PAPER – 2 : AUDITING AND ASSURANCE

QUESTION

State with reasons (in short) whether the following statements are true or False.

1. (a) Auditor's primary responsibility is to detect errors and frauds.
   (b) The decision in the London and General Bank case spelled out the auditor's duties towards prevention and detection of fraud and error in specific terms.
   (c) Financial auditor is not concerned with propriety of business transactions.
   (d) Test checks may be applied to all transactions.
   (e) In case of limited companies, the statutory auditor shall comment whether the internal audit system commensurate with the size and nature of business.
   (f) The auditor examines debit notes to vouch sales return.
   (g) Inventory turnover ratio is calculated by the auditor to obtain evidence concerning management's assertion about valuation of inventory.
   (h) The first auditors of a public limited company appointed by the board of directors hold office till the conclusion of its statutory meeting.
   (i) If an auditor lacks independence, he may issue an adverse report.
   (j) The CAG conduct audit of Government companies .

2. Comment – One customer from whom Rs.5 lakhs are recoverable for credit sales gives a motor car in full settlement of dues. The directors estimate that the market value for the motor car transferred is Rs.5.25 lakhs. As on the date of the balance sheet the car has not been registered in the name of auditee.

3. State briefly the duty of the auditor with regard to each of the following:
   (a) A sum of Rs.10,00,000 is received from an Insurance Company in respect of a claim for loss of goods in transit costing Rs.8,00,000. The amount is credited to purchases account.
   (b) A loss of Rs.2,00,000 on account of embezzlement of cash was suffered by the company and it was debited to salary account.

4. State your opinion/comment on the following :

   An auditor purchased goods worth Rs.1,500 on credit from a company being audited by him. The Company allowed him one month's credit, which is normally allowed to all known customers.

5. Give your comments on the following :

   PQR and Co., a firm of chartered accountants has three partners, P, Q and R; P is also in whole time employment elsewhere. The firm is already holding audit of 40 companies including audit of one foreign company. The firm is offered the audit of Z Ltd. and its 20 branches.

6. Write Short Notes on the following :
   (a) Analytical Review Procedures
   (b) Evaluating Inherent Risk
   (c) Evaluating Internal Control
7. Enumerate basic principles governing an audit of financial statements and outline the planning process involved in audit.
8. What is surprise check and why it is carried out ?
9. Comment on the following case:

   Lehar Ltd. installed a new water treatment plant at its factory on 1.10.2007. The company estimated that the new plant will become obsolete after 4 years only and hence charged depreciation at a rate higher than that envisaged in Schedule XIV to the Companies Act. During the year 2007-08, the company therefore had written off 1/4th of the cost.
10. Explain the accounting treatment and audit approach of packages and empties.
11. How you will vouch cash receipts or debit side of cash book ?
12. Write Short Notes on the following:
   (a) Capital Expenditure
   (b) Revenue Expenditure
   (c) Consignment Sale
13. How will you verify Trademarks and Copyright ?
14. What are the special considerations to be taken while verifying debts ?
15. What are the points to be considered while using the work of an expert ?
16. "The auditor should obtain reasonable assurance while using the work of another auditor" – Comment.
17. Explain the procedures to be adopted with regard to reappointment of auditor.
18. Briefly explain the basic elements of Audit Report .
19. What are the considerations to be taken while auditing non-governmental Organisations?
20. Briefly explain the duties of the statutory auditor while examining the work of the internal auditor.

SUGGESTED ANSWERS/HINTS

1. **(a)** False: Auditor's primary responsibility, as per AAS-2 (SA 200 A) , is to express an opinion on financial statements.

(b) True: Lord Justice Lindley observed in this case, - "An auditor has nothing to do with prudence or imprudence of making loans without security. It is nothing to him whether the business of the company is being conducted prudently or imprudently, profitably or unprofitably, it is nothing to him whether dividends are properly or improperly declared provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of audit and his duty is confined to that."

