



The Quaide-Milleth College for Men-Medavakkam
Department of Commerce (Accounting and Finance)

Practical Auditing (BPG5A)

Class: III B.com AF

Question Bank

Unit-1

AUDITING AND ACCOUNTING

Section-A (2 marks)

1. Define Auditing:

Examining the Books of accounts in a systematic manner is called auditing

2. What do you mean by Audit programme?

A detailed information about the audit of a particular concern is called audit programme.

3. Meaning of Cost Audit?

It is the type of audit which indicates the cost of a product and cost related items of a manufacturing concern.

4. What do you mean by accounting?

Accounting is the process of recording of business transactions in a systematic manner

5. Two main objectives of Auditing?

1. Verification of Accounts

2. Reliability of the concern

Part B

1. Explain the precautions to be taken before applying test checking.

Ans.: Precautions to be taken by an auditor while applying test check techniques

While adopting test check technique, an auditor should take following precautions

- (i) The transactions of the concern should be classified under appropriate heads and may be stratified in case of wide variations between the transactions of the same kind.
- (ii) Authorisations, documentations, recording of the transactions should be studied right from the beginning to end.
- (iii) Evaluating the system of internal control for its efficiency, soundness and capability to produce reliable accounting and financial data.



- (iv) Preparation of test check plan with clear audit objective understood by the audit staff.
- (v) Un-biased selection of the transactions with reference to the random number tables or other statistical methods.
- (vi) Identification of the areas where test check may not be done.
- (vii) Based on degree of reliance and the confidence level required in the audit, the number of transactions to be selected for each test plan should be pre- determined.
- (viii) Setting up criteria to judge what constitute material or immaterial errors. Further investigation of only material errors be carried out and all immaterial errors may be avoided.

2- What are the contents of audit programme?

Ans.: Contents of Audit Programme

1. Name

The audit programme contains the name of client. The auditor can write the name of business. There is a need of complete address of the concern in case of public limited company.

2. Objects

The audit programme contains the objects of the business enterprise. There are various objects of any business unit. A small business has few objects while large companies have many objects.

3. Date

The audit programme contains the date of start of an audit. The auditor can consult the client before fixing the audit date. It must be convenient to the management. The audit programme can show the details of audit work date wise.

4. Duration

The audit programme contains the time limit of starting and completing the work. The duration of audit period may be one month. The size of audit work becomes the basis of duration.

3. Explain the characteristics of internal control.

Ans: Characteristics of Good Internal Control Systeme are:-

- 1. There should be a well developed plan of organization with delegation of proper



responsibilities at various levels of operational hierarchy.

2. These should be a scientifically developed system *of* record procedures with a view to maintain reasonable control over assets, liabilities, revenues and expenses.
3. A system of healthy practices and traditions is also necessary for the performance of duties and activities of various departments of the organization.
4. The personnel engaged in the business should be of high quality and character with a deep understanding of their responsibilities and a proper background of training and ability. This is necessary because controls are exercised by personnel engaged in the business.
5. There should be managerial supervision and reviews of the company's financial operation and positions at regular and frequent intervals by means of interim accounts and reports and operating summaries etc.



4. Distinguish between ‘auditing* and ‘accounting’.

Ans: Comparison Chart

BASIS FOR COMPARISON	ACCOUNTING	AUDITING
Meaning	Accounting means systematically keeping the records of the accounts of an organization and preparation of financial statements at the end of the financial year.	Auditing means inspection of the books of account and financial statements of an organization.
Governed By	Accounting Standards	Standards on Auditing
Work performed by	Accountant	Auditor
Purpose	To show the performance, profitability and financial position of an organization.	To reveal the fact, that to which extent financial statement of an organization gives true and fair view.
Start	Accounting starts where book-keeping ends.	Auditing starts where accounting ends.
Period	Accounting is a continuous process, i.e. day to day recording of transactions are done.	Auditing is a periodic process.

5. What is Audit? State its advantages, or what are the advantages of auditing?

An audit is the examination of the financial report of an organization- as presented in the annual report - by someone independent of that organisation. The financial report includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and notes comprising a summary of significant accounting policies and other explanatory notes.

The purpose of an audit is to form a view on whether the information presented in the financial report, taken as a whole, reflects the financial position of the organisation at a given date



The main advantages of auditing are:

1. Errors and frauds will be located at an early date.
2. The management may consult the auditor and seek his advice on certain technical points.
3. If the business is to be sold as a going concern, there will not be much difficulty regarding the valuation of assets and goodwill.
4. Income tax authorities generally accept the profit and loss account which has been prepared by a qualified auditor

8. What are the advantages and disadvantages of audit programme? Or
Explain the usefulness of audit programme. Or

Describe the merits and demerits of audit programme.

Ans.: Advantages of Audit Programme:

1. Assignment of responsibility is made easier since each job or portion of a job is entrusted to specific audit staff.
2. The extent of audit work can be estimated in advance.
3. The audit staff can understand the audit objectives of each audit area.
- 4 Programme wise time table can be prepared.
5. It is considered as reliable evidence in future.

Disadvantages of Audit Programme:-

1. It cannot be laid down for different types of business.
2. It is not much useful in the case of a small audit.
3. It may not be completed.
- 4 It gives always a tendency to speed up the work.

