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(Introduction to Auditing)

For

M. Com. Part-I

Semester - II

(In accordance with National Education Policy 2020)
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Preface

Auditing is an examination of the books of accounts, voucher of the organisation. It confirms a true and fair view of the state of affairs of the business. The students of accounting can learn philosophy of subject by learning auditing.

This is a small book covers two units, one consists of basic concepts of audit and another includes audit procedure and audit report.

We express our deep sense of gratitude to Hon. Vice-Chancellor Prof. (Dr.) D. T. Shirke, Pro-Vice-Chancellor Prof. P. S. Patil and Prof. (Dr.) D. K. More, Director the Centre for Distance and Online Education for giving us opportunity to contribute this book. Suggestions for improvement in the book are welcome from stakeholders of all corners.

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M. Com. Part-I

SIM IN ADVANCED ACCOUNTANCY PAPER VIII
(INTRODUCTION TO AUDITING)

INDEX

Each Unit begins with the section objectives -

Objectives are directive and indicative of :

1. what has been presented in the unit and
2. what is expected from you
3. what you are expected to know pertaining to the specific unit, once you have completed working on the unit.

The self check exercises with possible answers will help you understand the unit in the right perspective. Go through the possible answers only after you write your answers. These exercises are not to be submitted to us for evaluation. They have been provided to you as study tools to keep you in the right track as you study the unit.

Dear Students

The SIM is simply a supporting material for the study of this paper. It is also advised to see the new syllabus 2023-24 and study the reference books & other related material for the detailed study of the paper.

Unit-1

Basic Concepts of Audit

Index:

1.0 Objectives:

1. To understand the basic concept of audit and its scope.
2. To describe the Objectives of Audit.
3. To understand the basic principles of governing audit (AAS-1).
4. To Study the Various Types of Audit.

1.1 Introduction:

Audit in the present form came into existence after the Industrial Revolution during the 18th century when age of large scale production commenced. The organization of business was limited to sole proprietor activities, however, after the Industrial Revolution, due to large scale production, scope of business organization enhanced and many stakeholders involved especially investors. Such stakeholders are interested to know what happen with their resources involved in the specific business organization, hence, audit become important. In new forms of organization like a company, owners (shareholders) and management (board of directors and managers) are different. Here, the management who is handling capital and accounts of a company. It is not possible to every shareholder to check the accounts of the company. So they appoint a person, on their behalf, who will check the accounts, here is a need of auditor and auditing by him. Luca Pacialo who first published his treatise on double entry system of book-keeping for first time in 1494, he described the duties and responsibilities of an auditor.

1.2.1 Meaning of Audit:

At the beginning, let us see the meaning of audit. The word "audit" is derived from the Latin word "audire" which means "to hear". As the changes took place in duties and responsibilities of auditor, the change in the meaning of audit came and hence, various definitions of audit are given by distinct authors, thinkers and organizations which we are going to see in this section.

According to Spicer and Pegler, an audit is 'such an examination of the books, accounts and vouchers of a business, as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as give a true and fair view of the state of affairs of the business, and whether the Profit and Loss Account gives a true and fair view of the profit earned or loss suffered for the financial period, according to the best of his information and the explanations given to him and as shown by books, and if not, in what respects he is not satisfied."

1.2.2 Definitions of Audit

L. R. Dicksee has defined an audit in the words "An audit is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they purport to relate. In some instance it may be necessary to ascertain whether the transactions are supported by proper authority."

As per the opinion of **F. R. M. de Paula**, the term "Audit denotes something much wider, namely, the examination of a balance sheet and profit and loss account prepared by others. As a result of his examination of the books, accounts, vouchers etc. and of his inquiries, the auditor must satisfy himself that such balance sheet and profit and loss account are properly drawn up so as to exhibit true and fair view of the state of affairs and of the earnings of a particular concern."

The Institute of Chartered Accountants of India has said about auditing that "It is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report."

According to **Montegomery**, "Auditing is a systematic examination of books and records of a business or other organization, in order to ascertain or verify, and to report upon, the facts regarding its financial operations and results thereof."

J. R. Batliboi has defined auditing as "an intelligent and a critical scrutiny of the books of account of a business with the documents and vouchers from which they are written up, for the purpose of ascertaining whether the working results for a particular period, as shown by the Profit and Loss Account, as also the exact financial condition of that business, as reflected in the balance sheet are truely determined and presented by those responsible for their compilation."

On the basis of analysis of all the definitions of auditing we can come to the conclusion that the auditing has the following characteristics:

1. It is a systematic and independent examination of financial data
2. It ensures the correctness of Trading, Profit and Loss Account and Balance Sheet which makes a verification of true and fair view presented in financial statements.
3. An examination of books of accounts with motive is to detect errors and frauds in the books of accounts and financial statement.
4. An intelligent and a critical scrutiny of the books of account.
5. Through process of audit, an auditor collects the evidences, vouchers for transactions.

6. Auditor expresses an opinion on the quality of financial statements after ensuring the compliance of financial statements with the accounting standards.
7. Auditing concludes with audit report.

We can conclude on the basis of above definitions and characteristics of auditing that the audit means a critical and intelligent examination of facts-financial or otherwise, to give in the form of certificate or report an attestation, an expert opinion or an expert advice.

1.2.3 Scope of Audit:

The scope of audit is determined by the auditor having regard to following:

(a) Terms of the Audit Engagement,

(b) Requirement of Relevant Statute and

(c) Pronouncements of the ICAI. However, the terms of engagement cannot supersede the requirements of statute or pronouncements of ICAI.

According to ICAI, the following points are merit considerations as far as scope of audit is concerned:

1. Audit should cover the examination of all aspects of an entity relevant to financial statements being audited.
2. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements.
3. In forming his opinion, the auditor should also decide whether the relevant information is properly disclosed in the financial statements subject to statutory requirements, where applicable.
4. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
   (a) making a study and evaluation of accounting systems and internal controls and

(b) Carrying out such other tests enquires and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.

5. The auditor determines whether the relevant information is properly disclosed in the financial statements by:

   (a) comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein; and

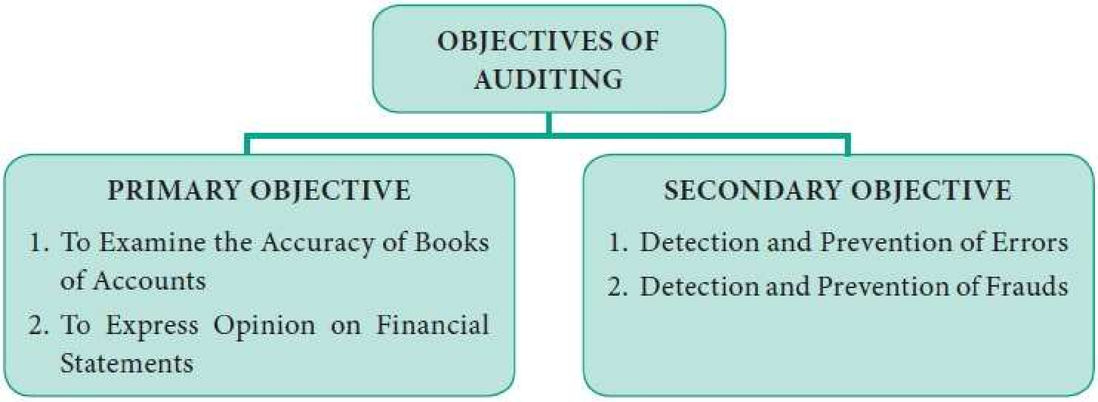
   (b) considering the judgments that management has made in preparing the financial statements accordingly, the auditor assess the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

6. The auditor is not expected to perform duties which fall outside the scope of his competence. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.

7. Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.

1.2.4 Objectives of Auditing:

The objective of an audit is to express an opinion on financial statements. The auditor has to verify the financial statements and books of accounts to certify the truth and fairness of the financial position and operating results of the business. Therefore, the objectives of audit are categorized as primary or main objectives and secondary objectives.



Primary Objectives

The primary or main objective of audit is as follows:

1. To Examine the Accuracy of the Books of Accounts

An auditor has to examine the accuracy of the books of accounts, vouchers and other records to certify that Profit and Loss Account discloses a true and fair view of profit or loss for the financial period and the Balance Sheet on a given date is properly drawn up to exhibit a true and fair view of the state of affairs of the business. Therefore the auditor should undertake the following steps:

- Verify the arithmetical accuracy of the books of accounts.
- Verify the existence and value of assets and liabilities of the companies.
- Verify whether all the statutory requirements on maintaining the book of accounts has been complied with.

Meaning of Books of Accounts

- Books of Accounts mean the financial records maintained by a business concern for a period of one year. The period of one year can be either calendar year i.e., from 1st January to 31st December or financial year i.e., from 1st April to 31st March. Usually, business concerns adopt financial year for accounting all business transactions.
- Books of accounts include the following: ledgers, subsidary books, cash and other account books either in the written form or through print outs or through electronic storage devices.

2. To Express Opinion on Financial Statements

After verifying the accuracy of the books of accounts, the auditor should express his expert opinion on the truthness and fairness of the financial statements. Finally, the auditor should certify that the Profit and Loss Account and Balance Sheet represent a true and fair view of the state of affairs of the company for a particular period.

Meaning of Financial Statement

Financial Statement means the statements prepared at the end of the year taking into account the business activities that took place for a year, for example, transactions that takes place in a business concern from 1st April to 31st March.

Components of Financial Statement

Financial Statement includes the following:

- Trading and Profit and Loss Account, and
- Balance Sheet.

Elements of Financial Statements include the following:

Assets: Assets include cash and bank balance, value of closing stock, debtors, bills receivable, investments, fixed assets, prepaid expenses and accrued income.

Liabilities: Liabilities include capital, profit and loss balance, creditors, bills payable, outstanding expenses and income received in advance.

Revenue: Revenue includes sales, collection from debtors, rent received, dividend, interest received and other incomes received.

Expenditure: Expenditure includes purchases, payment to creditors, manufacturing and trade expenses, office expenses, selling and distribution expenses, interest and dividend paid.

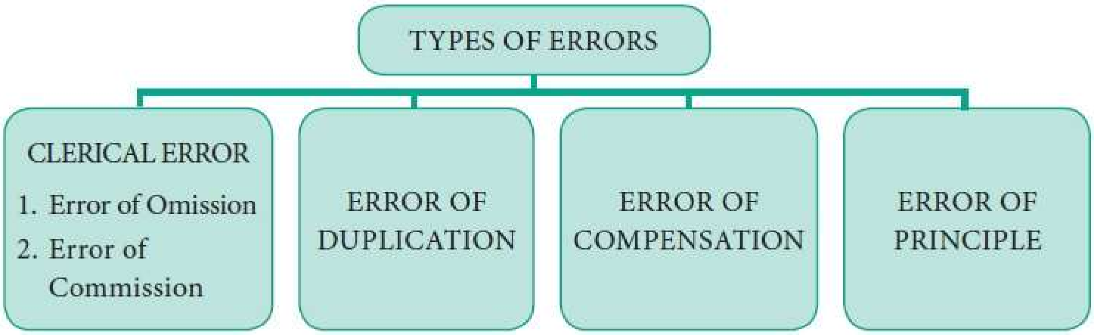
Secondary Objectives

The secondary objectives of audit are:

(1) Detection and Prevention of Errors, and

(2) Detection and Prevention of Frauds.

The Institute of Chartered Accountants of India defines an error as, "an unintentional mistake in the books of accounts." Errors are the carelessness on the part of the person preparing the books of accounts or committing mistakes in the process of keeping accounting records. Errors which take place in the books of accounts and the duty of an auditor to locate such errors are discussed below:



1. CLERICAL ERROR

Errors that are committed in posting, totalling and balancing of accounts are called as Clerical Errors. These errors may or may not affect the agreement of the Trial Balance.

Types of Clerical Errors:

(A) Errors of Omission:

When a transaction is not recorded or partially recorded in the books of account is known as Errors of Omission. Usually, it arises due to the mistake of clerks. Error of omission can occur due to complete omission or partial omission.

(1) Error of Complete Omission: When a transaction is totally or completely omitted to be recorded in the books it is called as "Error of Complete Omission". It will not affect the agreement of the Trial Balance and hence it is difficult to detect such errors.

Example – 1: Goods purchased on credit from Mr. X on 10.5.2016 for Rs. 20,500, not recorded in Purchases Book.

Example – 2: Goods sold for cash to Ram for Rs. 10,000 on 1.7.2016, not recorded in Cash Book.

