

PRINCIPLES AND PRACTICE OF AUDITING



6TH SEMESTER B.COM

BANGALORE UNIVERSITY


MODULE 5

AUDIT OF LIMITED COMPANIES & OTHERS

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MEANING OF COMPANY AUDITOR



An auditor is a qualified Chartered Accountant appointed for the purpose of examining the accounts of a Joint Stock Company & giving the report thereon to the shareholders every year at the annual general meeting

- **Only CA is qualified to act as an auditor of the company**
- **A firm can be appointed as the auditor of the company, if all partners are practicing CA in India**
- **A person who holds a certificate under restricted auditors certificate rules, 1956, is also qualified to act as an auditor of the company**



DISQUALIFICATIONS OF AN AUDITOR

- A body corporate
- An officer or employee of the company
- A director or a member of a private company or partner of a firm, who is the managing agents or the secretary & treasurer of the company
- A person who is indebted to company for amount exceeding Rs. 1000 or a person who has given guarantee to any 3rd party regarding the repayment of any debt exceeding Rs. 1000 due to the company
- A holder of shares exceeding 5% in nominal value of subscribed capital, of anybody of corporate, who is the managing agents or the secretary & treasurer of the company



PROFESSIONAL QUALITIES

- Knowledge of principles & practice of General Accounting, Cost Accounting & Management Accounting
- Knowledge of provisions relating to Income Tax, Sales Tax, Wealth tax
- Knowledge of Economics, Business Law, Mathematics, Statistics, Business management, Financial management
- Ability to draft report clearly, correctly, concisely & forcefully
- Vigilant & Alert in his work
- Methodical & systematic
- Not disclose confidential information about the business of his client to others
- Independent & impartial



APPOINTMENT OF AN AUDITOR

First Auditor

Subsequent Auditor

**Appointment of auditor
by Central Government**

**Appointment in case
of casual vacancy**

**Appointment by
special resolution**



RIGHTS AND POWERS

- Right of access to books of account & vouchers
- Right to obtain information & explanations
- Right to comment on inadequacy of accounting system in his report
- Right to receive notices & other communications of general meeting
- Right to have legal, technical or expert advice
- Right to receive remuneration for his audit work
- Right to be indemnified
- Right to sign the audit report
- Right to make representation & to speak in the general meeting when he is asked to vacate office
- Right to refuse to start the audit work until books of account of business is balanced by the management





STATUTORY DUTIES

- **Duty to make certain enquiries**
- **Duty to sign his audit report**
- **Duty to assist investigators or inspectors**
- **Duty to assist the Central Government in connection with prosecution**
- **Duty to certify the statutory report**
- **Duty to report**



- **To perform special duties under the contract with the company like conduct of efficiency audit or propriety audit**
- **To perform contractual duties with reasonable care & diligence in order to avoid his liability for breach of contract**



DUTIES IMPOSED BY LEGAL OR COURT DECISIONS

- He is not bound to be a detective or to approach his work with suspicion or with foregone conclusion that there is something wrong
- He must correspond in writing with the previous auditor in whose place he has been appointed as an auditor of the company



DUTIES ARISING OUT OF PROFESSIONAL ETHICS

- **Not to practice as an auditor unless he is a member of Institute of Chartered Accountants & a holder of a certificate of a practice from the Council of the Institute**
- **Comply with the rules & regulations formulated by the ICAI**



CIVIL LIABILITIES OF THE COMPANY AUDITOR

1

In case of negligence

- London Oil Storage Co. vs. Sears Hasluck & Co.
- Leeds Estates Building & Investment Co. vs. Shepherd
- Irish Woolen Co. vs. Tyson & others

2

In case of misfeasance

- London & General Bank Ltd.
- Union Bank of Allahabad
- The City Equitable fire Insurance Co. Ltd.