5. What are the objects of Auditing?

Ans: 1. Primary objects: The Primary objects of auditing are to see whether the financial statements are prepared in conformity with the law and to see whether the financial statements reveal the true and fair view of the state of affairs of the business concern.



2. Secondary objects: Detection and Prevention of errors and Detection and Prevention of frauds are the secondary objects of auditing. Errors arise out of the innocence or carelessness on the part of those responsible for the preparation of accounts. Fraud may be referred to intentional misrepresentation of financial information by one or more individuals among management, employees, or third parties.

6. Write a note on custody & ownership of audit working papers?

Ans.: A query often arises as to who is the real owner of the audit working papers. Regarding this issue there has been a controversy as to whether they belong to the client or the auditor. The client claims that these papers belong to him. He justifies his claim on the plea that since the auditor is his agent, he has no right to retain these papers with him. Contrarily, the auditor argues that these papers are his property on the ground that he has collected the information for discharge of duties.

As per AAS3, 'Documentation' issued by the Institute of Chartered Accountants of India, working papers are the property of the auditor. The auditor may at his discretion make portions of extracts from his working papers available to his client. The auditor should adopt reasonable procedures for safe custody and confidentiality for his working papers and should retain them for a period of time sufficient to meet' the needs of practice and satisfy any pertinent legal or professional requirement of record retention.

Section - C (Ten Marks Questions)

1. Explain the advantages of audit.

Ans.: Advantages Of Audit

Auditing has become a compulsory task in the business organization. All the organizations like business, social, industries and trading organizations make audit of books of accounts. Now-a-days, owner of business and its management are separate. So, to detect and prevent frauds, auditing has become essential. Its advantages are as follows:

1. Audit Helps To Detect and Prevent Errors and Frauds

An auditor's main duty is to detect errors and frauds, preventing such errors and frauds and taking care to avoid such frauds .thus, even though all the organization do not have compulsion of audit, they make audit of all the books of accounts.



2. Audit helps to maintain account regularly

An Auditor raises, questions if accounts are not maintained properly. So, audit gives moral sure on maintaining accounts regularly.

3. Audit Helps To Get Compensation

If there is any loss in the property of business, insurance company provides compensation on the basis of audited statement of valuation made by the auditor. So, it helps to get compensation.

4. Audit Helps To Obtain Loan

Especially financial institutions provide loan on the basis of audited statements. A business organization may obtain loan considering the audited statement of last five years. So, an organization should make audit compulsory to obtain loan.

5. .Audit facilitates the Sale of Business

Valuation of assets is made by the auditor. On the basis of valuation of assets and liabilities, businessman can sell his business. It helps to determine the price of business.

6. Audit Helps To Assess Tax

Tax authorities assess taxes on the basis of profit calculated by the auditor. In the same way sales tax authority calculates sales tax on the basis of sales shown in the audited statement.

7. Write explanatory notes on:

(a) Cost Audit

(b) Special Audit

(c) Branch Audit

(d) Social Audit

Ans.: (a) Cost Audit: Cost Audit is audit of cost records of the company. It is checking of cost accounts and costing techniques, methods system followed by the entity- The cost audit seek to verify the truth and fairness of cost of production of goods or rendering of service by an entity. It lays down that the central government may, by order, direct that the cost records maintained by the company be subject to cost audits The cost audit is generally carried out by cost accountants



within the meaning of cost and works accountants Act 1959. In case of companies the cost auditors are appointed by board of directors. The cost audit report is submitted to the management and to the central government.

- (b) Special Audit: A special audit is a type of audit conducted by the central Government for some special objectives. Under section 233 A of the Companies Act, 1956 the Central Government is empowered to appoint a special auditor in the case of companies under certain circumstances. The circumstances are

4. The management of the company is not in proper form and may cause serious damage to trade and industry and the shareholders of the company.

5. When the financial position of the company is constantly deteriorating.

6. When the company is not being managed according to sound business principles. The central Government may appoint special auditor.

(c) Branch Audit: Some companies have branches in various towns and cities. Commercial banks open branches throughout the country. Branches also carry on commercial transactions on a large scale on par with Head office. The profit and loss of these branches also should be incorporated into the Profit and Loss account of the Head office.

Hence, the accounts of branch offices should also be properly audited. Such an audit is called branch office audit. As branch audit is also a part of annual audit. The companies Act specifically gives the provisions as to branch audit.

- (d) Social Audit-Social audit is now receiving worldwide acclaim and is declared all over the world. It is a devise to measure the benefits made by an enterprise to the society. It aims at the protection of the interests of consumers, employees, and all those who are affected by the decisions of the company. It is considered as a sophisticated and scientific - technique of testing the truth of the social performance of a company with reference to its means and motives by an independent authority with a view to detect and prevent abuse of power. Social audit emanates from the basic democratic that "Those entrusted with authority must account for the use of the authority so that everyone knows as to what is going on in the business and other centers of authority".