(c) False: The financial auditor, as per AAS-2 (SA 200 A), is not generally, concerned with propriety of business conduct. However, the Companies Act, 1956 has provided for propriety audit relating to some specific transactions in case of limited companies.

(d) False: Some transactions like opening and closing entries, depreciation entries and non-recurring or exceptional transactions should not be subject to test check. Cash book and pass book should be thoroughly checked.

(e) False: Clause 4(vii) of CARO, 2003 requires the auditor to comment whether the company has an internal audit system commensurate with the size and nature of business. This clause is compulsorily applicable to listed companies. However, in case of unlisted companies the clause is applicable only if its:

(a) paid-up capital and reserves of the company are more than rupees fifty lakh as at the commencement of the financial year; or

(b) average annual turnover exceeds five crores for a period of three consecutive financial year preceding the financial year under audit.

(f) False: The auditor should examine purchase return book with reference to copies of debit notes issued to suppliers and outward return notes to vouch purchase return.

(g) True: Calculation of inventory turnover ratio and their comparison with those of previous years' ratio will provide an evidence on correct valuation of slow-moving, defective and obsolete items included in inventories.

(h) True: Section 224(5) has laid down the tenure of first auditors until the conclusion of the first annual general meeting. The first general meeting of a public limited company is referred to as statutory meeting as per the provisions of section 165(1).

(i) False: An auditor who lacks independence must issue a disclaimer of opinion audit report.

(j) False: The Chartered Accountant(s) appointed by the CAG as statutory auditor conducts the audit of government companies. The CAG has a right to conduct supplementary audit.

2. According to AS – 10, Accounting for Fixed Assets, when fixed asset is acquired in exchange or in part exchange for another asset, the cost of asset acquired should be recorded either at fair market value or at the net book value of the asset given up. In the present case the latter is more evident (Rs.5 lakhs given up) than the fair value of motor care (Rs.5.25 lakhs estimated by the directors). Hence, the Customer's account should be credited with Rs. 5 lakhs and the motor car recorded at the same account.

AS – 1, Disclosure of Accounting Policies, the accounting treatment and presentation in the financial statements of transactions and events should be governed by their substance and not merely by legal form. The motor car has not been registered in the name of the company on the date of the balance sheet in the present case. Taking accounting principle of substance over form into consideration as laid down by AS – 1 the auditor should ensure that the car's acquisition is recorded in the present year though the car is not registered in the name of the auditee.

3. **(a)** Claim received from insurance company

(i) According to AS-5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Polices" requires that all items of income and expenses which are recognized in a period should be included in the determination of net profit or loss for the period.

(ii) The loss of goods in transit costing Rs.8,00,000 should be therefore, charged to profit and loss account of present financial year and insurance claim of Rs.10,00,000 should be credited to profit and loss account under an appropriate head. It should not have been credited to purchases account. If done so, the purchases would be overstated.

Insurance claim (excess) is profit from ordinary activities. AS-5 states that when items of income (and expense) within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the entity for the period, the nature and amount of such items should be disclosed separately. Thus, a separate disclosure of insurance claim received is necessary as per the requirements of AS-5, and it should not be credited to purchases account.

(b) Embezzlement of cash

(i) AS-5, Net Profit or Loss for the Period, Prior Period items and changes in Accounting Policies "requires that (income and) expenses within (Profit of) loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

(ii) Embezzlement of cash of Rs.2,00,000 is an ordinary business loss which as per the requirements of AS-5 should be disclosed separately in the profit and loss account. It should not be merged with salary.

4. (i) According to section 26(2)(d) of the Companies Act, 1956 if a person is indebted to the company for an amount exceeding one thousand rupees, he is disqualified from being appointed as the auditor.

(ii) According to Guidance Note on Independence of Auditors, even if a person is allowed normal period of credit as allowed to other customers and the amount exceed Rs1,000, he cannot be appointed as an auditor.

(iii) Taking into consideration, the view expressed in the Guidance Note, the auditor who has purchased goods worth Rs.1,500 on one month credit has been disqualified for being auditor, even if he has been allowed normal period of credit, his office stands vacated automatically.

