prior approval of the Central Government. The requirements of Section 225 of the Companies Act, 1956 relating to removal of auditor shall in any case would apply. Thus, the Companies Act, 1956 contains stringent provisions to remove an auditor before the expiry of the term.

Ceiling Limit for accepting Audit of Companies: As per section 224(1B) of Companies Act, 1956, a Chartered Accountant cannot hold more than the specified number of company audit. It further says that in case of Chartered Accountant firms, the specified number is 20 companies per such partner who is not in whole time employment elsewhere. While counting 20 companies, not more than 10 companies may have a paid up share capital of Rs. 25 lacs or more. Besides, while counting 20 companies ceiling up share capital of Rs. 25 lacs or more besides while counting 20 companies ceiling limit, the following companies should not be considered as these companies are outside the scope of section 224.

(i) Branch audit
(ii) Special audit
(iii) Audit of foreign companies, and
(iv) Audit of private companies.

Remuneration of An Auditor

(1) When an auditor is appointed by the Board of Directors, remuneration is also fixed by the Board of directors.
(2) When the auditor is appointed by the shareholders at the annual general meeting, remuneration will also be determined by them.
(3) Where the central Government appoints the auditor, it will also fix auditors remunerations.

Self Check Questions

1. What is the Process of the removal of Auditor?
2. Define section 224(7).
3. Who appoints the first auditor?
4. What is the provision for casual vacancy?
5. Give the provision relating remuneration of auditor?
6. Give the rules relating to provisions.