8. Explain the works of Auditing begins where the works of Accountancy ends” • Discuss.

Ans.: The term accountancy may be defined as “ the art of recording, classifying and summarizing in a significant manner, and in terms of money transactions and events which are in part at least of financial character and interpreting other result thereof”. Book keeping is the initial part of accounting involving. recording of all transactions, journalizing, posting and balancing. The errors are rectified and the balances are arrived at by the accountant. The profit earned or loss incurred for a particular period is arrived by the preparation of profit and loss account. The financial status of the organisation as on a particular date is shown in the balance sheet. In addition to the above, accounting also provides financial information to the management in the form, of forecasting, budgeting and various analysis.

At present there are many user friendly software available which prepare the profit and loss account and balance sheet in no time. Advanced software programs also support the management information system by providing the results of various analysis and fund flow statement whenever required by the management.

It is commonly said that the auditing begins where accountancy ends. During auditing, an auditor verifies authenticity of all the transactions by scrutinizing the supporting documents and gives his opinion on the financial statements whether they show the true and fair view of the state of affairs of the organisation.

The differences between Auditing and Accountancy gives meaning for the statement of auditing begins where accountancy ends.

9.Explain different types of audit Or Explain the classification of audit

Ans.: Audits are of many types. Generally, they can be classified into two broad categories. They are as follows:

.1. Classification on the basis of the organization, n. Classification on the basis of the method of performance.



4. Classification on the basis of the organisation:

1. Private Audit: Though audit of accounts of private concerns is not compulsory. If a private concern's turnover exceeds Rs. 40 lakhs, audit has been made statutory. In case of sale trading concerns, there is no legal compulsion to audit their accounts.

In partnership firms, the accounts are audited in the interests of the partners, and so considered as most desirable. In case of audit of individuals to audit their accounts and to verify their accuracy, which will relieve them from the harassment of the income tax authorities.

Audit under statute: In case of certain concerns, audit has been made compulsory. Public corporations such as RBI, LIC, UTI etc., come under this category. The powers, duties and liabilities of the auditors are also well-defined and fixed by the relevant statutes. As per Companies Act 1956 the amendments made to it have made tremendous changes in the rights, duties, liabilities, power, etc., of an auditor.

In case of trusts there are more chances of frauds and misappropriation of income and properties. It is provided that if its income exceeds a certain level, its accounts are to be audited as per the requirements of the Income Tax Act.

Government Audit: Government audit is applicable to Government departments and departmental undertakings. Government of India maintains a separate department known as Accounts and Audit Department. Comptroller and Auditor General of India leads this department.

Internal Audit:- Internal audit is an examination of books of accounts, which is conducted by the salaried officials of a business firm known as internal auditors throughout the year.

n. Classification on the basis of the method of performance:

Continuous Audit: A continuous audit is one where auditor's staff is occupied continuously on the accounts the whole year round, or where the auditor attends at intervals fixed or otherwise, during the currency of the financial year and performs an interim audit.

Annual Audit: It is clear that the final audit takes place only after the end of the trading period when all the transactions for the whole year are completely recorded and balanced.

Interim Audit: It means taking up an audit on an interim date during the currency of the financial year. Interim audit is closely related to the statutory audit of an undertaking.



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Balance sheet Audit: In balance Sheet Audit the auditors verifies the Balance Sheet items such as capital, liabilities reserves and provisions, assets and other items given in the Balance Sheet. It is of recent origin and it is expected that it will be more extensively used in future.



Unit II vouching

Section A

1. What are the points involved in the verification of assets?

Ans: Verification of assets involves the followings points

1. To compare the ledge accounts with the balance sheet;
2. to verify the physical existence of assets as on the date of balance sheet and to that these assets are acquired by proper authority by proper authority and for business purposes;
3. to satisfy that the assets are free from any change or mortgage or encumbrance and that the business under audit is the real owner of there and that they are under proper custody.

2. State the meaning of audit of ledger.

Ans: Ledger scrutiny is part of audit procedures, like vouching, posting etc. The scrutiny is required in all type of audit whether the same is Internal Audit, Statutory Audit. Ledger security is to be done for all type of clients whether the same is Private Co., Public Ltd, or a concern. The ledger Scrutiny is also required irrespective of whether the accounts are maintained manually, on Ihlly, or SAP or customized accounting software. Where ever there is a ledger, whether the same Stock Ledger, Accounts Ledger, Debtors, Creditors, Expense Ledger, Ledger scrutiny is must.

3. What is vouching?

Ans.: Vouching means and includes the examination of every business transaction with its supporting documentary evidence, the checking of which enables the auditor to satisfy himself that the transaction is in order; that it is in order; that it has been properly authorized; and that it has been correctly allocated and entered in the books.

4. Define vouching

Ans.: "By vouching is meant the verification of the accuracy and authenticity of transactions as recorded in the books of accounts". B. Bose

5. Suite the importance of vouching.

Ans: Vouching is the essence of auditing since it is through vouching that an auditor can satisfy himself about authenticity and completeness of the transactions recorded in the books.

6. What are the objects of vouching?

Ans. To ensure that all receipts are accounted for.

To ensure that no fraudulent payments have been made.

11- What do you mean by verification of assets?

Ans.: Verification means "proving the truth or confirmation" as on the date of balance sheet. It implies an enquiry into the value, ownership and title, existence and possession, the presence of any charge on the assets.



9. State the meaning of outstanding liability.

Ans.: Expenses which have become due but have remain imp aid mid which pertain to that

period is called as outstanding liability. It should be debited to the profit & loss account and shown as outstanding liability in the balance sheet.