5. According to Section 224(1B) of the Companies Act, 1956, and notification issued by the ICAI :

(a) In case of partnership firms of auditor, the ceiling on audit is twenty companies per partner of the firm.

(b) Any partner who is in full-time employment elsewhere is not to be taken into account while computing the ceiling on number of companies that the firm can audit.

(c) Audit of head office and branches would be taken as one audit.

(d) Audit of foreign companies would be excluded from specified number of audits under this section.

In the given case,

(a) The firm can taken maximum of forty audits $(20 \times 2) + (10 \times 0)$. There are three partners – P, Q and R. Since P is in full-time employment, the firm cannot undertake any audit on his behalf.

(b) The firm is holding 39 audits at present since foreign company is not counted towards specified number under Section 224(1B). It can take one more audit.

(c) The firm can, therefore, accept audit of Z Ltd. and its 20 branches. Such an audit would be counted as one assignment.

6. (a) Analytical procedures used in the overall review: AAS – 14 (SA 520) in forming his overall conclusion that the financial information as a whole is consistent with his knowledge of the entity's business and relevant economic conditions, the auditor should perform analytical procedures at or near the end of the audit. The conclusions drawn from the results of such procedures are intended to corroborate conclusions formed during the audit on individual elements of financial information and assist in arriving at the overall conclusion as to the reasonableness of the financial information. However, they may also identify areas requiring further procedures.

(b) Evaluating Inherent Risk: To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors, having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which might have taken place since his last assessment. Examples of are such factors are:

At the Level of Financial Statements:

- Management's experience and knowledge and changes in management during the period, for example, the inexperience of management may affect the preparation of the financial statements of the entity.
- Unusual pressures on management, for example, circumstances that might predispose management to misstate the financial statements, such as the industry experiencing a large number of business failures or an entity that lacks sufficient capital to continue operations.
- The nature of the entity's business, for example, the potential for technological obsolescence of its products and services, the complexity of its capital structure, the significance of related parties and the number of locations and geographical spread of its production facilities.
- Factors affecting the industry in which the entity operates, for example, economic and competitive conditions as indicated by financial trends and ratios, and changes in technology, consumer demand and accounting practices common to the industry.

At the level of Account Balance and Class of Transactions:

- Quality of the accounting system.
- Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation.
- The complexity of underlying transactions and other events which might require using the work of an expert.
- The degree of judgement involved in determining account balances.
- Susceptibility of assets to loss or misappropriation, for example, assets which are highly desirable and movable such as cash.
- The completion of unusual and complex transactions, particularly at or near

period end.

- Transactions not subjected to ordinary processing.

(c) Evaluating Internal Control: The auditors' assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This should be done by:

(a) documenting the extent to which the system is computerised; and

(b) preparing or updating overview flowcharts to record the files and transactions relating to significant systems-derived account balances.

If there are significant computer systems, the auditor should obtain an understanding or the IT controls so decide whether to make an extended assessment of monitoring controls. Whether it is necessary to carry out any preliminary work for strategy purposes to ascertain whether IT controls are likely to be satisfactory will depend on the auditor's previous knowledge about IT controls. For an existing audit, the objective will normally be to carry out the minimum work necessary to update this previous understanding. If more information is needed, or if the engagement is new or substantially changed, the auditor should carry out an overview assessment of IT controls. However, even if auditor has not carried out an overview assessment of the IT controls for strategy purposes, it may be necessary to do so later, to help design and perform substantive tests and draw conclusions on whether proper accounting records have been kept. Whether this work is done before determining the strategy or subsequently as part of the fieldwork is a matter of audit efficiency.

7. AAS – 8 (SA 300), Audit Planning, suggests that the auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan. Megis has defined audit programme as, "A detailed plan of auditing work to be performed, specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required".

Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

- Terms of his engagement and any statutory responsibilities

- Nature and timing of reports or other communication.
- Applicable legal or statutory requirements.
- Accounting policies adopted by the client and changes in those policies.
- Effect of new accounting or auditing pronouncements on the audit.
- Identification of significant audit areas.
- Setting of materiality levels for audit purposes.
- Conditions requiring special attention, such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- Degree of reliance he expects to be able to place on accounting system and internal control.
- Possible rotation of emphasis on specific audit areas.
- Nature and extent of audit evidence to be obtained.
- Work of internal auditors and the extent of their involvement, if any, in the audit.
- Involvement of other auditors in the audit of subsidiaries or branches of the client.
- Involvement of experts.
- Allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- Establishing and co-ordinating staffing requirements;
- Documentation of the overall planning on due consideration of the above should be done for drawing a systematic, logical and an adequate audit programme.

8. Surprise checks are checks on transactions which the auditor conducts without prior notice to the client. These are incorporated in the audit programme to assess the effectiveness and reliability of internal control system. They also assure the auditor that the books of account have been kept up-to-date. Surprise checks are considered more appropriate in certain cases, for example, where internal control system is weak and when the operations of the client are geographically spread. For certain types of accounts such as for verification of cash and investments surprise checks are very suitable. The frequency of surprise checks is a matter of professional judgement of the auditor. But wherever possible surprise checks should be made at least once a year. If the surprise checks indicate some weakness in internal control system or any fraud or error or lacunae in the maintenance of books of account and other records the auditor should communicate it to the management and ensure that it has addressed the issues raised.

9. As per AS-6 on Depreciation Accounting, assessment of depreciation and the amount to be charged in respect thereof in an accounting year/period are usually based on the following three factors:-

(i) Historical Cost.

(ii) Expected useful life of the asset.

(iii) Estimated residual value of the asset.

If the management's estimate of the useful life of an asset in shorter than that envisaged under the relevant statute (Companies Act) the depreciation is appropriately computed by applying a higher rate. The depreciation rate provided in Schedule XIV is the minimum rate and a company can charge higher than those prescribed. Hence, in the instance case decision of Lehar Ltd., to write off the cost of water treatment plant over four years is absolutely correct and as per AS-6.

However, the company has wrongly charged full year's depreciation during 2007-08 instead of half year's depreciation as per requirement of Schedule XIV. The auditor should highlight this to the company and ask to rectify the same.

10. In certain cases, such as beverage and chemical concerns customers are supplied with packages i.e. bags, crates, cans, jars, etc. Accounting treatment and audit approach to vouch them would depend upon circumstances. Examples of some such type of situations are discussed below:

(i) Customer pays for the containers and returns them within stipulated time as per agreement – In such a case, memoranda system should be adopted. At the time of issue, the customer's account is debited with the cost of containers and credited when they are returned. The cost of containers is not included in the sales. Rather, double entry is completed by posting it in the sales return book, under a separate column to be known as 'Packages and empties' or ' Returnable containers'. Such returned containers should be valued at cost or net realizable value, whichever is lower. The auditor should note that accumulated depreciation on containers lost has been removed from the books.

(ii) Containers not returned within stipulated time – In such cases, list of empties 'not returned' by the customers should be prepared. Based on past experience, percentage of containers that are likely to be returned by the customers should be calculated and should also be shown in the balance sheet at cost or net realizable value, whichever is lower.

(iii) Containers still returnable (i.e. period specified for returning of containers has not expired) – These are treated as stock with the customers and along with stock-in-hand of containers are carried forward to next accounting year at depreciated value.

11. The function of audit in respect of cash receipts being much the same as that in the case of cash payments. The internal check in respect of cash receipts should be closer and stricter, primarily because these have to be verified generally only by reference to the internal evidence which, if it is not in existence or is manipulated, would not be of any assistance for the detection of incomes that either have not been credited or have been credited only partially. For example, if in respect of sale proceeds of goods or an item of miscellaneous income no bill or voucher has been prepared, audit would not disclose that the amount has been misappropriated. Similarly, if the amount on the copy of a cash memo has been cleverly altered from Rs. 50 to Rs. 5 and the latter amount only has been entered in the Cash Book, unless the alteration is detected and the fact that it has been altered is established, it would not be possible for the auditor to know that part of the cash sales has been misappropriated.