(2) Errors of Partial Omission: When a transaction is partly recorded, it is called as "Error of Partial Omission". Such kind of errors can be detected easily as it will affect the agreement of the Trial Balance.

Example – 1: Credit purchase from Mr.C for Rs. 45,000 on 10.12.2016, is entered in the Purchases Book but not posted in Mr.C's account.

Example – 2: Cash book total of Rs. 1,10,100 in Page 5 is not carried forward to next page.

(B) Errors of Commission:

Errors which are not supposed to be committed or done by carelessness is called as Error of Commission. Such errors arise in the following ways:

(1) Error of Recording,

(2) Error of Posting,

(3) Error of casting, or Error of Carry-forward.

(1) Error of Recording: The error arises when any transaction is incorrectly recorded in the books of original entry. This error does not affect the Trial Balance.

Example – 1: Goods purchased from Shyam for Rs. 1000 wrongly recorded in Purchases Day Book as Rs. 100.

Example – 2: Goods purchased from Ram for Rs. 1,000, instead of entering in Purchase Day Book wrongly entered in Sales Day Book.

(2) Error of Posting : The error arises when a transaction is correctly journalised but wrongly posted in ledger account.

Example – 1: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to debit side of Repairs account instead of debit side of Rent account.

Example – 2: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to credit side of Rent account instead of debit side of Rent account.

(3) Error of casting, or Error of Carry-forward: The error arises when a mistake is committed in carrying forward a total of one page on the next page. This error affects the Trial Balace.

Example – 1: Purchases Book is totalled as Rs. 10,000 instead of 1,000.

Example – 2: Total of Purchases Book is carried forward as Rs. 1,000 instead of Rs. 100.

2. ERROR OF DUPLICATION

Errors of duplication arise when an entry in a book of original entry has been made twice and has also been posted twice. These errors do not affect the agreement of trial balance, hence it can't located easily.

Example: Amount paid to Anbu, a creditor on 1.10.2016 for Rs. 75,000 wrongly accounted twice to Anbu's account.

3. ERROR OF COMPENSATION (or) COMPENSATING ERRORS

When one error on debit side is compensated by another entry on credit side to the same extent is called as Compensating Error. They are also called as Off-setting Errors. These errors do not affect the agreement of trial balance and hence it cannot be located.

Example: A's account which was to be debited for Rs. 5,000 was credited as Rs. 5,000 and similarly B's account which was to be credited for Rs. 5,000 was debited for Rs. 5,000.

4. ERROR OF PRINCIPLE

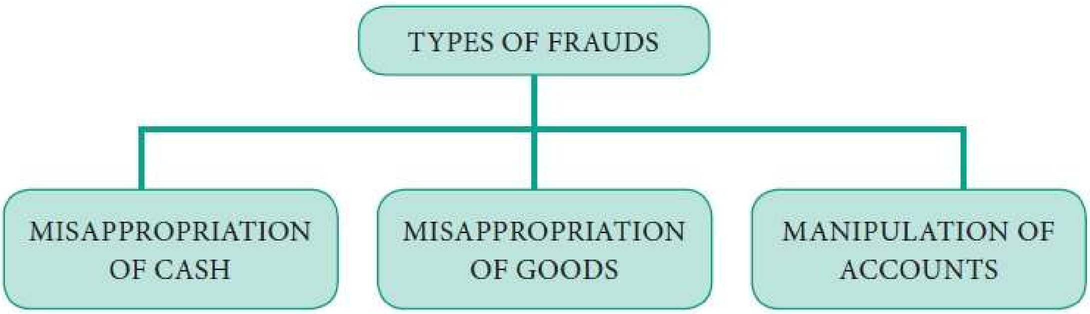
An error of principle occurs when the generally accepted principles of accounting are not followed while recording the transactions in the books of account. These errors may be due to lack of knowledge on accounting principles and concepts. Errors of principle do not affect the trial balance and hence it is very difficult for an auditor to locate such type of errors.

Example – 1: Repairs to Office Building for Rs. 32,000, instead of debiting to repairs account is wrongly debited to building account.

Example – 2: Freight charges of Rs. 3,000 paid for a new machinery, instead of debiting to Machinery account wrongly debited to Freight account.

Detection and Prevention of Frauds

Fraud is the intentional or willful misrepresentation of transactions in the books of accounts by the dishonest employees to deceive somebody. Thus detection and prevention of fraud is of great importance and constituents an important duty of an auditor. Fraud can be classified as:



1. MISAPPROPRIATION OF CASH

This is a very common method of misappropriation of cash by the dishonest employees by giving false representation in the books of accounts intentionally. In order to detect and prevent misappropriation, the auditor should verify the system of internal check in operation and by making a detailed examination of records and documents. Cash may be misappropriated in the following ways:

(1) By omitting to enter cash which has been received.

(2) By accounting less amount on the receipt side of cash book than the actual amount received.

Example: Cash received on account of cash sales for Rs. 35,000 is accounted in the debit side of the cash book as Rs. 25,000. The difference of Rs. 10,000 may be defrauded by the cashier.

(3) By recording fictitious entries on the payment side of cash book.

Example: Cash book is credited for Rs. 44,000 as amount paid to Mr.X for goods purchased on credit but actually no amount is paid. Hence, cashier misappropriates Rs. 44,000 of cash as paid to Mr.X.

(4) By accounting more amount on payments side of cash book than the actual amount paid.

Example: Amount paid to Gopal for Rs. 5,000 is accounted on the credit side of cash book as Rs. 15,000. The difference of Rs. 10,000 may be defrauded by the cashier.

(5) Teeming and Lading of Fraud which means cash received from one customer is misappropriated and remittance received from another debtor is posted to the first debtors account.

2. MISAPPROPRIATION OF GOODS

Fraud which takes places in respect of goods is Misappropriation of Goods. Such a type of fraud is difficult to detect and usually takes place where the goods are less bulky and are of high value.

- By showing less amount of purchase than actual purchase in the books of accounts.
- By showing issue of material more than actual issue made.
- By showing good materials as obsolete or poor line of goods.
- By showing fictitious entries in the books of accounts.

Example – 1: Goods purchased amounting to Rs. 58,000 is wrongly accounted in Purchases Book as Rs. 50,000. Hence, showing less amount of purchases than the actual and misappropriating goods worth Rs. 8,000.

Example – 2: Goods issued from stores for 1000 units is wrongly accounted in the Ledger accounts as 3000 units issued. The difference of 2000 units may be misappropriated by the storeskeeper.

Example – 3: Entries in the Purchases Book may be suppressed or inflated to show more or less profit.

Detection of Misappropriation of goods is a difficult task for an Auditor. Only through efficient system of inventory control, periodical stock verification, internal check system and adequate security arrangement the scope for such frauds can be eliminated or minimized.

Auditor has to thoroughly scrutinize the inward and outward registers, invoices, sales memos, audit notes, etc., to detect the goods-related frauds.

3. MANIPULATION OF ACCOUNTS

There is a very common practice almost in every organization, some dishonest employees have intention to commit this type of fraud. Manipulation of accounts is the procedure to alter books of accounts in such a way that there will be an increase or decrease in the amount of profit to achieve some personal objectives of the high officials. It is very difficult for the auditors to identify such frauds which may be due to manipulation of accounts.

Causes of Manipulation of Accounts

- There are different reasons for manipulation of accounts. The reasons are:
- To get more commission calculated on profit
- For evasion of income tax and sales tax
- To get huge loan from financial institutions by showing more profit in the books of accounts.
- To declare more dividend to the shareholders.
- By showing more profit than actual to get confidence of the shareholders.
- To make secret reserves by showing less income or by showing more expenses in the books of accounts.

Ways of Manipulation of Accounts

Manipulation of accounts may be made in the following ways:

- By showing more or less amount on fixed assets,
- By showing over valuation or under valuation of stock,
- Over or under valuation of liabilities,
- Creation of over or under provision for depreciation,
- Charging capital expenditure as revenue expenditure or vice versa,
- By making more or less provision for bad debts and for outstanding liabilities,
- By showing advance income or expenditure in the current year accounts.

Objectives of Manipulation of Accounts

The objectives of Manipulation may be window dressing or creation of secret reserves.

Window Dressing: In window dressing, accounts are manipulated in such a manner to reveal a much better and sound financial position of the business than what actually it is, in order to mislead the outsiders by inflating the profit.

Secret Reserves: Accounts are prepared in such a manner that they disclose a worse financial position than the real. The real picture of the business is concealed and a distorted one is revealed.

Check Your Progress-1

(A) Choose the appropriate alternative from given alternatives below the statement:

1) Principle of Independence is the elementary principle of auditing which refers to the following ....

   (a) The work of auditing should be based on the related evidences and should be done in an unbiased manner.

   (b) Auditor should examine material transactions as well as probable frauds and errors in much greater depth.

   (c) The work of auditing should be separate and independent from work of accounting. Accounts should be examined in an independent and unbiased manner, in the audit.

   (d) Client should provide the auditor with all available records, evidences and explanations. The auditor should also declare the result of his examination in clear and unambiguous manner.

2) The scope of audit is determined by the auditor having no regard to which following point:

   (a) Relation with client

   (b) Terms of the Audit Engagement,

   (c) Requirement of Relevant Statute and

   (d) Pronouncements of the ICAI.

(B) State whether the following statement is true or false:

1) Audit is not an intelligent and a critical scrutiny of the books of account, it is simple verification of transactions.

2) Audit should cover the examination of all aspects of an entity relevant to financial statements being audited.

3) The auditor should determine whether relevant information is disclosed in financial statements.

1.2.5 Basic Principles of Governing An Audit (AAS-1):

This Auditing and Assurance Standard was the first standard on auditing issued by the Institute. This Standard describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out. An audit is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. Other Auditing and Assurance Standards to be issued by the Institute (taken in other unit) will elaborate on the principles set out herein to give guidance on auditing procedures and reporting practices. Compliance with the basic principles requires the application of auditing procedures and reporting practices appropriate to the particular circumstances.

These principles are, namely, integrity, objectivity and independence, confidentiality, skills and competence, work performed by others, documentation, planning, audit evidence, accounting system and internal control, and, finally, audit conclusions and reporting.

1. ***Integrity, Objectivity and Independence:***

The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

2. ***Confidentiality:***

The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

3. ***Skills and Competence:***

The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing. The auditor requires specialized skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognized for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

4. ***Work Performed by Others:***

When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956, the auditor's report should expressly state the fact of such reliance. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

5. ***Documentation:***

The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

6. ***Planning***:

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business. Plans should be made to cover, among other things:

(a) acquiring knowledge of the client's accounting system, policies and internal control procedures;

(b) establishing the expected degree of reliance to be placed on internal control;

(c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and

(d) coordinating the work to be performed.

Plans should be further developed and revised as necessary during the course of the audit.

7. ***Audit Evidence:***

The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. They are of two types:

a) tests of details of transactions and balances;

b) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

8. ***Accounting System and Internal Control:***

Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

9. ***Audit Conclusions and Reporting***

The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

(b) the financial information complies with relevant regulations and statutory requirements;

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

The audit report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down in or prescribed under any agreement or statute or regulation, the audit report should comply with such requirements. An unqualified opinion indicates the auditor's satisfaction in all material respects with the matters dealt with in paragraph 21 or as may be laid down or prescribed under the relevant agreement or statute or regulation, as the case may be.

When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons therefor.

(Effective Date: This Auditing and Assurance Standard becomes operative for all audits relating to accounting periods beginning on or after April 1, 1985).

Check your progress-2:

(A) Fill in the blanks:

1) .... is an act of showing accounts a much better than the actual condition.

2) The books of accounts must be kept according to the .... Accounting Principles.

3) Auditor must be fair and must not allow prejudice or bias to override his ....

4) The auditor should obtain sufficient appropriate .... through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information.

(B) State whether the following statement is true or false:

1) We can say the accounts are true and fair when the financial performance shown by financial statements is true and fair.

2) If window dressing is found in the financial statements and accounts, it means they are presented with true and fair view.

3) For reflecting a true and fair view in accounts, it is not necessary to match value of stock in the books and its value according to physical verification.

4) All the material facts regarding revenue, expenses, assets and liabilities must be disclosed in the books of accounts.

1.2.5 Types of Audit

Once we complete preparing the final statements and accounts for the year the accounting process is over. However, we still cannot be completely certain of the accuracy of these accounts. This is when the concept of auditing comes in. Let us see the different types of Audit.