13.What are wasting assets?

Ans:Wasting assets are those fixed assets which are depleted gradually in the processing of working such as mine ,quarries,oil,well,etc.wasting assets are found in certain industries only.

SECTION B (FIVE MARKS)

1. Explain the procedure of Vouching.

Ans: Procedure of Vouching

The Vouching is a task of the auditor. The junior audit can read out the contents of the vouchers. He can inform the senior auditor about the data name of organization, number of Voucher and amount of vouchers.

comparison:

The senior can head the contents called out by junior auditor. He tally each and every item stated in the voucher with entries in the books of accounts. Thus comparison is a part of vouching procedure.

Ticking

The senior auditor can use various ticks or symbols to clear the items checked. The ticks may be an abbreviation of words. Such ticks or symbols may differ from auditor to auditor because these are code words.

Stamping

The senior auditor instead of signature or initials he can use stamps for checking the vouchers can use the rubber stamps. The rubber stamp may have the wording checking and cancelled on it.

Signatures

The senior auditor can vouch the entries with the help of vouchers. He can put bis signature or initials on every voucher for safety measures. The signed vouchers cannot be presented again for another entry.



2. Distinguish between vouching and verification Ans.: Comparison Chart

BASIS FOR COMPARISON	VOUCHING	VERIFICATION
Meaning	Vouching means checking the accuracy of the transactions recorded in the books of accounts	Verification means a process to substantiate the validity of assets and liabilities appearing in the Balance Sheet.
Basis	Documentary Evidence	Observation and Documentary Evidence
Examination of	Items of Profit & Loss account	Items of Balance Sheet
Carried out by	Audit clerks	Auditor
Time Horizon	Year-round	At the end of the financial year.
Objective	Examine the correctness, validity and completeness of the transactions.	Confirm the ownership, possession, existence, valuation and disclosure of the items appearing on the Balance Sheet.

3. Briefly explain the objects of Valuation.

Ans.: The main objects of valuation are as follows:

- To know the correct financial position of the concern
- To know about the goodwill of the concern
- To know the true position of assets at the balance sheet date.
- To know about the mode of investment of capital of the concern.

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To know about the difference in the value of the assets at purchase dates and the balance sheet date and also to find out the reasons for the difference.

To satisfy the auditor about the accuracy of the balance sheet.

4. What are the Objects of verification of assets? (Nov* 13, Nov¹11)

Ans.: The objectives of verification of assets are as follows.

- To establish the existence of actual items of assets shown in the books of accounts



- To examine the title or ownership of assets.
- To examine possession of assets.
- To establish proper classification of assets and liabilities.
- To facilitate valuation of assets and liabilities.
- To substantiate the expert opinion.

5. Write short notes on Audit of Share capital.

Ans.: 1 Capital is not the liability of a company so far as going concern principle is concerned. Still the auditor is required to verify its correctness so that he can report on correctness of the balance sheet.

2. The auditor has to check the 'Authorized share capital with the relevant clauses of the memorandum of association.

3. Obtain a list of shareholders, check with the register of members, and verify the capital account.

4 Obtain a schedule showing the movement of what during the year in the above account. Verify entries in respect of the additions on account of issue of new shares (calls, issues, rights, bonus, etc.)

8. What are the objectives of vouching?

Ans.: The main objectives of vouching are as follows:-

7. To verify whether all transactions connected with the business have been properly recorded in the books of account.

8. To ensure that all transactions recorded in the books of account are accurate, authoritative authentic and genuine.

9. To ensure that all the entries made in the books of account are supported by necessary documentary evidence.

4 To ensure that no transaction connected with the business has been omitted to be recorded in the books of account and that no transaction which is not connected with the business has been recorded in the books of account.

5. To ensure that the vouchers have been carefully processed through each stage of an effective system of internal check.

6. To ensure that the vouchers supporting the entries have been properly authorised, properly dated, addressed to the business of the client and are not fraudulent in nature

10. How would you vouch cash receipts?

Ans. The auditor should examine the effectiveness of the system of internal check operation in regard to cash sales.

he auditor should check the summaries and the cash book to make sure that no error or fraud has taken place,

«. 3^ The auditor should check the dates of the cash memos and the dates of entry in the cash book and ensure that both the dates are the same.

If any cash memos have been cancelled, all the copies including the cancelled copies should be kept in the cash book.

/The auditor should ensure that the policy of allowing discount to customers is uniformly



followed. In case any customers have been allowed higher rates of discount the auditor should satisfy himself about the same by getting proper explanation from the concerned responsible official. cash memos should be checked with the daily summary sheets. He should ensure that the cash memos are properly pre-numbered and each number is accounted for.

Discuss the importance of vouching

Ans.: Importance:

Vouching is the act of checking evidential documents to find out; errors and frauds and to know the authenticity, accuracy and reliability of books of accounts. Thus, it is important for an auditor due to the following reasons:

Vouching Is the Backbone of Auditing

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Main aim of auditing is to detect errors and frauds for proving the true and fairness of results presented by income statement and balance sheet. Vouching is only the Way of detecting all sorts of errors and planned frauds. So, it is the backbone of auditing.