On this account, it is essential that the auditor before starting the audit of cash receipts, should examine the internal check in operation and bring to the attention of the management any weakness therein, as well as to the possible consequence that might follow if it is not removed. If he fails to do so, he may be held responsible at some later date for not having detected a defalcation or misappropriation in cash, the cause of which was the absence/inadequacy of the internal check.

Cash receipts are usually checked with counterfoils of the receipts issued. But the issue of receipts with counterfoils in respect of amounts collected by itself would not ensure that all the amounts collected have been fully accounted for or have been correctly adjusted. For instance, a receipt might be issued for a larger amount than entered on its counterfoils. Again, only one receipt might have been issued for two or more amounts collected from a party while the counterfoils may show that separate receipts have been issued in respect of each amount collected and the one or more receipts forms, thus saved, may have been used for issuing a receipt of another amount collected which have been misappropriated. Therefore, before accepting counterfoils or receipts as evidence or the correctness of the amount collected, the auditor should satisfy himself that there exists an efficient system of internal check which would prevent any receipt from being misappropriated. For the purpose, the auditor should make the following enquiries :

(i) Who opens letter, what record is kept, and whether all cheques and postal orders are immediately endorsed to bankers and crossed 'Account Payee Only' ?

(ii) Whose duty is to enter cash, cheques and other forms of remittance in the Pay-in-Slip and who deposited it in the bank ?

(iii) Are receipts banked daily ?

(iv) Who prepares receipts and who countersigns the same before these are issued to the parties from whom the amounts have been received ?

(v) Whether printed receipts with counterfoils, numbered serially by a machine, are used and who maintains the stock of unused receipts ?

(vi) Are the receipt books kept in safe custody and are they issued only when the current receipt book has been used up ?

(vii) What internal check is being exercised over the collection of cash sales and miscellaneous income ?

(viii) Are travelling salesmen allowed to collect any advance against orders booked and what control exists over such collections ?

(ix) How often are the bank statements checked and compared with the Cash Book ?

(x) Who controls the preparation and despatch of monthly statements of account to customers ?

(xi) Are ledgers posted by the cashier or some other person ?

There are certain firms which insist upon a receipt furnished to them on their own forms. In such a case, this fact should be noted on the counterfoil of the receipt which has been issued and the unused receipt form cancelled, as an additional precaution, balances in such customer's should be get confirmed periodically.

While vouching cash receipts, it should be seen that the date of each receipt as it is entered in the cash memo or the counterfoil of the receipt issued in respect thereof corresponds with the date on which it is entered in the Cash Book. If there is a time lag between them, it is possible that the person who had collected the amount had failed to deposit it with the cashier immediately thereafter. When such a discrepancy is observed, the cause thereof should be ascertained.

12. (a) **Capital Expenditure**: A capital expenditure is that which is incurred for the under mentioned purposes:

(a) Acquiring fixed assets, i.e., assets of a permanent or a semi-permanent nature, which are held not for resale but for use with a view to earning profits.

(b) Making additions to the existing fixed assets.

(c) Increasing earning capacity of the business.

(d) Reducing the cost of production.

(e) Acquiring a benefit of enduring nature of a valuable right.

The different forms that capital expenditure takes are: (i) land; (ii) building; (iii) plant and machinery; (iv) electric installations; (v) premium paid for the lease of a building; (vi) development expenditure on land; and (vii) goodwill; etc.

Expenses which are essentially of a revenue nature, if incurred for creating an assets or adding to its value or achieving higher productivity, are also regarded as expenditure of a capital nature.

Examples :

(i) Material and wages-capital expenditure when expended on the construction of a building or erection of machinery.

(ii) Legal expenses- capital expenditure when incurred in connection with the purchase of land or building.