1. Statutory Audit

One of the main types of audits is a statutory audit. It is a legal requirement as per the state or national laws prevalent in the region. In India, the laws regarding a statutory audit are in the Companies Act, 2013. A statutory is another name of a financial audit. It is essentially an audit of the final statements of a company, i.e. the profit and loss and the balance sheet. The purpose of a statutory audit is to ensure that these accounts of the company represent a fair and accurate picture of the company's current financial position on the date of the balance sheet. It is important that we understand the need for a statutory audit to be carried out. In case of a company, the owners of the company are the shareholders. However, they do not run or manage the day to day affairs of the company. This is done by the board of directors and the management of the company.

So the shareholders need assurance that the accounts maintained and published by the company are authentic and genuine. This is why the law requires that an independent auditor to conduct a statutory audit.

The independent auditor has full authority to check the financial records of the company and publish his findings via an auditor's report. The shareholders and owners of the enterprise can then be assured of the authenticity and reliability of the financial statements.

Other stakeholders like creditors, employees, potential investors etc. also benefit from the statutory audit. They too can base their decisions on these accounts, since they are authentic.

2. Internal Audit

The management of an organization may want the safety of having an independent audit team within the organization, that keeps a constant check on the accounting and finance practices. So they usually set up an internal audit. This is quite different from a statutory audit. As per the name, an internal audit occurs within an organization. So an independent auditor or team of auditors, who are actually employees of the organization, will review the financing, accounting and operating activities of the organization. It is actually a part of the internal control system of the company.

For most organizations, the appointment of an internal auditor is completely mandatory. However, according to Rule 13 of the Companies (Accounts) Rules 2014 the following classes of companies are required by law to carry an internal audit,

- Every company listed on the stock market
- Every unlisted public company that has
  - Paid up capital exceeding 50 crores in the previous year
  - Turnover greater than 200 crores in the previous year
  - If at any point in the previous year if outstanding loans and liabilities exceeded 100 crores
  - Outstanding deposits exceeds 25 crores in the previous year
- And every private company that,
  - Has a turnover of more than 200 crores in the previous year
  - If at any point in the previous year if outstanding loans and liabilities exceeded 100 crores

Objectives of Internal Audit

1. Proper Control

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

2. Perfect Accounting System

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

3. Review of Business

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

4. Asset Protection

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

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

5. Keeps a Check on Errors

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

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

6. Detection of Fraud

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

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

3. Cost Audit

The Cost and Works Accountants of India (ICWA) actually defines a cost audit as a system that reviews and examines cost accounting records.

This means it examines the accuracy of the costing records and that all cost accounting principles were adhered to. It helps to determine whether the cost accounts reflect a true picture of the organizations financial status.

So cost accounting comprises of a lot of factors. Let us take a look at some of these,

- The first objective of a cost audit is to determine if the cost plan that is in place is effective and fulfills its purpose. Say for example the objective of the cost accounting is to maximize the efficiency, then the figures collected will be different. But if the purpose is to fix prices, then the cost accounting plan will differ. A cost audit will help determine if the organization is on the right path.
- The treatment of the numbers and figures must also be audited. A cost audit has to ensure that treatment of special items like an abnormal loss, indirect expenses etc.
- There is also vouching for a process for the numbers and figures collected as well.

Advantages of a Cost Audit

Management needs data to make all the major decisions like price setting, manufacturing decisions etc. The process of cost accounting provides the management with this data. And cost audit ensures the accuracy of this process, so it is equally important. Let us take a look at some advantages of a cost audit.

- Cost audit ensures that the organization keeps a close check on any wastage in the company. This could be wastage of labor, materials, stores etc. When such wastage is discovered the company will be able to take steps to correct these.
- It also helps in pointing out any inefficiencies in the production process. Solving such inefficiencies will help the company save a lot of money.
- Also, a cost auditor closely examines various expenditures and compares them to standards. This will help him find any errors that the financial auditor may have missed.
- A cost audit actually helps the statutory auditor with his job as well. Audited costing data helps him determine the value of stocks, managerial remuneration, and other such aspects.
- Cost auditing also allows fixing individual responsibility. This will allow the management to effectively manage their staff.

4. Tax Audit

In India, all businesses have to pay a direct tax to the central authorities if they fall in the tax slab. The rules regarding tax and tax payments are in the Income Tax Act, 1961. Section 44AB of this Act provides for a compulsory tax audit of certain assesses.

This is done to ensure to the tax authorities that the financial records submitted are reliable and the tax liability is calculated correctly. The authorities also rely on a tax audit to ensure that the deductions are taken, exemptions prevailed etc. are also lawful.

So if the turnover of an organization is over a certain prescribed limit or if they are claiming certain deductions or filling their tax returns under cert ion sections or provisions they may have to compulsorily go under tax audit by a certified Chartered Accountant.

5. Propriety Audit

Generally, in companies and other big organizations, ownership and management are separate. This means the real owners of the business have to rely on executives to make the correct decisions and take the due course of action as per the law. This is where the concept of propriety audit is born.

Propriety audit has been described as an audit of the actions and decisions of the executives. The focus of such an audit is on the financial discipline, the authority structure, efficiency, rules and regulations and the protection of public interest.

Some of the important aspects of verification during a propriety audit are as follows

i. Financial records and accounts are accurate and up to the mark

ii. The assets of the company are safeguarded and not misused

iii. Propriety audit will check the utilization of funds

iv. The results that are budgeted and expected are being met

v. One of the biggest use of propriety audit is for government companies and public organizations as such. In such organizations, there is heavy involvement of public funds and deposits.

vi. And so public interest is a concern here. So a propriety audit will keep a check on improper expenditures, disregard for rules, wastage of public money and any such irregularities.

6. Efficiency Audit

- Efficiency is the level of productivity of an organization. Essentially, it is the ratio of productivity, i.e. the levels of inputs (raw materials) we need to achieve the desired output (finished goods). So efficiency indicates how well the company is using its resources. The aim is the optimum use of resources by the company. Let us understand a few important terms in relation to efficiency,
- Input: Resources of any kind, example – human resources, finances, raw material, assets, machinery etc
- Output: Goods and services produced by the company to meet the needs of the customers
- Quantity: Amount of goods/services produced
- Productivity: A ratio of goods produced to the amount of resources needed to produce them

So an efficiency audit will help the organization measure its efficiency in many ways. There is financial efficiency, technical efficiency, production efficiency etc.

Two of the main objectives of an efficiency audit are to make sure that the organisation has

- optimum utilization of the investments in the organization
- that the organization channels the investment in their most profitable ventures

One thing to understand is that efficiency is a relative concept. So the efficiency of an organization is measured against certain industry standards, a target or the norms. After the audit, the management can then focus on improving its efficiency. The way to do it is to achieve more output from the same amount of input as before.

7. Bank Audit

Banks are the cornerstone of our economy. They handle huge amounts of public deposits and savings, so they have to be closely monitored and reviewed. A bank audit is one important process of this monitoring.

An auditor carrying out this bank audit have to verify the financial statements of such a banking institution. They have to ensure that the final accounts truly represent the financial position and condition of the bank.

Other than this, there are other special transactions that a bank audit must cover. These include the provisions for NPA's (non-performing assets), maintaining credit ratios, fulfilling RBI's statutory requirements etc.

8. Insurance Audit

Just like a bank audit, an insurance audit is also important since insurance companies are providing a public service. Again the auditor will check for financial accuracy of their accounting records.

They will also ensure that customers have paid an appropriate premium for their insurance coverage. He will ensure the company follows all rules laid out in the Insurance Regulatory and Development Act of 1999.

9. Government Audit

Just like companies, organizations, institutions etc. the government also goes through an audit. Both the Central Government and the State Government are audited. The responsibility of this falls on the Comptroller and Auditor General of India (C&AG).

C&AG ensures that the financial transactions of the government are executed correctly and have the proper authorization. The focus is mainly on the expenditures done by both governments. Also, government audits will include an audit of government and public companies as per the provisions of the Companies Act 2013.

10. Management Audit

Management audit is a relatively new concept that originated in the USA. The main objective of such an audit is to help the company maximize their profits by improving their efficiency and time management.

It involves auditing the functioning of all the departments to find gaps in performance and efficiency. These are then passed on to the management so that they can make the necessary changes.

11. Secretarial Audit

A Secretarial Audit is a mechanism to check the compliance of an organization to the laws, rules, regulations, notifications etc prevalent at the time of the audit. In this case, it is to check if a company has been complying with the provisions of the Companies Act 2013 and all of its rule therein.

The rules and regulations around companies are very complex and ever increasing. The responsibilities of the directors, promoters and other managerial positions are also very complicated and crucial. So it is important that a Practicing Company Secretary (PCS) be hired to conduct a secretarial audit.

Secretarial Audit as per Companies Act

Section 2014 (1) of the Act deals with the provisions regarding Secretarial Audit. As per the act, the audit is compulsory for the following companies,

i. Every listed company

ii. Public company with paid-up capital greater than 50 crores

iii. Public company with turnover greater than 250 crores

iv. Any private company who is a subsidiary of a public company which falls under the above two categories

The act also states that only a practicing Company Secretary who is a member of the Institute of Company Secretaries of India (ICSI) has authorization to carry out a statutory secretarial audit of these companies.

1.3 Summary:

Audit is a systematic and independent examination of data, statements, records, operations and performances of an enterprise for a stated purpose. The auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report. The elementary principles of auditing are: (a) Principle of Independence, (b) Principle of Objectivity, (c) Principle of full disclosure and (d) Principle of Materiality. There are some other principles of auditing such as Integrity, Confidentiality, Skill and Competence, reliance on work performed by others and documentation.

The objectives of auditing are To Examine the Accuracy of the Books of Accounts, To Express Opinion on Financial Statements, Detection and Prevention of Errors, and Detection and Prevention of Frauds.

The scope of audit has been described in this unit. This unit has highlighted this concept in lucid manner. Auditing and Assurance Standard-1 is entitled as "Basic Principles of Governing Audit" which describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out.

Audit is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. Investigation is a process of searching enquiry into the profit-earning capacity or the financial position of a concern or to find out the extent of the fraud if there is any suspicion about it and so on.

1.4 Terms to Remember:

1. **Audit:** Audit is a systematic and independent examination of data, statements, records, operations and performances of an enterprise for a stated purpose. The auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.

2. **True and Fair View:** Accounts are true and fair when the financial performance shown by financial statements is true and fair. It is auditor's prime duty to verify whether financial statements represent true and fair view.

3. **Window dressing:** It is an act of showing accounts a much better than the actual condition.

4. **Independence of Auditor:** Independence implies acting without any fear or favour. Unless and until the independence of auditor is maintained properly, auditor cannot perform his duties rightly.

5. **Investigation:** It is a process of searching enquiry into the profit-earning capacity or the financial position of a concern or to find out the extent of the fraud if there is any suspicion about it and so on

1.5 Answers to Check your progress:

Check Your Progress-1

(A) 1) - (c), 2) - (a)

(B) 1) False, 2) True, 3) True

Check Your Progress-2

(A) 1) Window dressing, 2) Generally Accepted,

3) objectivity, 4) audit evidence

(B) Answer: 1) True, 2) False, 3) False, 4) True

1.6 Exercise:

1) What is audit? Describe the scope of audit.
2) Explain the basic principles governing an audit according to Auditing and Assurance Standard-1.
3) Explain the Objectives of the Audit.
4) Write short notes on:
   (a) Statutory Audit.
   (b) Cost Audit.
   (c) Tax Audit

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Unit-2
Audit Procedure and Audit Report

Index

2.0 Objectives:

After Studying this Unit you will be able to:

1. Understand concept of vouching, verification and valuation
2. Explain the procedure of vouching of different types of transactions
3. Find the relation between vouching, verification and valuation
4. Understand the contents of Audit Report
5. Understand Auditor's Opinion and Types of Audit Report

2.1 Introduction

In the first unit we understood the concept of audit, its objectives, scope, types and basic principles governing audit. As we know the audit is a systematic examination of books of accounts and records by an independent qualified auditor to ascertain whether the financial statements and other books of accounts are maintained as per the norms and whether these exhibit true and fair view of state of affairs. Another object of audit is to detect errors and frauds in the books of accounts. After study of the overview of audit, we are now going to understand some important and practical aspects in audit procedure.

The present chapter deals with the audit procedure and audit report. Audit process refers to the method that auditor follow to obtain and evaluate audit evidences and examine the books of accounts. However there is no fixed rule regarding the procedures the auditor would follow in course of audit. He would fix up the procedure after reviewing the situations on the basis of auditor's own knowledge, intelligence, efficiency and experience. Vouching, verification & valuation of assets and liabilities and preparing an audit report are some of the vital steps in audit procedure. In this chapter we will understand the concepts vouching, verification and valuation of assets and liabilities. We will also learn the audit report, the contents in audit report, types of audit report and auditor's opinion.