9. Vouching Is the Essence of Auditing

Auditing not only checks the accuracy of books of accounts but also checks whether the transactions are related to business or not. All the transactions are performed after the prior approval of concerned authority or not, transactions are real or not because an accountant may include fictitious transactions to commit frauds. All these facts can be found with the help of vouching. So, vouching is essential for auditing.

10. Vouching Is Important To See Whether Evidences Are Correct or Not

An auditor checks the books of accounts to detect errors find frauds. Frauds may be committed presenting duplicate vouchers! All the small and big amounts of frauds can

10. summary of daily cash sales memos with the cash book and bank paying in-slips and see that all cash sales proceeds have been deposited daily in the bank.

11. In the case of automatic cash registers, the daily totals entered in the cash book should be checked with the TILL Rolls. In other words where automatic tills are in use, the entries in the cash sales book and the cash book should be verified from the till records.

v&The summaries of daily sales should be checked with the entries in the stock register. 4P^He should check the rough cash book with the main or general cash book.

6. vouching Is the backbone of Auditing” - Discuss.

Ans.} Vouching is a sort of preliminary work, which forms an important part of audit work.

Vouching is carried on to ensure that the transactions relating to a particular period have been recorded and there is no voucher left unrecorded in the authority books. The auditor after satisfying himself as to the authority and authenticity of the transactions says. '

“Books of accounts are correct and Balance sheet auri Profit and Loss account exhibit backbone of auditing”.

examine the truth and propriety of the transactions recorded in the books of accounts

Ans.: Verification of various kinds of assets

1. Plant and Machinery
2. Closing stock
3. Sundry creditors
4. Bills payable.



5. Goodwill
6. Patent
7. Trademark.

11. Plant and Machinery: The auditor should examine the Plant Register in order to know - about the cost of plant and machinery, provision made for depreciation on plant and machinery, etc.

The machinery purchased during the year should be vouched by reference to the invoice to the relevant vouchers. In case a part of the machinery is sold out, it should be seen that necessary entries have been passed at proper places and profit or loss if any arising out of sale is duly recorded. The auditor should see whether the plant and machinery account is shown properly in the Balance Sheet as stated above.

12. Closing Stock: Value of the inventories plays a main roll in determining the profits of present and succeeding years. If the closing stock is overvalued, it enhances the profit of the current year and as a opening stock of next yea; it reduces the profit shown in the profit and loss account of that year. It is the duty of the management to correctly value the inventories at hand and to disclose them in the Balance Sheet.

13. Sundry Creditors: The posting in purchase ledger are to be checked by verifying the books of prime entry. The balances shown in creditors schedule prepared by the management are to be verified with the statement of accounts obtained from the creditors. The ledger accounts are also to be verified with goods inward book to confirm that all goods received before the close of the year are duly accounted for.

14. Bills Payable: The payments made against the bills are to be vouched. The bills payable book is to be verified as to its correctness of recording. The schedule of Bills Payable is to be verified with the closing balances in the Bills Payable accounts. The hills may be confirmed with the parties who have accepted the bills if any charge is created on the assets as security for Bills Payable, the same is to be disclosed in the Balance Sheet.

15. Goodwill: The value of the goodwill depends upon the future earning capacity of the organization and the regulation of the organization. The goodwill maybe purchased, self-generated or an amount paid in excess of the value of net tangible assets taken over on acquisition of a business. In the case of valuing goodwill as the excess of amount paid over the value of the net tangible assets, the auditor shall ensure that the correct amount is debited to the goodwill amount. It is the duty of the auditor to ensure that the goodwill .is valued by the method agreed upon and the calculation of normal profit, value of net tangible assets, etc., are correct.



UNIT III:

DEPRECIATION AND RESERVES

SectionA:

1. What is reserve?

Ans: "Depreciation may be defined as the measure of the exhaustion of the effective life of an asset from any cause during the given period". - Spicer and Pegler

2. What is General Reserve?

Ans.: It is an amount set aside out of the profits or surplus of a business to provide additional working capital or to strengthen the liquid resources of the business.

3. Define provision.

(OR)

. What is a specific reserve?

Ans.: The reserve which is a charge against revenue for the purpose of providing for losses and contingencies which may result in losses and which are known or expected at the date of making provision for such a contingency to occur at a future date is known as provision.

4. What are the causes of depreciation?

Ans: The causes of depreciation may be classified under two heads:

7. Internal causes - wear and tear, Exhaustion, Depletion and Deterioration.

8. External causes - Effluxion of time, Obsolescence, Permanent fall in the market value and Weather and accidental elements.

SECTION B (5 MARKS QUESTIONS)

1. What are the duties of auditor towards reserve?

- Ans.: Duties of an Auditor towards General and Special Reserves
- The auditor has to verify the minutes of the board of directors and ensure that the profits are appropriated as per the decision taken by the directors.
- The auditor should ensure that the requirements of Articles of Association regarding the appropriation of profit to general or special reserves are duly followed by the company.



- The auditor should verify the accounts and ensure that the company has transferred the required amount to the general reserves and special reserves before declaring the dividend, as required by the company law.
- If any part of the general reserve is utilized for payment of dividend, the auditor should ensure that the provisions of Companies Act are duly complied with.
- The auditor should also ensure that the reserves are utilized only for the purpose for which they are created.
- He should also ensure that the general reserves and special reserves are disclosed on the liabilities side of the balance sheet under appropriate heads.