CRIMINAL LIABILITIES OF THE COMPANY AUDITOR

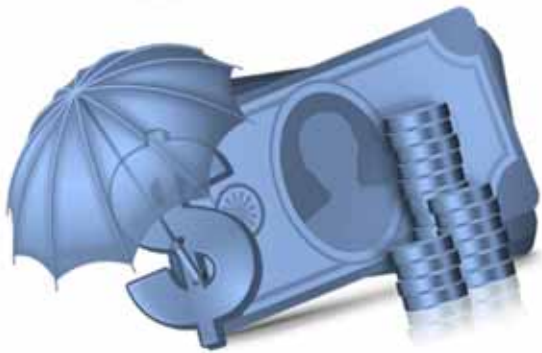


- **Criminal liabilities of an auditor under the Companies Act of 1956**
- **Criminal liabilities of an auditor under the Indian Penal Code**
- **Criminal liabilities of an auditor under the IT Act of 1961**
- **Criminal liabilities of an auditor under the Chartered Accountants Act**

- Familiarize himself with the provisions of Banking regulation Act relating to accounts & audit
- Thoroughly study the systems of internal control & internal check in operation in the bank
- Visit bank on last day of the accounting year to verify cash in hand, drafts, cheques
- Obtain confirmation certificate for money deposited with RBI or other banks
- Verify money at call & short notice with cash deposit receipts
- Examine investments, loans against securities, provisions for bad & doubtful debts
- Verify assets & liabilities are duly brought in account
- Ensure that contingent liabilities are shown in the foot note of balance sheet
- Vouch for incomes, expenses, capital & revenue expenditures
- Ensure that 20% of annual profits, before payment of dividend, have been transferred to reserve fund unless RBI has exempted the bank



AUDIT OF INSURANCE COMAPNIES



- Check premiums received with the insurance policy register, premium register, counterfoils or copies of money receipts, cashbook
- Outstanding premiums must be recoverable & outstanding premiums on lapsed policies are not taken credit
- Check receipts for interests & dividends with schedule of investments & loans
- Claims admitted but not paid are considered as an expense in revenue account & as liability in balance sheet
- All expenses incurred with claims are debited to the claims
- Annuities due but not paid considered as annual accounts
- Limits imposed by Insurance Act, 1938 on expenses of management must be duly observed
- Check for cash balances, market value of investments, assets, liabilities & contingent liabilities



AUDIT OF EDUCATIONAL INSTITUTIONS

- Inspect minutes' book to ascertain resolutions passed
- Study internal check system in operation
- Obtain a copy of budget or financial statements
- Verify receipts of monthly or term fees with counterfoils or carbon copies
- Vouch receipts on account of admission fees, exam fees, lab fees, fines, donations, incomes from endowments, salaries paid to staff, cashbook, payment of scholarships, items of capital expenses
- TDS must be deducted & deposited with IT department
- Investments representing prize endowment funds are kept separately & not mixed up with ordinary investments
- Verify stock of stationery, sports materials, equipment





MEANING OF AUDIT REPORT

It is a statement through which an auditor submits his findings & expresses his opinion on the state of affairs of the company's business.



SIGNIFICANCE OF AUDIT REPORT

- **Statutory requirement in the case of company audit**
- **Summarizes results of audit work done by auditor**
- **Submits findings & expresses opinions on state of affairs of client's business**
- **Evidence of auditor's work**
- **Tangible proof of financial affairs**





TYPES OF AUDIT REPORT

Clean or Unqualified Report
An auditor gives report without any reservations, qualifications or modifications

Qualified Report
An auditor gives report with any reservations, qualifications or modifications



A QUALIFIED REPORT IS GIVEN BY AN AUDITOR ONLY UNDER CERTAIN CIRCUMSTANCES

- **Not satisfied with accounts presented to him**
- **Proper books of accounts as required by law have not been maintained**
- **Violation of companies act & other laws**
- **Substantial departure from GAAP**
- **Material mis – statement in financial statements**
- **Omission of material disclosure**
- **Discrepancy in treatment of certain items**
- **Assets are over – valued or under – valued**
- **Stock in trade valued at market price which is more than cost price**
- **Insufficient provision for depreciation on fixed assets, bad & doubtful debts**
- **If secret reserves have been created**



A QUALIFIED REPORT HAS CERTAIN ADVERSE CIRCUMSTANCES

- Adverse reflection on the activities of the directors
- Fall in value of company's shares in the stock market
- Appointment of investigators by Central Government to investigate the affairs of the company



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THANK YOU