(iii) Freight- capital expenditure when incurred in respect of purchase of plant and machinery.

Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalised it is the duty of the auditor not only to examine the precise particulars of the expenditure but also the considerations on which it has been capitalised.

(b) Revenue Expenditure: An expenditure, the benefits of which is immediately say within one year expended or exhausted in the process of earning revenue., eg., on purchase of goods for sale, on their movement from one place to another, on maintaining assets, on keeping a business organisation going, etc. is a revenue expenditure. Examples of revenue expenditure are:

(i) Cost of raw material and stores consumed in the process of manufacture.

(ii) Salaries and wages of employees engaged directly or in-directly in production.

(iii) Repairs and renewals of fixed assets.

(iv) Advertisements

(v) Postage

(vi) Printing and Stationery

(vii) Rent, rates and taxes

(viii) Insurance

(ix) Interest on borrowings, etc.

(c) Consignment Sale: Where the number of consignments sent out in a year is large, usually a separate consignment Sales Day Book and Ledger are kept. In that case, the entries in the Day Book in respect of price of goods sent out and expenses incurred on their transport and insurance should be verified with copies of proforma invoices and other relevant documents; the sale price of goods sold and expenses incurred by the consignee should be verified from the Account Sales.

The balances in the consignment ledger, at the end of the year in such a case, would represent the cost of unsold goods, including a proportion of non-recurring expenses incurred on their transport and insurance. These balances should agree with those shown in the respective account sales received from the consignees.

If the goods sent out for sale on consignment have been charged at the invoice price, the difference between the cost and the invoice price would be credited to the consignment stock adjustment account. The appropriate part of the amount credited in this account attributable to the stock remaining unsold at the year end, should be reversed so that credit can be taken for the net amount representing the difference for the part actually sold.

13. The existence of a trademark is verified by an inspection of the certificate as regards grant of the trademark. Where it has been purchased, the agreement surrendering it in favour of the client should be examined. It must also be observed that the rights are alive and legally enforceable. Copyrights are also acquired by surrender of rights and they also should be verified similarly. The auditor should obtain a schedule of trademarks and copyrights and verified that renewal fees have been paid and charged to revenue. The last renewal receipt should, in each case, be examined to ascertain that the trade mark has not lapsed. Copyrights and trademarks are generally revalued at cost less amortisation charges till date. If copyright and trademarks are generally revalued at cost less amortisation charges till date. If copyright and trademarks were purchased, the cost includes purchase price and registration charges. If it has been developed by the client, the cost should include cost of developing outlays, design costs and other associated direct cost. The cost of trademarks and copyright should be amortised over the period of legal validity or useful commercial life, whichever is shorter. Where auditor finds that any publication has ceased to command sale, he should have the amount of its copyright written off to revenue. AS-26 has suggested for every intangible assets useful life of ten years unless and until there is clear evidence that useful life is longer than ten years.

14. The special considerations to be taken while verifying debts accounts:

(1) Debts due in foreign currency : In the case of debts in a foreign currency, the auditor should find out by converting the amount into home currency whether it is more or less than the amount shown as recoverable. If there is any deficiency or appreciation, it should be appropriately adjusted in the Profit and Loss Account.

(2) Hire Purchase debts : Strictly, these are not debts since the hirer has the option of returning the goods, the auditor should, therefore, confirm that the instalments of hire money which had accrued have been realised in case there are any arrears and the article which is the subject of hire purchase is still in the possession of the hirer, it should be necessary to set up a provision for the loss anticipated on sale of the asset or on account of non-recovery of the outstanding balance.

(3) Package and empties : If packages are returnable but the customer has not deposited any security against their return, it is possible that he may fail to return

them. Against such a contingency, the auditor should ask the client to make a suitable provision.