2. Distinguish between reserves and provision.

BASIS FOR COMPARISON	PROVISION	RESERVE
Meaning	The Provision means to provide for a future expected liability.	Reserves means to retain apart of profit for future use.
What is it?	Charge against profit	Appropriation of profit
Provides For	Known liabilities and anticipated losses	Increase in capital employed
Presence of profit	Not necessary	Profit must be present for the creation of reserves, except for some special reserves.
Appearance in Balance Sheet	In case of assets it is shown as a deduction from line concerned asset while if it is a provision for liability, it is shown in the liabilities side.	Shown on the liabilities side.
Compulsion *	Yes, as per GAAP	Optional except for some reserves whose creation is obligatory.
Payment of Dividend	Dividend can never be paid out of provisions.	Dividend can be paid out of reserves.
Specific use	Provisions can only be used, for which they are created.	Reserves can be used otherwise.

12. What are the objectives of creating Secret Reserve? (April' 09)

- Ans.. Maintaining a strong financial position.
- Improving the solvency position of the entity.
- Meeting sudden future financial losses.
- 4 Facing competitions.



- Providing additional working capital.
- Maintaining a stable dividend payment.
- Hiding a portion of profit.
- Enabling the directors to tide over unfavorable time.
- Helping the management not to distribute the hidden portion of profit, which is retained in the business in the form of secret reserve to the shareholders in the interest of the business.
- Confusing the rivals regarding profitability.

Part C

1. Explain the duties regarding auditing of reserves and Provisions:

Duties of auditor regarding auditing of reserves :

the auditor as to verify the minutes of the board of directors and ensure that the profits are appropriate as per the decisions taken by the directors.

He should ensure that the requirements of the articles of the association regarding appropriate of the profit to general company.

He should verify that the company has transferred the required amount.

Duties regarding Provisions:

The auditor should verify that provisions are made with regard to all liabilities and contingencies.

He should ensure that the amount provided is adequate.

He should examine the Minutes and Articles of Association regarding the provisions to be made.

He should ensure that the provisions are utilized only for the purpose for which they are created.

If the auditor is of the opinion that any of the provisions made is in excess or inadequate, he should advise the management to provide correct amount. If the management fails to do so, he may give his opinion on the same in his report.



UNIT 4

APPOINTMENT OF AUDITORS

Section -A (Two Marks Questions)

1. Explain any three disqualifications of an auditor.

Ans.: 1. A person who is a partner or employee of an officer of the company.

2. Body corporate,

3 An officer or an employee of the company.

2. Define Audit of Share Capital.

Ans.: he auditor should examine memorandum of association and the articles of association

of the company. He should see that issue of capital is according to memorandum and articles Of association.

3. State the provisions relating to auditor's remuneration. / White a note on remuneration

Ans.: In the case of an auditor appointed by the board or the central Government, the remuneration may be fixed by the board or the Central Government. In the case of an auditor appointed under section 619 by the comptroller and auditor general of India, it shall be fixed by the common general meeting.

4. State the procedure for filling up of casual vacancy

Ans.: In case of resignation, only the members in the General Meeting can fill up the vacancy. The auditor appointed for the casual vacancy shall hold office till the conclusion of the next Annual General Meeting.

5. State the provisions relating to auditor's remuneration. / White a note on remuneration

Ans.: In the case of an auditor appointed by the board or the central Government, the remuneration may be fixed by the board or the Central Government. In the case of an auditor appointed under section 619 by the comptroller and auditor general of India, it shall be fixed by the company in general meeting.

6. What are the basic qualities of an auditor?

Ans.: 1. Professional Qualification

13. Professional Qualities

14. Personal Qualities.

7. what are the different types of audit report? / State the kinds of audit report?

Ans.: (a) Clean Report

Qualified Report

Disclaimer: Negative Report



8. What do you mean by auditor's lien on working papers?

Ans: The working papers contain the information of confidential nature. This information is gathered by the auditor from the books of account. Therefore the auditor can claim the possession of the working papers on the ground that he had collected these papers to perform audit.

9. What do you mean by special auditor?

Section 233(A) of Companies Act, 1956 provides for special audit may be carried out when the position of any company is in such a state as to endanger its solvency. An auditor appointed for a purpose is called as a special auditor.

10. State the meaning of audit report?

The final stage in the audit process is the audit report. The auditor's report is the by which the auditor formally communicates the results of his audit to the members of the company as well as to other readers of financial statements.

Section-B (5 Marks Questions)

1. Explain qualification and of an Auditor

Qualification

According to Provisions of Section 141(1) of the Companies Act, 2013 "a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant within the meaning of Chartered Accountants Act, 1949 and holds a valid Certificate of Practice.-

It has been further provided that the firm shall also considered to appointed by its firm name whereof majority of partners practicing in India are qualified for appointment as auditor of a company.

According to Provisions of Section 141(2) of the Companies Act, 2013, a firm including limited liability partnership who are chartered accountants shall be authorised to act as auditor and sign on behalf of, the such limited liability partnership or firm.