Section 1: Vouching

2.2.1 Vouching: Concept and Definitions

Vouching is the core aspect of auditing. It is an act of establishing the accuracy and authenticity of the entries made in the books of accounts by examination of the documentary evidences in support of the transaction. It consists of comparing the actual entries in the books of accounts with the supporting documents in order to ensure that the actual transaction has taken place as per the entries made in the books of accounts. It helps auditor to find out errors and frauds in the business. Vouching gives basis to form an opinion on the financial matters of the business. It gives confidence by providing concrete information about the financial records so that the auditor can express his opinion on the financial records maintained by the company. Vouching starts which the examination of vouchers. So let's now understand the concept of voucher.

Voucher:

A voucher is a documentary evidence on the basis of which an accounting entry is passed. The documentary evidence may be purchase receipt, counterfoils of a receipt book, invoice, fixed deposit receipt, an agreement, correspondence, gate keeper's book, wage book etc. There are two types of vouchers i.e. Primary Voucher and Collateral Voucher. A written original evidence is said to be primary voucher while in case original voucher is not available then the copies there of are produced in support, such voucher is known as collateral voucher.

Example:

When a depositor deposit cash in the bank, he needs to fill the 'pay-in-sleep' and hand over cash along which 'the pay-in-sleep' to the casher. Then a casher makes a data entry on the basis of 'pay in sleep' given by the depositor. Here '*pay-in-sleep'* is a voucher. In the process of vouching auditor see that whether entry made in the books of accounts matches which the matter written over pay in sleep i.e. amount, date, name, account number etc. and whether voucher (here 'pay-in-sleep') is properly authorized and authenticated. It means pay-in-sleep is been duly signed and stamped by the casher and authorized by the officer.

Definitions of Vouching

The term vouching have been defined by different authors in different manner, following are some of the important definitions of vouching

Taylor and Perry: "Vouching may be defined as detailed examination of evidences offered in substantiation of entries in the books, including in such examination the proof, so far as possible that no entries have been omitted from the books."

De Paula: "Vouching does not mean merely the inspection of receipts with the transactions of a business together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in the books."

Spicer and Pegler: "Vouching may be defined as the examination by the auditor of all documentary evidences which is available to support the authority of transactions entered in the client's records."

B. B. Bose: "By Vouching is meant the verification of the authority and authenticity of transactions as recorded in the books of accounts."

Dicksee: "Vouching consists of comparing entries in the books of accounts with documentary evidence in support thereof."

2.2.2 Characteristics of Vouching

Form the above definitions, the characteristics of vouching can be stated as below:

1. Vouching is a detailed examination of vouchers and other supporting documents.
2. It consists of comparing entries in the books of accounts with documentary evidence.
3. Such documentary evidence supports and substantiate a transaction.
4. Vouching is an important aspect of auditing and done by an auditor.

5. Vouching is done to assure that transactions are in order, have been properly authorized and are correctly recorded in the books.
6. It ascertains that there is no omission in recording the transactions.
7. It helps in detection of fraudulent entries in the books of accounts.
8. It assures that actual transaction have been taken place and there is not just book of entry for recording purpose.

2.2.3 Objectives of Vouching

The following are the objectives of vouching.

1. To see all the transactions are recorded in the books of accounts.
2. To see the recorded transactions are actually taken place.
3. To ensure that all the entries recorded in the books of accounts are supported by the documentary evidences.
4. To verify authenticity of the vouchers and documentary evidences.
5. To verify the correctness of transactions.
6. To ensure that there is no fraudulent entries in the books of accounts.

2.2.4 Importance of Vouching

Vouching the most important step in auditing. It is process of a comparing entries in the books of accounts with the documentary evidences in support thereof so as to ensure that transactions are in order, have been properly authorizes and correctly recorded in the books. The importance of vouching can be explained as under

1. **Foundation of Audit:** Vouching is a first and prime step in audit process. It gives confidence and the valuable basis to the auditor to form an opinions on the true and faire view of state of affairs of the concern.
2. **Errors and Frauds:** Vouching helps auditor to find errors and frauds in the books of accounts. Careful inspection of the tractions with their documentary evidences can easily reveals errors and frauds if any.

3. **Actual Occurrence of Transaction:** Vouching helps auditor to ascertain whether the transaction actually occurred. It reveals the truth of the entries in the books of accounts.

4. **Check on Employee:** Vouching is also important from the company point of view. It acts as a moral check on employee. If employees are well aware that all entries are going to be examined with their vouchers, they may not go for recording fraudulent entries in the books of accounts.

5. **Relevant Entries:** Vouching helps the auditor to ascertain whether the entries recorded in the books are relevant i.e. they relate to the concern and to the current accounting year.

6. **As per Standards:** Vouching enables auditor to verify whether an item is accounted as per the recognised accounting standsrds, policies and practices.

7. **Compliance with Law:** Vouching ensures that the trasaction complies with the provisions of Law e.g. the Companies Act, Income-Tax Act. etc.

8. **Capital and Revenue Expenditure:** Vouching assist auditor to ensures the proper allocatin of expenditure into capital and revnue.

9. **Smooth and Easy Conduct of Audit:** Vouching is an important part of auditing. It makes smooth and easy conduct of audit.

10. **Disclosure:** Vouching enables the auditor to ensure that an item is properly disclosed in the final accounts as per the requirement of applicable law.

2.2.5 Important Points to be considered while vouching

1. **Serially Numbered:** All vouchers should be serially numbered according to the date and entries made in the books of accounts. It will save the time of auditor. If vouchers are not serially numbered, the auditor has right to ask client to do so.

2. **Name:** Auditor should check the name of the concern written over the voucher to ensure that the transactions pertains to the client and not to any other concern.

3. **Date:** The date of transaction must be written on the voucher. This is the proof that the transaction pertain to the current year and not to earlier or next year. Auditor should carefully examine the date as there is a chance that the voucher of the same date of the last month or year may be produced again.

4. **Amount:** This is the most important part of voucher. Auditor should verify the amount written over voucher and the amount of transaction. Auditor should also check the amount in world and amount in figures and whether the amount is clearly written.
5. **Particulars:** Auditor should carefully examine the particulars written over the voucher. It helps the auditor to know the nature of transaction i.e whether the nature of expenses are capital expenditure or revenue expenditure.
6. **Signature:** The auditor should see that whether voucher is properly signed by authorized official, person preparing voucher, payee and the party involved.
7. **Revenue Stamp:** In case of expenditure exceeding Rs. 5000. Then auditor should ensure whether revenue stamp is affixed on the voucher.
8. **Voucher in Personal Name:** Auditor should pay special attention to those vouchers which are in personal name of the partners, directors, managers or secretary etc. because such a voucher may not relate to the business.
9. **Authentication:** Auditor should see that whether voucher is properly authenticated. He should see that every voucher is passed as in order by a responsible officer.
10. **Duplicate Voucher:** If duplicate voucher is produced on account of loss of original, an auditor should carefully scrutinize to avoid any fraud.
11. **Checked Vouchers:** Auditor should mark the checked voucher so that they cannot be produced again.
12. **Own Printed Vouchers:** Sometimes business firms issue their own printed receipts and get it signed by the payee. In such case, an auditor should be very careful because these practices may lead to frauds. In such cases auditor should get more documentary evidences to support of a voucher.
13. **Continuous Vouching:** Once auditor or his staff start vouching of a particular book, they should finish it in single sitting because if it remains incomplete, then there are chances of figures being altered and frauds being committed after vouching is over.

14. **Missing Vouchers:** List of missing vouchers should be prepared and reason and explanation for their loss should be obtained from client and if auditor is not satisfied with the explanation, he should mention this fact in his report.

2.2.6 Vouching of Different Types of Books of Accounts

I] Vouching of Cash Book

Cash book is an important book of account in which all cash receipts and payments are recorded. It chronologically records all the cash transactions of the business relevant to the accounting period. An Auditor should be very carefully while vouching cash book, because mostly errors and frauds are found in cash transactions. The main object of vouching cash book is to ensure that all cash receipts and payments are properly recorded under correct heads. Before vouching cash books, the auditor should enquire into the internal check system in operation. He should firstly understand the system of internal check of the firm. If internal system is not efficient, there is chances of misappropriation of cash. After the enquiry of internal check system, an auditor should start vouching of cash book on following manner:

A) Debit Side of Cash Book:

All cash receipts are recorded in the debit side of the cash book. Auditor should ensure that all the receipts of cash entries are recorded. If auditor finds that cash received and not recorded, he much be very cautious and enquire deeply further, because in such cases there are more chances of frauds. Following are some of the important items appear on the debit side of cash book:

1. Opening Balance:

Closing balance of last financial year is recorded as opening balance of current financial year on the debit side of cash book. In order to verify opening balance of the cash book, an auditor should go through last years audited accounts and ensure that the last years closing balance is correctly brought forward as opening balance during the current year.

2. Cash Sales:

Cash received as a result of sales is recorded in the debit side of the cash book. Number of transaction pertaining to the cash sales are generally large. Further there are chances that cash sales have been taken place, however no entry made in cash books. Such amount may be misappropriated. Hence auditor should be extremely careful in recording cash sales. Following points need to be considered by auditor which vouching cash sales:

i. Efficient internal check system can set check on such practices. Therefore it is important that an auditors should satisfy himself that there is proper system of internal check system in operation especially in recording cash sales.

ii. Cash memos are issued after cash sales. Auditor should verify carbon copies of cash memos and should check date, particulars of goods sold, their rates, taxes etc.

iii. Auditor should check and reconcile summary of cash sales and cashier's report.

iv. Similarly auditor may verify transactions in stock register to ensure proper delivery of goods sold on cash basis.

3. Cash Received From Debtor:

Cash received from debtors is entered on the debit side of the cash books. Following points need to be considered while vouching cash received from debtors:

i. When cash is received from the debtors, receipts are issued to them by the cashier. The counterfoils of receipts are important evidences in respect of actual receipt of cash received from the debtors.

ii. The auditor should check the receipts issued to the debtors and the Rough Cash Book to detect the frauds of "teaming and lading" nature.

iii. If discount are allowed to the debtor, the auditor should enquire into the policy and method of discount and should ensure that discount allowed are according to this.

iv. Auditor should also check bad debts written off if any, and enquire that it is been properly authorized by proper authority. Auditor can collect the balance confirmation certificate from debtors directly.

4. Proceeds of Bill Receivables:

When the bills are matured or discounted, the proceeds are recorded on the debit side of the cash book. Following points need to be considered while vouching proceeds of bills receivables:

i. The auditor should compare bills receivable book with cash book and bank statement to confirm that the amount have been received on due dates.

ii. Auditor should enquire about the bills matured but amount has not been received to ascertain whether these are dishonored or defrauded.

iii. In case of dishonored but not matured bills, a footnote by way of contingent liabilities be shown on balance sheet, auditor should check the same.

5. Interest and Dividend Received:

i. Interest received on bank deposits should be vouched with the fixed deposit receipts issued by the bank and bank pass book in case of savings deposits.

ii. Sometime fictitious fixed deposit receipt may be produced. Care must be taken in these respect.

iii. Interest may be received on loan granted. In such case an agreement with borrower should be inspected to ascertain the rate of interest, date of payment of interest etc.

6. Receipt of Loan:

Cash received on account of loan is recorded on the debit side of the cash book. In such case auditor look into following things:

i. The auditor should enquire the loan agreement to know rate of interest and repayment schedule and other the term and conditions.

ii. The auditor should see that whether client is entitles to raise loan.

iii. He should see whether the security offered is indicated in the balance sheet

iv. He should check whether interest payable but not paid is adjusted in the accounts at the end.

7. Sale of Investment:

i. If investment is sold through brokers, brokers sold note should be examined to vouch the sales proceeds received.

ii. The auditor should see that the authority by which investment is sold is authorized to do so.

iii. If investment is sold through bank, auditor should examine bank advice.

iv. If investment is sold ex-dividend then the auditor should see that the dividend is subsequently received and that the sale proceeds is proceeds is properly apportioned between capital and revenue.

v. If the client is investment firm or a dealer then the profit or loss of investment should be treated as revenue profit or loss.

vi. If any investment is sold in respect of any earmark fund, then profit or loss made out of the investment should be credited or debited to that particular fund.

8. Sale of Fixed Assets:

i. The auditor should verify the sale of fixed assets with the board resolution, broker's statement, auctioneer's note, tender of sales price etc.

ii. The auditor should ensure that the sale of fixed assets has been properly sanctioned.

iii. The auditor should see that the proper asset account has been credited with the amount. If there is any profit on the sale of fixed assets, that should credited to capital reserve account which is not available for distribution to the shareholders.

9. Rent Received:

Rent received on account of lease property is shown on the debit side of the cash book. It should be vouched in following manner:

i. Firstly auditor should check lease agreement.

ii. Auditor should see that rent is received as per lease agreement and on the due date.

iii. When rent is received by the agent, a copy of account of such agent should be vouched.

iv. Auditor should verify the receipt of rent with the property rented.

v. Auditor should be take due care while vouching rend outstanding, as it may have happened that rent is received however shown as outstanding and this amount is misappropriated. In such case, if the amount is large, auditor may take confirmation from the tenant.

10. Commission Received:

If commission income is received it is entered on the debit side of the cash book. Commission received is to be vouched on following manner

i. Auditor should examine commission agreement with the parties to know the rate of commission and its method of calculation

ii. Commission account should be checked with the accounts of parties from whom commission has been received.

iii. Counterfoils of the receipts should be checked with the account in the cash book.

iv. The auditor should verify the accuracy of the calculation of commission.

v. The commission received in case of consignment business should be vouched with copies of account sales to the consignor.

11. Subscription Received:

i. In certain kind of business subscription is the major source of income.

ii. The receipts of subscription from various members is vouched with the subscription receipt, counterfoils etc.

iii. The auditor should carefully see the period of subscription for which subscription is received.

12. Insurance Claim Received:

i. The amount of insurance claim received in response to the claim filed the client should be vouched with the correspondence with the insurance company and the statement received.

ii. The amount of the insurance claim sanctioned and actual amount credited to the banks account should be confirmed with the bank statement.

iii. If insurance company have issued cheque and the said is deposited with the bank then the auditor should verify bank pass book.

13. Income from Sale of Scrapped Machinery:

i. If machinery have scrapped due to obsolesce, the sale proceeds, the auditor should examine the plant register, bank statement and the correspondence,

ii. The auditor should see that whether machinery account is credited as it is written down value on the date of sale.

iii. He also need to verify whether profit or loss on its sale be transferred to Profit and Loss A/c.

14. Income from Hire-purchase Agreement

i. If client have sold asset on hire-purchase agreement and as a result installment is received, the auditor should examine the hire purchase agreement.

ii. Auditor should verify the rate of interest and should see that amount of the interest included in the installment amount, is properly accounted for.

iii. Proper allocation between sales and interest should be made.

15. Income Tax Refund:

i. The auditor should vouch the refund amount with the assessment order and refund order issued by income tax department.

ii. The auditor should also see whether interest on refund amount is applicable and it is properly calculated and received form income tax department.

iii. Auditor should verify that the actual receipt of refund amount with the refund order and assessment order. He should inspect bank statement also.

16. Share Capital

Public limited company issue shares to raise capital. The auditor should vouch cash received on account of issue of shares in following manner:

i) The auditor should examine the share applications received and share allotment from the Application and Allotment Books

ii) The auditor should check the board resolution in respect of the allotment of shares. He should ensure that the allotment is made as per the norms.

iii) The auditor should verify the application money received and allotment made from the bank statement and allotment sheet. As the share application money is directly credited to the bank account, it is important to examine the bank statement carefully.

iv) If share are not allotted, the company need to return application money received. In such case auditor should see that money have been return to the applicants who are not allotted shares. These entries should be verified with the bank statement and allotment sheet.

v) The auditor should see whether shares are properly allotted, minimum subscription has been subscribed and calls have been made according to the provisions of the company's articles of association by examining minutes of board meeting and board resolutions.

vi) Shares may be issued for consideration other than cash. In such cases auditor should inspect contract with the parties concern and the board resolution in this respect.

vii) Usually the company takes underwritten services, for issue of shares. If so the auditor should examine the underwritten contract, board resolution and should ensure that unsubscribed share (if any) have been subscribed by the underwriters as per the contract.

viii) If share are nor fully paid, then the auditor should see that the money have been received as per the call made by the company. In such case the auditor should examine the board resolution in respect of the calls made, bank statement, share ledger and articles of association.

ix) The amount of call in advance must be verified with entries in bank statement and cash book. The call in advance should be shown as a separate item from share capital in the balance sheet.

x) Shares may be issued at a premium or discount. In such cases, the auditor should inspect the board resolution. The premium should have been credited to a separate share premium account and shown separately in the balance sheet. The auditor should ensure that the premium have been utilized for the purpose mentioned in the Act.

17. Issue of Debentures

The company may also issue debentures to raise capital. It is borrowed sources of capital. The cash received as a result of issue of debentures are recorded in the debit side of the debentures. While vouching cash book for the entries with respect to the debentures, the auditor should see following things

i) Firstly auditors should inspect the boards resolutions regarding issue of debentures to know the amount of capital planned to raise by issue of debentures, issue price of debentures, types of debentures, collateral securities and other terms and conditions.

ii) The auditor should examine debenture applications and allotment sheet.

iii) The actual amount received is to be verified by comparing bank statement, entries in the cash book and application and allotment sheet.

iv) If contract is made with debentures holders, then it must be examined.

v) In case of redemption of debentures, the entries in the bank statement and cash book is to be compared. The auditor must see that debenture certificate is received back.

vi) If debentures are issued as collateral security for loan, then the loan contract and resolution for issue of debentures must be examined.

18. Bank Loan

If a business organization has taken a loan to rise funds, then the cash received is recorded on the debit side of the cash book. In such case the auditor should vouch in following manner

i) Initially loan agreement and board resolution much be inspected to know terms and conditions of loan such as rate of interest, EMI, repayment schedule etc.

ii) The auditor should see whether client is entitled to raise loan.

iii) The security offered should be indicated in the balance sheet.

iv) The auditor should verify the loan sanction, actual cash received and the entries made in the cash book by comparing bank statement, cash book and loan agreement.

v) The interest due but not paid at balance sheet date should be adjusted in the account.

B) Credit Side of Cash Book:

Entries regarding cash paid are recorded on the payment side of the cash book. While vouching the payment side of the cash book, the auditor should see following points

i) Payment is made to the right person

ii) Payment is related to the business firm only

iii) Payment is related to the year for which the accounts are being audited

iv) Payment have been sanctioned by a person having authority to do so

v) Payments are approved and authenticated

vi) Payment have been recorded properly in the books of accounts

vii) No payment is remained unrecorded.

viii) The amount on the voucher and amount paid is correct.

ix) All payments are supported by proper vouchers and other supporting documents

x) The particulars of the vouchers should tally with particulars in the books of accounts

xi) The legality of payment should be verified

Following are some important items which usually appear on the credit side of the cash book and duties of an auditor thereto are given below

1. Cash Purchases

i. The auditor should see that whether the cash purchase is authorized and the amount paid for purchases of goods is correct.

ii. The auditor should compare the inward invoice with goods inward register and verify the quantities received with those shown in the invoices.

iii. If any voucher for purchase is missing, he should prepare a list of such missing vouchers and call for proper explanation in this regard.

iv. If discount is provided by the supplier on cash purchases, the auditor should see that net amount after deducting discount availed have been entered in the books.

2. Payment to Creditors

i. Payment made to the creditors can be vouched with the receipt issued by the creditors acknowledging the receipt of money.

ii. Money due to the creditors can be compared with the accounts of the creditors and actual invoices received from the suppliers of the goods.

iii. The auditor should verify the periodical statements submitted by the creditors with the creditors accounts.

iv. The auditor should also see the minutes, contracts, original bills, counterfoils of cheques, bank statement and other evidences regarding payment received form the creditors.

3. Payment of Wages and Salaries

The payment of wages is an important item on the credit side of the cash book where the amount may be comparatively large and therefore the chances of fraud are more. Here are some rooms where frauds of errors might be possible

a) the inclusion of fictitious names of dummy workers in the wage book

b) errors and frauds in time and piece-work records

c) the names of the employees who have resigned or whose services have been dispensed with, may have been included in the wage sheets

d) over-stating the rate of wages

e) overstating the hours of work or days of work put by the workers

f) conversion of unpaid wages

g) understatement of deductions

Hence the auditor should take adequate care while vouching payment of wages. The auditor should vouch the payment of wages in the following manner

i. The auditor should check the internal check system to satisfy himself that the arrangements for preparation of wage sheets and system of payment is adequate so as not to leave any loophole fraud.

ii. If the workers are paid wages on time basis, the auditor should examine the attendance register of workers and time spent by the workers.

iii. If wages have been paid on piece work basis, he should examine piece work or job cards. The calculation of wages with rate should be verified.

iv. The auditor should see that wage-sheets or wage registers are properly authenticated. He should check that wage-sheets have been properly initialed by those who have taken in its preparation.

v. When temporary workers are paid wages, their appointment should be approved by the competent authority.

vi. The auditor should see that wages are paid to the concern employee or the person who is duly authorized by him to receive amount.

vii. If wages are unpaid, the auditor should see that the entry for unpaid wages is passed in the books of accounts.

viii. The auditor should ensure that the payment is same as recorded in the cash book, correct amount of wages is paid and such payment is authorized by roper person.

ix. The payment of salaries to the employees of office is to be vouched by examining attendance register, appointment register, agreement of service etc.

x. The auditor should see that payment of salary is authorized by the competent person.

xi. The auditor should ensure that the increments are according to the terms and conditions of appointment and have been properly authorized.

xii. The deductions in regard to provident fund contribution, income-tax etc. should be verified in the same manner in case of wages.

4. Payment of Bills Payable

i. Bills paid on the maturity should be vouched with bills payable book, counterfoils of cheque, bank statement and cancelled bill payable after they have been paid.

ii. The auditor should compare payable amount of bills and the entries made on the payment side of cash book with respect to the bills payable.

5. Capital Expenditure

Capital expenditure means money spent on acquiring fixed assets. The duty of an auditor in this connection is to see that the payment is in order, that it is duly authorized and that the money spent has been properly capitalized. Following are some important cases of capital expenditure

5.1 Freehold and Leasehold Property Building

i. The auditor should examine the agreement for purchase of property or the lease deed, conveyance and title deed.

ii. The auditor should see that a resolution have been passed in the board meeting regarding purchase of property. Minutes of the board meeting can give all such details.

iii. If the property has been purchased through a broker, his account should be examined.

iv. If asset have purchased in auction, auditor should check auctioneer's statement.

v. The auditor should see that the property has been registered in the name of his client under section 17(1) of Trust of Property Act. He should see that the title of the property has been duly verified by the solicitor.

vi. In case of building has been constructed, Architect's certificate, Builders contract and his receipt should be examined.

vii. The auditor should see whether all related expenses like architects fees, brokerage, commission, registration fees, solicitor's fees etc. are duly capitalized.

5.2 Plant and Machinery

i. The auditors should check the suppliers invoice to ascertain the price paid.

ii. He should see whether expenses incurred on erection and installation, trial run etc. are capitalized.

iii. To ascertain the actual payment the auditor should compare entries in bank statement and receipt of supplier.

iv. The auditor should examine board resolutions to ascertain the section for purchase.

5.3 Investments

The company may invest in various assets classes such as shares, debentures, mutual funds properties etc. The auditor should vouch investment in following manner

i. The auditor should ensure that the investments has been made in accordance with provisions of Companies Act. and other applicable governing laws.

ii. Investment in shares and mutual funds should be vouched with the broker's statement, DMAT Account and Bank statement.

iii. The auditor should ensure that the dividend have been properly received.

iv. In cash of bonus issue of stock split, the auditors should ensure that bonus shares have been credited to the DMAT Account.

v. The auditor should ensure that resolution have been passed in the directors meeting regarding purchase of investments.

vi. The auditor should also see that purchased investments are registered in the name of the company.

5.4 Payments under Hire-Purchase and Installment Agreement

i. The auditor should examine the hire-purchase agreement.

ii. He should examine the vouchers for payment of the installments. Those installments which have been paid include interest also, and, therefore, the auditor should see that such interest is not capitalized but is transferred to revenue account.

5.5 Patent and Copyrights

i. If patent has been purchased, the auditor should examine the agreement for use of patent and copyrights, receipts acknowledging the purchase consideration.

ii. The auditor should see that payment made on this account is supported by stamped receipts.

iii. The documents for assignment of patents and copyrights should be examined.

iv. The expenses such as registration expenses, legal charges, commission paid to agent (if any) etc. should be capitalized.