Summary

A person shall appointed as an auditor if he is chartered accountant within the meaning of Chartered Accountants Act, 1949 and holding valid certificate of practice and acting in capacity as

8. a) Individual
9. b) Partnership Firm
10. c) Limited Liability partnership

It has been further provided that only partners who are Chartered Accountants will be authorised to sign on behalf of the firm

2. Explain the rights of auditors.

Right of access to books and vouchers: An auditor has an absolute right to inspect all the books, accounts and supporting documents which give evidence for any of the transactions of the company.

Right to require information and seek explanations: An auditor is entitled to require the officer of the company to provide him with all relevant information and seek all explanations that will enable him to perform his duty as an auditor.



Right to visit branch offices: A company auditor is entitled to visit branch offices and also a right to inspect all the books and vouchers of the branch office.

Right to receive notice and to attend general meeting: The auditor is entitled to attend all the general meeting of the company held during his tenure.

16. What are the duties of an auditor in share capital audit?

Ans.: 1. The auditor should ensure that the nominal value of shares allotted does not exceed the authorized and issued capital.

9. He should see whether the allotment has been made in conformity with the conditions mentioned in the prospectus.

10. He should compare the balance in the shareholder's account with that in the share capital account. In case the issue has been underwritten, he should see that the terms of the underwriting contracts have been duly complied with.

17. Payments on account of underwriting commission and brokerage should be verified by reference to the underwriting contract.

Part c

4. Enumerate the Rights, Duties of Company Auditors.

Ans.: Rights of an Auditor:

15. The auditor has a right of access to books Of account, vouchers and relevant documents of the company at all times during his term of office.

16. The auditor has a right to obtain whatever information or explanation he requires to performing his duty.

The auditor is also having a right to suggest suitable modification in the method o: accounting followed by the management.

4 The auditor is also entitled to visit the branches of the company.

1. The auditor has a right to receive all notices and communications relating to all general meeting during his term.

2. Only the auditor can sign the auditor's report.

3. He has a right to receive the remuneration fixed by the appointing authority.

4. The company under certain circumstances can take both civil and criminal proceedings against the auditor.

5. The auditor has a right to take advice or opinion of legal and technical experts if there is a need for it.

Duties of an Auditor.

Statutory duties: The auditor can enquire into any matter connected with the entries in the books of account. He can call for any information or explanation. He can also examine the relevant documents. The auditor shall make a report to the members of the company on the accounts examined by him.

Duties imposed by the court of law: Besides the duties referred above, the judicature has also imposed a number of duties upon the auditor. The auditor should have a complete knowledge of all the documents of the company. The report should be clear and not misleading.



Other Duties: A company for purposes other than the statutory audit may hire a professional accountant in all such cases the duty of the auditor will depend upon the terms and condition of his appointment.

5. Discuss the procedure for the removal of a company auditor under the Companies Act?

Removal after the Expiry of tenure

Unjustified removal of auditors

Compliance with legal provisions

Auditor's resignation

Removal before expiry of tenure:

The first auditors of the company are appointed by the board of directors prior to the first annual general meeting. Such auditors may be removed before the expiry of their tenure of office by the company in general meeting by ordinary resolution of which a special notice is to be given to the members at least 14 days before the date of the meeting.

Removal after the expiry of the tenure:

An auditor can be removed after the expiry of his tenure of office. Section 225, makes special provisions in respect of a resolution appointing a person, other than a retiring auditor or for providing expressly that a retiring auditor shall not be re-appointed.

Unjustified removal or auditors:

Where an auditor resigns from his appointment as an auditor of a company or does - not offer himself for re-appointment as auditor of such company he may send a communication in writing to the board of directors of the company giving thereof if he considers that there are professional reasons connected with his resignation.

Compliance with Legal provisions:

Under clause 9 of part I of the First Schedule to the Chartered Accountants Act, The incoming auditor of a company has complied with the provisions of the Companies act regarding the appointment of an auditor.

Auditor's resignation:

The auditor may resign at any time by giving a proper notice to that effect to the client company. The notice must contain either:

A statement that there are no circumstances connected with his or her resignation that should be brought to the attention of members or creditors;

A statement of any such circumstances



UNIT V:

ELECTRONIC DATA PROCESSING (EDP) AUDIT

Section - A (Two Marks Questions)

1. Explain the term output devices.

Ans.: An output device is an device used to send data from a computer to another device or user.

2. Given any two objectives of EDP audit.

Ans.: EDP audit - Computer-assisted audit techniques (CAATte) are those featuring the 'application of auditing procedures using the computer as an audit tool'. The key objectives of an audit do not change in a computer environment. The auditor still needs to obtain an understanding of the system in order to assess control risk and plan audit work to minimise detection risk. The level of audit testing will depend on the assessment of key controls. If these are programmed controls, the auditor will need to 'audit through the computer*' and use CAA't to ensure controls are operating effectively.

In small computer-based systems, 'auditing round the computer' may suffice if sufficient audit evidence can be obtained by testing input and output.

Objectives of EDP audit

Independently access the data stored on a computer system without dependence on the client;

Test the reliability of client software, i.e. the IT application controls (the results of which can then be used to assess control risk and Resign further audit procedures);

Increase the accuracy of audit tests; and

Perform audit tests more efficiently, which in the long-term will result in a more cost effective audit.