6. Loan

i. If the client has given loan to their employees or other persons, the auditor should see whether the client is allowed to advance loans by examining the articles of association, board resolution and provisions of governing laws.

ii. The auditor should examine the loan agreement and ensure that all transactions are made according to the loan agreement.

iii. The auditor should verify receipt of loan amount paid to the borrower to the borrower's account.

iv. The auditor should ensure that the borrowers are repaying the loan as per repayment schedule and interest have properly charged and accounted.

v. The auditor should see what actions have been taken by the client for unpaid installment if any and as per the loan agreement penal interest have been charged for delayed payment.

vi. The auditor should examine the securities given to ascertain whether those are sufficient.

vii. He should examine the mortgage deed and title deed, if loan is given against mortgage.

viii. In case loan to the directors and employees of the company, the auditor should check whether provisions of the Companies Act are complied.

ix. The auditor should examine the proper accounting of disbursements, interest, securities etc. is done in the books of accounts.

7. Travelling Expenses and Allowances

i. The company usually pays travelling allowances to the directors, salesman and other employees for business purpose or as a welfare facility.

ii. The auditor should verify the rules regarding reimbursement of travelling expenses and allowances and ensure that actual travelling expenses are paid in accordance with the rules and policy of the company.

iii. The auditor should vouch travel bills submitted by the employees and ensure that the employees have actually spent the amount.

iv. There is possibility that actual expenses are different from the travel bills claimed by employees. Hence auditor should carefully examine the authenticity of the bills submitted. He should check whether travel bills are properly authorized.

v. When travelling expenses and allowances are paid to the directors for attending directors meeting, the auditor should examine the attendance register and minutes of the board meeting to ensure that the directors are present in the meeting.

vi. The limit fixed by the Income-Tax Act regarding travelling expenses to the employees should be kept in mind and if the payment is made in excess of the prescribed limit, the auditor should bring notice to the management.

8. Insurance Premium

i. Insurance policy is taken on the properties like factory building, machinery etc. and on the stock. A premium paid on account on insurance is shown on the debit side of the cash book.

ii. While vouching insurance premium paid, the auditor should examine the insurance contract to known the terms and conditions.

iii. The auditor should check the period of insurance policy. If more than one insurance policies are taken for various types of properties, he should advice the client to maintain separate insurance register.

9. **Petti Cash**

There are some chances of misappropriation of cash in petti cash as number of cash transactions more and on most of the cases transactions are not supported by the proper vouchers. Therefore auditor should carefully inspect the petti cash transaction. Following things he should consider while vouching petti cash

i. The role of internal check in pretty cash is important as if internal check systems and procedure are proper with respect to the petti cash it may load to room for misappropriation of cash and fraud. Therefore firstly auditor should satisfy himself with respect to the internal check system and procedure for petti cash.

ii. The auditor should examine cash book and petti cash book simultaneously for verifying cash receipts shown in petti cash book.

iii. The auditor should examine each and every voucher of petti cash expenditure to check the date, amount, head of expenditure, recipients' signature etc.

iv. Auditor should see whether petti cash expenses are properly authenticated by the responsible officer or not.

v. The auditor should see whether the expenses are grouped under proper head or not.

vi. He should also see that expenses shown in petti cash book are really petti in nature.

vii. The auditor should verify petti cash, physically in hand by surprise visit.

viii. The auditor should examine the relevant register like postage register and confirm balance of postage stamps.

10. **Directors Fees and Remuneration**

i. Section 197, Section 198 (computation of net profits) and Schedule V of the Companies Act of 2013 states about remuneration paid to the directors. The auditor should ensure that such remuneration paid to the directors is according to this provision.

ii. Further the auditor should inspect rules in the articles of association to know the terms and conditions regarding director's fees and remuneration.

iii. If articles of associate are silent as to remuneration payable to directors, the same may be fixed by the shareholders resolution. If such payment is free of income-tax, the auditor should see that the same is approved by general meetings of the shareholders.

iv. The auditor should also check the minutes of board meetings, director's attendance register and receipt of payment made to the directors.

v. Where the commission payable is to be calculated as a percentage on profits, the auditor should examine the agreement and find out the basis of calculation of profits which should be according to the provisions laid down in the Companies Act.

vi. The remuneration paid to the directors by way of fees or commission etc., it must be shown separately in the Profit and Loss Account.

11. Bank Account

In the recent past years technological advancement in the banking sectors have taken place to a large extent and it is continues till today. As a result new ways of payments systems have been introduced. These included RTGS, NEFT, IMPS Cheque Truncations System, UPI etc. As a result now a day's significant amount of transactions are routed through bank. Hence vouching of bank account is crucial, important and a bit of challenging also. However at the same time application accounting software and using advance technology brought more transparency in accounting and business transactions.

i. The auditor should compare the entries in the cash book with the bank statement.

ii. The auditor should examine whether bank changes such as commission, fees, changes, interest are accurately calculated by the bank.

iii. If the client have issue any cheque which is not been presented by the payee up to the last day of accounting year, the same should have been accounted for bank reconciliation statement and the balance as per the bank statement must be tallied.

iv. Payment into the bank should be vouched with the counterfoils of bank challans.

v. Payment out of the bank can be checked with the counterfoils of bank cheques if available or with bank statement or with the receipt of payees.

vi. Payment made by the bank as per standing instructions of the client, be verified with bank statement, payees receipts and bank advice.

vii. In case of transactions in foreign banks in foreign country, the balance should be converted at prevailing exchange rate. In such cases auditor should obtain balance confirmation certificate from that bank.

viii. As the number of transactions in bank account are more, the auditor may apply 'test check' i.e. few transactions may be checked at random.

ix. The auditor should carefully check authenticity of bank statement as the client may produce duplicate or fake bank statement.

II] Vouching of Purchase Book or Credit Purchases

Vouching of purchase book is another crucial aspect of auditing as there are chances of frauds in regards to the purchase. The main objective of vouching of credit purchase is to see that all purchase invoices are entered in the purchase book and the goods entered in the purchase books are actually received by the client and the client pays for only those goods which are delivered by the supplier. Following are some area with respect to purchase book where there are some chances of frauds:

a. Goods are not purchased but purchase invoice is prepared and the cash may be misappropriated

b. Double payment is made for the same purchase and entries in the purchase book may be recorded twice and cash is misappropriated

c. Purchase invoices may be suppressed and purchase may not be entered in the books but good may be included in the closing stock. The profit thus may be inflated and also less liability than actual liability may be shown.

d. The reverse may be also possible i.e. purchases may be entered in the books of accounts but goods purchased may be omitted from closing stock. Thus less profit may be shown.

By considering these possibility of frauds the auditor should be vouch purchase book in the following manner:

i. The auditor should examine the internal check system regarding recording credit purchase and assure that it is adequate. If auditor finds some lacunas in internal check system, then auditor should check purchase book exhaustively with invoices.

ii. The auditor should see that purchase of goods is sanctioned by responsible officer. Purchase orders should be signed by such authorized officer.

iii. the auditor should see that all purchase invoices are in order i.e. date of purchase invoices matches with the date of entry in the purchase book, the name of client in the purchase book, initial of sanctioning officer etc.

iv. The auditor should see that all incidental expenses relating to purchases are added in invoices.

v. The auditor should verify goods received with purchase order, goods inward book and the purchases invoices.

vi. The auditor should confirm that purchase of fixed assets are not entered in the purchase book.

vii. The auditor should prepare the list of missing vouchers and call for explanations for missing vouchers.

viii. In case of Joint Stock Company if goods are purchased in from another company in which directors are interested, then the resolution of board of directors should be examined.

ix. Some time it may have practice of the company to inflate the profit by including the goods in closing stock but not entered in the purchase book. To find such frauds, the auditor should examine in detail Goods Received Book of last month and verify that all gods which are included in the stock are recorded as purchase of that period.

III] Vouching of Sales Book or Credit Sales

Another important aspect of audit is vouching of sales book where all the entries of credit sales are made. Following are the areas where there are chances of frauds:

a) Goods may have sent in excess quantity than entered.

b) Preparing fictitious invoices of sales

c) Sales may not be shown

d) Sales have shown but less than the actual

The auditor should vouch sales book in following manner:

i. Firstly the auditor should examine internal check system regarding credit sales. If such internal check system is efficient then then the auditor may apply test check otherwise he should extensive checking of sales book is to be done.

ii. Auditor should see that all credit sales is being authenticated. He should get the names of officer in charge for credit sales and should ensure that he has sanctioned the credit sales.

iii. The auditor should carefully examine the date of sale, particulars, the amount, signature etc.

iv. The auditor should compare the outward invoices with entries in the sales book. He should confirm that no sales invoices are omitted from being entered in sales book as omitting such an entry may result into misappropriation of sales proceeds.

v. The auditor should also have to confirm that whatever goods have been dispatched, they are billed to the customers by an examination of Goods Outward Book.

vi. The auditor should check the amount of trade discount allowed and see that such discount is in accordance with the policy of business and is properly authorized.

vii. The auditor can also get confirmation letters from customers as against goods sold.

viii. The auditor should see that all sales invoices are recorded in the sales book and the payment made by the debtor is not misappropriated.

ix. When goods are sent on sale or return basis, he should see that they are not included in the sales. At the end of year, the value of such goods lying with the customers should be taken into closing stock at its cost price and not at selling price. The basic accounting principle is that until goods are actually sold, no credit should be taken for profit on such sales.

x. The auditor should confirm that sale of fixed assets are not entered into the sales book.

xi. If auditor finds any altered sales invoices, he should see that it is been authenticated or initiated by responsible person.

xii. The auditor should see the terms and conditions of sales. If loading charges, cartages, freight etc. are to be borne by client then such expenses should be debited to respective accounts. Where such expenses are paid on behalf of the customers, tha same should be debited to customers' accounts.

Check Your Progress -1

A) Choose the appropriate alternative from the given alternatives below statements

1. Documentary evidence on the basis of which an accounting entry is passed is called as …..

   a) valuation b) verification c) voucher d) report

2. ………..consists of comparing entries in the books of accounts with documentary evidence in support thereof

   a) Book Keeping b) Balance Sheet

   c) Profit and Loss Account d) Vouching

3. Vouching helps auditor to find …………… in the books of accounts.

   a) errors and frauds b) missing entries

   c) authenticity of vouchers d) all of the above

4. The main object of vouching ……… is to ensure that all cash receipts and payments are properly recorded under correct heads.

   a) sales book b) cash book

   c) fixed assets register d) purchase book

5. ……………means money spent on acquiring fixed assets.

   a) Capital expenditure b) Revenue expenditure

   c) Fixed expenditure d) Variable expenditure

B) State whether the following statements are true or false

1. It acts as a moral check on employee.
2. All cash receipts are recorded in the credit side of the cash book.
3. Before vouching cash books, the auditor should enquire into the internal check system in operation.

Section 2: Verification and Valuation of Assets and Liabilities

2.2.7 Verification of Assets: Concept and Definition

Verification is a process where auditor ensures that the assets actually existed in the business which are shown in the books of accounts. It also includes to see that existed assets are owned and valued correctly as shown in the balance sheet. Verification means the poof of existence of confirmation of assets and liabilities on the date of balance sheet. Verification usually indicates verification of assets of any organization by examining value, ownership, existence and possession of any assets. The liability of the auditor is not limited to checking the arithmetical accuracy only but he is also liable to verify assets and liabilities otherwise he may be held responsible for negligence.

Definitions

1. **Spicer and Pegler:** "Verification of assets implies an inquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets."
2. **Joseph Lancaster:** Verification of assets is a process by which the auditor substantiates the accuracy of the right side of the balance sheet, must be considered as having distinct objects a) the verification of the existence of the assets b) the valuation of assets and c) the authority of their acquisition.
3. **J. R. Batliboi:** In verification of assets the auditor must satisfy himself that they really existed on the date of the balance sheet and were free form any charge, and that they have been properly valued. In verifying liabilities, he has to see that all liabilities have been inserted at their proper figures and that no liability has been omitted."

From the above definition it can be inferred that verification involves the following:

i. To see that the assets actually exist in the organization on the date of balance sheet.

ii. Checking the ownership and he title of the assets

iii. The assets are properly valued

iv. The assets are in proper condition and free from charge or mortgage.

2.2.8 Importance of Verification

Verification is an importance part of audit from point of view of auditor, investors and the management itself. The importance of verification can be explained as below

i. True and Fair View of Sate of Affaires: The main object of auditing to comment on whether the financial statements exhibit true and fair view of the state of affairs or not. By merely examining books of accounts this objective cannot be achieved. Physical verification of assets and liabilities enable auditor to on true and fair view of state of affairs of business.

ii. Fraud in Connection with Assets: Any fraud in connection with the purchase or sale of assets or the fact of asset having been mortgaged comes to the light by verification only.

iii. Confidence to Shareholders and other Investors: Shareholders and other investors cannot visit the company to verify the applications of their money. They can only rely on the data provided by the management. Verification of assets and liability of a company by an independent auditor will certainly boost the confidence of shareholders and other investors on the company.

iv. True Information: Creditors and all other stakeholders of the company will get true information about assets and liabilities of the business.

v. Facilitates Valuation: Verification enables auditor to determine whether the assets and liabilities are overstated or understated.

vi. Extended Auditors Duty: As per the new provisions of the contained in Section 227 (4A) of Companies Act an auditor need to state in his report some additional matters, which include matter like verification of fixed assets and stock. On these accounts, it is essential that assets should be verified with utmost care.

2.2.9 General Principles for Verification of Assets

Auditor should consider following general principles while conducting verification of assets

1. Type of Assets:

The assets are of two type's i.e. fixed assets and currents assets. The auditor should devise plan and make check list of verification according to the type of assets. In case fixed assets auditor should examine the purchase invoices, receipts, correspondence and title deed of the assets. In case of current assets such as stock, debtors, cash etc. the auditor should check the closing balances and the end of the day of financial year as the value and portion of current assets keeps changing on daily basis.

2. Acquisition of Individual Asset

The auditor should verify the cost of assets with the purchase agreements and the receipt of the seller in respect of the price paid. It should be verified that expenditure on assets newly acquired and that on the renewal and replacement of old assets has been correctly recorded consistent with the method that has been generally followed in the past.

3. Acquisition of Group Assets:

If the organization has taken over the assets of the going concern, the agreement of purchase should be inspected and that the amount paid for them should also be ascertained.

4. Sale of Assets

If any asset have been sold during the year, the auditor should inspect the agreement to sell, the receipt, the amount of sale proceeds, authentication of sale by a responsible official or resolution that regard. If profit has been made on sale of the asset, the same should be treated as capital profit.

5. Physical Verification:

The auditor should verify the actual physical existence of the asset by inspection. While conducting physical verification of assets, the auditor should compare particulars of assets as entered in the schedule attached to the Balance

Sheet, with the Asset Register and also reconciling their total value with the general ledger balances.

6. Charge on Assets:

If any charge have been created on any asset, a certificate of a person whose favour charge is created should be obtained. Further the auditor should assure that no unauthorized charge has been created against an asset and all the charges are duly registered and disclosed.

7. Deposition of Asset:

If any asset like investments are deposited with third party, the auditor should see that the same is deposited proper person like banker.

8. Disclosure in Balance Sheet:

The auditor should see that all the assets and liabilities are shown in the balance sheet under proper headings. He should satisfy himself that the provisions of Indian Companies Act have been complies with.

2.2.10 Valuation of Assets and Liabilities: Concept

Valuation of assets and liabilities are most important part of accounting. The accuracy of balance sheet and estimated profits of the firm depends upon the correct valuation. Some time it may have practice of some business organization to overvalue or undervalue the assets to inflate or deflate the profitability of the business or the enterprise value. Therefore is duty of the auditor to see that assets and liabilities are correctly valued. However valuation does not mean that the auditor need to calculate and determine value of each and every asset, but to see that whether the company have followed generally accepted principles of accounting to value assets and liabilities. Auditor is not a technical man and cannot ascertain correct values of all assets. Hence he has many times rely on the certificates of valuators.

Thus valuation is an operation which includes

i. Obtaining all necessary information regarding valuation.

ii. Analyzing all the figures available.

iii. Confirming the fact that the valuation in being determined on the basis of generally accepted conventions and accounting principles.

iv. Ensuring the consistence of the method followed for the valuation from year to year and

v. Obtaining an opinion regarding accuracy of valuation.

2.2.11 Valuation Procedure

For valuing the different assets, shown in the balance sheet, the auditor has to follow following steps

i. Obtain the schedule of valuation prepared by the management.

ii. Examine and critically analyze all figures

iii. Get information about the valuation process adopted by the client.

iv. Ascertain and check the values of the assets given by the management at random

v. Ensure that the valuation of assets and liabilities are determined by following generally accepted conventions and accounting principles.

vi. Verify that the valuation process adopted by the management is continued from year to year and there no sudden change in the process of valuation of assets and liabilities.

vii. Enquire about variation, if any, in the process of valuation.

viii. If required take the help of valuator having technical knowledge.

ix. Verify the accuracy of depreciation provided and capitalization of revenue expenditure.

x. See that proper value of assets are shown in the balance sheet.

2.2.12 Difference Between Verification and Valuation

Sr. No.	Points of Differences	Verification	Valuation
1.	Meaning	Verification is a process of ensuring that the assets actually existed in the business and enquiry into title of ownership, charge	Valuation is a process of ensuring that the assets are correctly valued by enquiry into whether or not valuation in being determined on the basis of

		etc.	generally accepted conventions and accounting principles
2.	Object	The main object of verification is to check existence, ownership and possession of assets.	The purpose of valuation is to see that the values of assets shown in the balance sheet are determined accurately.
3.	Dependence	Verification is the responsibility of auditor. He himself certify regarding verification of assets and liabilities	Being auditor is not supposed to be the technical person, he most of the occasions need to depends on the certificate issued by the certified valuated
4.	Vouching	Verification includes vouching.	Valuation does not include vouching.
5.	Scope	The term verification is broader concept. The scope of verification is wider.	The scope of valuation is limited and narrow as compared with verification.
6.	Scrutiny	Verification involves through scrutiny of assets and liabilities which may include vouching, physical verification and valuation.	Valuation on the other hand only involves checking the correctness of value.
7.	Responsibility	Auditor is responsible for negligence of duty if he fails to verify assets and liabilities.	Auditor is not supposed to be valuator having technical and market knowledge of valuation. Therefore as compared to the verification auditor is having less

			responsibility with respect to the valuation. He has to only check whether valuation is done properly.
9.	Basis	Verification is done on the basis of accounting practices, guidelines of ICAI, Standard Auditing Practices and various Accounting Standards.	Valuation is done on the basis of generally accepted conventions and accounting principles.
10.	Errors and Frauds	Verification helps detection of errors and frauds.	Valuation helps to detect manipulation in accounts.
11.	Duty	It is auditors' duty to of verification of assets and liabilities.	It is duty of the management to value the assets and auditor should see that whether it is correctly valued or not.
12.	Cost	In verification actual cost incurred is considered.	In valuation of current assets both actual cost and market price is considered.

Check Your Progress -2

A) Choose the appropriate alternative from the given alternatives below statements

1. ………….. is a process where auditor ensures that the assets actually existed in the business which are shown in the books of accounts.

   a) Valuation b) Verification c) Voucher d) Report

2. The purpose of valuation is to see that the values of ……. are determined accurately.

   a) shares b) business c) debentures d) assets

3. Any fraud in connection with the purchase or sale of assets or the fact of asset having been mortgaged comes to the light by ………….. only

   a) valuation b) verification c) voucher d) report

B) State whether the following statements are true or false

1. Valuation means the poof of existence of confirmation of assets and liabilities on the date of balance sheet.
2. Physical verification of assets and liabilities enable auditor to on true and fair view of state of affairs of business.
3. Valuation implies that calculate and determine value of each and every asset by an auditor.

2.2.13 Audit Report

The main object of audit is to enhance the confidence of stake holders of the company especially of shareholders by commenting on the financial statement as whether it revels true and fair view of the state of affairs of not. An audit report is a way of communication of auditors' opinion financial statements and other aspects of company. As per the section 227(2) of the Companies Act 1956 auditor is required to examine the accounts and has to submit his report to the shareholders on the accounts audited by him.

Meaning of Audit Report

According to the LanCester "a report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in passion of the full facts of the subject matter of the report." An audit report is report prepared by the audit on the observations and his findings about company's financial statement and other financial matters. It is a medium through which an auditor expresses his opinion on the financial statement under audit. It is an important part of audit as it provides the results of the audit conducted by the auditor.

2.2.14 Contents of Audit Report

The audit report should have following basic elements as prescribed in standards on Auditing -700

i) Title:

The audit report should have an appropriate title such as “Audit Report”. It enable the readers to identify the report and distinguish it from reports issued by others.

ii) Address:

The audit report is addressed to the appointing authority. In case of audit of the joint stock company, the audit report is addressed to the shareholders

iii) Introductory Paragraph:

In the introductory paragraph of the audit report, auditor states that financial statements are the responsibility of the management of the organization and the responsibility of the audit is to express an opinion on the financial statements based on audit.

iv) Scope of Audit:

The audit is to be conducted in accordance with auditing standards acceptance in India. The main object of audit is to see that whether financial statements are free form material misstatement. This should be clearly stated in the audit report.

v) Observations:

a. Auditor should state whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of the audit.

b. He should state whether proper books of accounts as required by law have been kept by the company or not

c. He should mention whether Balance Sheet and Profit and Loss Account attached there to give true and fair view of the state of affairs of the company.

d. He should state whether Balance Sheet and Profit and Loss Accounts are in agreement with the books of accounts.

e. He should state whether the Balance Sheet and Profit and Loss Account read with notes there on give the information in the manner required by the Companies Act 1956.

vi) Opinion:

This is the most important part of audit report. The auditor should clearly gives his opinions on the financial statement of the company e.g. "the Financial statement give true and fair view of the state of affairs" The opinions may be either 1) Unqualified 2) Qualified 3) Adverse 4) Disclaimer v) Piecemeal

vii) Auditor's Signature:

The audit report should be signed by the auditor in his personal name or in the name of auditor or both as appropriate

viii) Place:

The name of the place where audit report is signed is also mentioned in the audit report

ix) Date of the Report:

The date when the audit report is signed is to be mentioned on the audit report. The date of the report informs the reader that the auditor has considered the effect on the financial statements.

2.2.15 Importance of Audit Report

An audit report is an end product of auditing. It is concluding part of audit process. It gives auditors opinion of the company, as examined by him. Audit report offers a great value to all parties concerned with the business. It enhances the confidence of the stake holders on the company. The importance of audit report to different stake holders are explained as under

1. Importance of Audit Report to the Shareholders:

Shareholders are the owners of the company. But as they are large in numbers and scattered all over, they cannot takes active part in the management. The management of affairs of the company is looked by the directors who are the elected representative of the company. All books of accounts and financial statements of the company are prepared under the supervision of the directors. Therefore from shareholders point of view it is important to make an independent inquiry in to the books of accounts of the company to assure that there are true and exhibit true and fare view of state of affairs of the company. Hence the role of audit is crucial. Audit is an independent and professional enquiry of books of accounts to report to the shareholders about the financial records of the company. As audit report is the concluding remark of the audit, it becomes very important documents for shareholders to take their investment decision.

2. Importance of the Audit Report to the Directors:

Though all the books of accounts are prepared under the charge of directors, they cannot look after day to day management. Directors are more concern with the policy decisions of the company. The audit report is therefore, important for them, as they can get an idea about the working, efficiency, integrity and honesty of the officials and other employees of the company.

3. Importance for Creditors of the Company:

The audit report is also important for the creditors of the company who supply goods and services to the company. Creditors are continually interested in the state of affairs of the company and its financial strength on the basis of which they can decide the period and quantum of credit which they can allow to the company.

4. Importance for the Debenture holders of the company:

Debenture holders provide long term finance to the company. They are always interested to know about company's financial health so that they can assure that their investment in the company is safe and they will get return as per their contract. Auditor report will assure them that the published accounts show the true financial position of the company.

5. Importance to Bankers and other Investors:

Most of the companies regularly takes finance for banks for meeting their working capital and long term financial needs. Banks along with the other investors of the company also wants to know about financial soundness of the company especially liquidity and solvency position of the company. The auditor's report gives safety to their investments. Investors study the audit report of the company before taking their investment decision.

6. Importance for Income Tax Department:

The income tax department is interested to know the taxable income of the company. The audit report helps income tax officer to rely on the financial statements of the company in calculation of income tax liability.

Apart from the above maintained parties, an audit report is important and serves valuable information and insights of the company to the government, prospective investors, suppliers, customers and general public.