3. What do you mean by auditing through the computer?

Ans.: Auditing through the computer approach is a situation where application processes large volume of input and produces large volumes of output. Significant part of the internal control system is embodied in the computer system.

4. Discuss the term audit software.

Ans.: Audit work is carried on traditionally and the computer software is used for certain operations such as calculating depreciation, comparing two figures, drafting letters, etc.

5. Define EDP:

Ans.: Electronic Data Processing (EDP) can refer to the use of automated methods to process large volumes of similar information. For example: stock updates applied to an inventory, banking transactions applied to account and customer master files, booking and ticketing transactions to an airline's reservation system, billing for utility services. The modifier "electronic" or "automatic" was used with "data processing", especially to distinguish human clerical data processing from that done by computer.



6. Explain 'Auditing with computers' or What is auditing through the computer?

Ans.: The audit work done by the Auditor with the help of computer is known as auditing with computers. It plays a significant role in assisting the auditor to perform his work.

7. What are CAATs?

Ans.: CAATs are the techniques, which use the computer itself as an audit tool. CAATs consist

8. Expand CAATs?

Ans.: Computer Assisted Audit Techniques. It may consist of package programs, purpose written programs and utility programs

9. What is meant by EDP audit?

Ans.: An Electronic Data Processing (EDP) environment exists when a computer of any type or

size is involved in the processing of accounting data by an organization. A large number of enterprises have switched over to computerized accounting. The computer based accounting requires an auditor to employ computer assisted audit technique consisting of Audit software and Test data.

10. What do you understand by audit around the computer?

Ans.: Auditing around the computer involves arriving at an audit opinion through examining the internal control system for a computer installation and the input and output only for application systems.

Part B

1. What are the characteristics of an EDP environment?

Ans.: 1. Real time Processing; The transactions are posted as soon as they occur. A printout taken may not reveal the actual position, because by the time the printout is taken, many transactions would have been processed. At anytime, the latest position can't be obtained from the system directly.

1. Online Data Entry: Customer orders are received orally and they are directly fed into system. No manual records are maintained as source documents to support a transaction.
2. Elimination of printouts: With online data entry and real time updating, printouts are taken only in exceptional cases.

From the above characteristics auditors are compelled to audit through the system.

2. What are the advantages of computer based accounting?

Ans.: 1. The operating system does all the complex and tedious tasks and the auditor's job is made easier

It saves time and reduces manual work to a great extent.

Bank balances can be verified and confirmed online.

EDP environment encourages decentralization of processing of data. Thus, the reports, required by the management can be obtained at anytime and the management takes quick action based on such reports.

Sophisticated software, which help the auditor in forming his opinion, are now being developed through computer aided software engineering and data base management systems



3. Explain auditing under EDP procedure/write short note on Electronic data processing.

Ans.: The extent and nature of audit procedure depends upon the audit risk-

1. If the system is complex with inherent risks, then the auditor may collect evidence relating to quality of controls. He extends the substantive procedures. He applies analytical procedures.

If the system is simple with inherent risk relating to occurrence of error, fraud or material misstatement, he may obtain all evidences relating to access to critical areas.

If the EDP environment has not changed, the auditor may utilize the results of the audit procedure of the earlier years. After applying the audit procedures, the auditor has to analyze the results. Some errors may be insignificant and some may be material. The effect of such errors on the financial reports is to be analyzed by the auditor.

Part - C

1. Explain the problems in EDP Environment.

Ans: An auditor cannot physically observe the process of accounting in computerized system i.e., visual observation of the processing is denied.

An auditor cannot ensure that the procedure followed in processing is proper.

The procedure may be changed by intervention or by malicious codes. This may not come to the knowledge of the auditor.

The actual procedure followed may be quite different from the standard procedure to be followed.

The source document, intermediate document and reports are eliminated completely or partially. Therefore, the auditor may not be able to trace the date from the source. In other words, one can say "Audit trail" disappears totally or partially with computerization of accounts. The source code given and the object code used may not agree with each other. It creates major problems for the auditors.

To ensure efficiency in operation, many banks have introduced real time processing wherein every transaction of the bank is processed or processed immediately by the head office through the computers.

2. State the advantages of computer in auditing. What are the differences between manual system and EDP system?

Ans.: Advantages of Computer in Auditing:

- The operating system does all the complex and tedious tasks and the auditor's job is made easier.
- It saves time and reduces manual work to a great extent.
- EDP environment encourages decentralization of processing of data.
- Sophisticated software, which help the auditor in forming his opinion, are now being developed through computer aided software engine data base management systems.
- Electronic Data interchange and other computer software/hardware systems have reduced the cumbersome paper work in the auditor's office.
- The audited balance sheets and other financial statements are now accepted by the income tax authorities and the registrar of the companies.



- Traditional data entry is prone to errors and frauds.
 - The real time processing has tremendously improved the stock-keeping and share.
- Difference between manual and computerized auditing system:

Manual accounting System	Computerized Accounting system
Presence of audit trail	Absence of audit trail
Presence of input document	Absence of input document
Controls are simple	Controls are complex
System is easy to design	System is complex to design
System is slow and inaccurate	System is fast and accurate