2.2.16 Auditor's Opinion and Types of Audit Report

An auditor is required to express his opinion in respect of the audit conducted and state whether the entity prepared financial statements considering all the material aspects and whether the financial statements are free from material misstatements, fraud or error and state the true and fair view. The auditor express an opinion on the financial statements of an entity on the basis of audit evidences that obtained during the course of audit. Evaluation of financial statements includes its qualitative aspects, accounting policies and practices and management judgment. Based on the auditor's opinion the audit report can be of the four types: 1) Clean Audit Report, 2) Qualified Audit Report, 3) Adverse Audit Report and 4) Disclaimer of Opinion Audit Report

1. Unqualified or Clean Opinion

When there is no qualified or adverse opinion or disclaimer of opinion in the report, an audit report is said to be clean report. In other words where the balance sheet of a company gives true and fair view of the state of affairs of the company and profit and loss account give a true and fair view of the profit or loss of the company, the auditor gives a clean report. A clean report indicates that the auditor is satisfied with all the points required to be stated in his report and states them in the affirmative, adding no reservation anywhere.

Specimen of Clean / Unqualified Audit Report

Independent's Audit Report

To
The Members of ABC Ltd.
ABC Ltd., Kolhapur

Dear Members

We have audited the annexed Balance Sheet of ABC Ltd., as at 31st March 2023 and also Profit and Loss Accounts of the company for the year ended on that date and report that:

i. We have obtained all the information and explanations which to the best of my/ our knowledge and belief were necessary for the purpose of audit.

ii. In our opinion proper books of accounts as required by law have been kept by the company so far as appears from our examination of such books and proper returns adequate for the purpose of our audit have been received from the branches not visited by us.

iii. The Balance Sheet and Profit and Loss Account dealt with in this report are in agreement with the books of accounts.

iv. In our opinion and to the best of our information and according to the explanation given to us, the said accounts, together with the notes thereon, give the information required by the Act in the manner so required and give true and fair view:

   a. In the case of the Balance Sheet of the state of affairs of the company as at 31st March 2023 and

   b. In the case of Profit and Loss Account of the profit of the company for the year ended on that date.

Place: Kolhapur

Date: August 10, 2023

For P.B.Patil & Co.
Chartered Accountants
ICAI Firm registration number: 0000000
Signature ……………………………..
P. B. Patil (Partner)
Membership No.: 504777
UDIN: 00000000AAAAAA0000

2. Modified Opinion

According to SA 705, any audit report, other than an unqualified report, is known as modified report. There are three types of modified opinion: 1) A Qualified Opinion 2) An Adverse Opinion and 3) Disclaimer of Opinion. Let us understand there types of opinion in details

2.1 Qualified Opinion

When an auditor expresses an opinion in his report with reservation or states anything in the negative, but its nature is such that it does not materially affect the true and fair picture shown by the accounts, then the auditor's report is said to be a qualifies report. In following circumstances auditor gives qualified audit report:

i. Non availability of certain books of accounts or records, information or explanations necessary for conduct of the audit

ii. The Balance Sheet and Profit & Loss Account have not been prepared in accordance with accepted accounting principles

iii. Provisions for Bad and Doubtful Debts, Depreciation etc. are not adequate

iv. Company has created certain secret reserve

v. The stock in trade has been valued at market price which is more than cost price.

vi. The Contingent Liability for bills discounted has not been disclosed

vii. Provision for taxation is not proper.

viii. There is an embezzlement of cash or misappropriation of goods or manipulation of accounts which considerably affects the financial position of the company.

Specimen of Clean / Unqualified Audit Report

Independent's Audit Report

To
The Members of ABC Ltd.
ABC Ltd., Kolhapur

Dear Members

We have audited the annexed Balance Sheet of ABC Ltd., as at 31st March 2023 and also Profit and Loss Accounts of the company for the year ended on that date and report that:

i. We have obtained all the information and explanations which to the best of my/ our knowledge and belief were necessary for the purpose of audit.

ii. In our opinion, proper books of accounts as required by law have been maintained by the company, kept in accordance with the accounting standards so far as it appears from our examination of the books subject to the comments given here under:

   a. The stock of the company have been valued at a current replacement price, which is higher than the cost price to the extent of Rs. 5,00,000/-

   b. Provisions for bad and doubtful debts have not been taken into consideration, which should have been taken in view of the fact that some of the debts are quite old and time-barred.

   c. A contingent liability for Rs. 45,00,000/- in respect of bills discounted but nor matured on the date of balance sheet, has not been shown.

iii. The Balance Sheet and Profit and Loss Account dealt with in this report are in agreement with the books of accounts.

iv. Subject to the qualification given above, in our opinion and to the best of our information and according to the explanation given to us, the said accounts, together with the notes thereon, give the information required by the Act in the manner so required and give true and fair view:

a. In the case of the Balance Sheet of the state of affairs of the company as at 31st March 2023 and

b. In the case of Profit and Loss Account of the profit of the company for the year ended on that date.

Place: Kolhapur

Date: August 10, 2023

For P.B.Patil & Co.
Chartered Accountants
ICAI Firm registration number: 0000000
Signature ……………………………..
P. B. Patil (Partner)
Membership No.: 504777
UDIN: 00000000AAAAAA0000

2.2 Adverse Opinion

When the auditor expresses an adverse or negative opinion in his report about principal point in the report for which audit is mainly intended, the report is called an adverse report. In adverse opinion, auditor expresses that financial statements do not exhibits true and fair view of the state of affairs of the concerns as the misstatements, individually or in the aggregate, are both material and pervasive to the financial statement. The auditor shall express an adverse opinion after obtaining sufficient and appropriate audit evidences.

An auditor expresses adverse opinion in following cases

- When the auditor has concluded that the audited financial statements do not fairly represents the organization's financial position or financial performance, and that there are significant departure from GAAP.
- When he considers that the misstatements either individually or in aggregate are both material and pervasive to the financial statements of the entity.

2.3 Disclaimer of Opinion

When an auditor is unable to express an opinion on the financial position of a concern due to absence of financial records or insufficient cooperation from management, he states disclaimer of opinion. This is an indication that no opinion over the financial statements was able to be determined. In the disclaimer of opinion the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. A disclaimer of opinion is always required to be supported by justified facts.

An auditor expresses a disclaimer of opinion in the following cases

- When he is unable to obtain sufficient and appropriate audit evidences.
- When he considers that the undetected misstatements could be both material and pervasive.
- When he decides that he cannot be impartial or independent regarding the company or organization audited.
- When he has not completed the examination of accounts, or the examination is not broad enough in scope to enable them to form an opinion

Apart from the above types of audit report, there is another types of audit report which is known as piecemeal report. Auditor's opinion in his report may not be on the entire financial statements. Such opinion may relate to some of the items contained in the statement on which only he can satisfactorily express opinion after audit. Such opinion as a part of the financial statement is a piecemeal opinion and auditor's report containing such opinion is called a piecemeal report.

Check Your Progress -3

Match the followings

Sr. No.	Types of Audit Report	Explanations
1	Unqualified Opinion	(A) Auditor is unable to express an opinion
2	Qualified Opinion	(B) Auditor expresses positive opinion
3	Adverse Opinion	(C) Auditor expresses an opinion in his report with reservation
4	Disclaimer of Opinion	(D) auditor expresses an negative opinion

2.3 Summary

Audit process refers to the method that auditor follow to obtain and evaluate audit evidences and examine the books of accounts. Vouching, verification & valuation of assets and liabilities and preparing an audit report are vital steps in audit procedure. Vouching is the first and prime step in audit process. It is process of a comparing entries in the books of accounts with the documentary evidences in support thereof so as to ensure that transactions are in order, have been properly authorizes and correctly recorded in the books. Vouching is a first and prime step in audit process. It gives confidence and the valuable basis to the auditor to form an opinions on the true and faire view of state of affairs of the concern. The main objects of vouching are to see all the transactions are recorded in the books of accounts, the recorded transactions are actually taken place, to ensure that all the entries recorded in the books of accounts are supported by the documentary evidences, to verify authenticity of the vouchers and documentary evidences and to ensure that there is no fraudulent entries in the books of accounts. While vouching the auditor should verify serial number, name, date, amount, particulars, signature, stamp, authentication etc. The auditor should pay particular attention on missing vouchers, duplicate vouchers and own printed vouchers. Vouching of cash book, purchase books and credit sales covers majority part of vouching.

Verification of assets implies an inquiry into the value, ownership and title, existence and possession, the presence of any charge on the assets. The liability of the auditor is not limited to checking the arithmetical accuracy only but he is also liable to verify assets and liabilities otherwise he may be held responsible for negligence. The accuracy of balance sheet and estimated profits of the firm depends upon the correct valuation. Therefore is duty of the auditor to see that assets and liabilities are correctly valued. However valuation does not mean that the auditor need to calculate and determine value of each and every asset, but to see that whether the company have followed generally accepted principles of accounting to value assets and liabilities.

As per the section 227(2) of the Companies Act 1956 auditor is required to examine the accounts and has to submit his report to the shareholders on the accounts audited by him. An audit report is a way of communication of auditors' opinion financial statements and other aspects of company. Based on the auditor's opinion, the audit report is classified into five categories i.e. clean audit report, qualified audit report, adverse audit report, disclaimer of opinion and piecemeal audit report.

2.4 Terms to Remember

1. **Voucher:** A voucher id a documentary evidence in support of a transaction in the books of accounts.
2. **Vouching:** Vouching is the examination of the documentary evidences in support of transactions contained in the books of accounts. It consists of comparing entries in the books of accounts with documentary evidence.
3. **Verification:** Verification of assets and liabilities means an inquiry into the value, ownership, existence, possession and charge on the assets of the business organization. It is a process where auditor ensures that the assets actually existed in the business which are shown in the books of accounts.
4. **Valuation:** Valuation of assets means the examination of the accuracy and propriety of the valuation of the assets which are shown in the balance sheet. In valuation auditor see that whether the company have followed generally accepted principles of accounting to value assets and liabilities.
5. **Audit Report:** An audit report is report prepared by the audit on the observations and his findings about company's financial statement and other financial matters. A clean report indicates that the auditor is satisfied with all the points required to be stated in his report and states them in the affirmative, adding no reservation anywhere
6. **Clean/Unqualified Audit Report:** When an auditor gives positive opinion on all matters contained in the audit report, it is said to be unqualified or clean audit report. A clean report indicates that the auditor is satisfied with all the points required to be stated in his report and states them in the affirmative, adding no reservation anywhere.
7. **Qualified Audit Report:** When an auditor expresses an opinion in his report with reservation or states anything in the negative, but its nature is such that it does not materially affect the true and fair picture shown by the accounts, then the auditor's report is said to be a qualifies report.

8. **Adverse Audit Report:** When the auditor expresses an adverse or negative opinion in his report about principal point in the report for which audit is mainly intended, the report is called an adverse report.

9. **Disclaimer of Opinion:** When an auditor is unable to express an opinion due to certain reasons and states this in his report, it becomes a report with disclaimer of opinion. A disclaimer of opinion is always required to be supported by justified facts.

10. **Piecemeal Report:** Auditor's opinion in his report may not be on the entire financial statements. Such opinion may relate to some of the items contained in the statement on which only he can satisfactorily express opinion after audit. Such opinion as a part of the financial statement is a piecemeal opinion and auditor's report containing such opinion is called a piecemeal report.

2.5 Answer to check your progress

Check Your Progress- 1

A) 1. – c 2. – d 3. – d 4. – b

B) 1. True

2. False: True Sentence: All cash receipts are recorded in the debit side of the cash book.

3. True

Check Your Progress-2

A) 1. – b 2. – d 3. – b

B) 1. True 2. True

3. False,

True Sentence: Valuation does not mean that the auditor need to calculate and determine value of each and every asset, but to see that whether the company have followed generally accepted principles of accounting to value assets and liabilities.

Check Your Progress -3

Match the followings

Sr. No.	Types of Audit Report	Explanations
1	Unqualified Opinion	(B) Auditor expresses positive opinion
2	Qualified Opinion	(C) Auditor expresses an opinion in his report with reservation
3	Adverse Opinion	(D) Auditor expresses negative opinion
4	Disclaimer of Opinion	(A) Auditor is unable to express an opinion auditor expresses an opinion

2.6 Exercise

1) What is 'vouching'? What points will you consider while vouching?
2) How would you vouch cash book?
3) What important points should be kept in mind by the auditor while vouching purchase book?
4) Explain the concept and importance of verification and valuation.
4) Explain the components of audit report.
5) Explain various types of audit report.
6) Write short notes on
    a) Importance of vouching
    b) General principles for Verification of Assets
    c) State the difference between verification and valuation
    d) Explain the objectives of verification and valuation
    e) Qualified Opinion
    f) Adverse Opinion
    j) Disclaimer of Opinion

2.7 References

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