15. During the audit the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations, and statements of an expert.

Examples are:

- valuations of certain types of assets, for example, land and buildings, plant and machinery, works of art, and precious stones.
- determination of quantities or physical condition of assets, for example, minerals stored in stockpiles, mineral and petroleum reserves, and remaining useful life of plant and machinery.
- determination of amounts using specialised techniques or methods, for example, an actuarial valuation.
- the measurement of work completed and to be completed on contracts in progress for the purpose of revenue recognition.
- legal opinions concerning interpretations of agreements, statutes, regulations, notifications circulars, etc.

When determining whether to use the work of an expert or not, the auditor should consider:

- the materiality of the item being examined in relation to the financial information as a whole.
- the nature and complexity of the item including the risk of error therein, and
- the other audit evidence available with respect to the item.

Skills and competence of the expert: When the auditor plans to use the expert's work as audit evidence, he should satisfy himself as to the expert's skills and competence by considering the expert's:

- professional certification, licence or membership in an appropriate professional body.
- experience and reputation in the field in which the auditor is seeking evidence.

However, when the auditor uses the work of an expert employed by him, lie will not need to inquire into his skills and competence.

Objectivity of the expert: The auditor should also consider the objectivity of the expert. The risk that an expert's objectivity will be impaired increases when the expert is:

- employed by the client, or
- related in some other manner to the client.

Accordingly, in these circumstances, the auditor should (after taking into account the factors stated above) consider performing more extensive procedures than would otherwise have been planned, or lie might consider engaging another expert.

16. When the auditor uses work performed by other auditors, the auditor should obtain reasonable assurance that such work is adequate for the purpose of the audit. Such a situation may arise in case a company having branch or having different branch auditors or the auditor is using the work of another independent auditor with respect to the financial statement of one or more subsidiaries or associated companies. Generally when another auditor has been appointed for the branch / division/ component, the principal auditor would be entitled to rely upon the work of such auditor unless there are circumstances to indicate that he should not rely. The procedure to be followed by the company auditor in relation to branch auditor is outlined in chapter on the company audit. It should however be noted that the aforesaid instances do not cover cases where two or more auditors are appointed as joint auditors nor does it deal with the auditor's relationship with the predecessor auditor.

17. The Companies Act, 1956 stipulates the office of auditor in a company as a continuing one; therefore, it has laid down that an auditor shall hold office from the conclusion of the annual general meeting in which he is appointed till the conclusion of the next annual general meeting. Excepting cases of appointment of the first auditor, appointment or filling of casual vacancies in the office of the auditor, companies are required to appoint an auditor or auditors in the annual general meeting as a routine feature. A specific resolution is required to re-appoint the auditors. The retiring auditor cannot be deemed to be re-appointed automatically at the annual general meeting. Till a formal resolution is passed, a retiring auditor cannot be said to have been re-appointed as contemplated by the section. It is not correct to say that in the absence of a resolution to the effect that the retiring auditors shall not be re-appointed, the retiring auditors shall stand re-appointed as auditors of the company. This appointment is subject to the following conditions :

(i) The auditor proposed to be appointed or re-appointed must possess the qualification prescribed under Section 226.

(ii) The proposed auditor does not suffer from the disqualifications enumerated in sub-Sections (3) and (4) of Section 226.

(iii) In the case of proposed re-appointment of the retiring auditor, it should be ensured that:

(a) he has not given to the company notice in writing of his unwillingness to be reappointed;

(b) no resolution has been passed at the annual general meeting appointing somebodyelse instead of the retiring auditor or providing expressly that the retiring auditor shall not be re-appointed;

(c) no notice of the intended resolution to appoint some other person or persons in place of the retiring auditor was received by the company that could not be proceeded with due to death, incapacity or disqualification of the other person or persons [Section 224(2)].

(iv) A written certificate has been obtained from the proposed auditor to the effect that the appointment or re-appointment, if made, will be in accordance within the limits specified in sub-section (1B) of Section 224.

18. The Basic Elements of the Auditor's Report

The auditor's report includes the following basic elements, ordinarily, in the following layout:

(a) title;

(b) addressee;

(c) opening or introductory paragraph

(i) identification of the financial statements audited;

(ii) a statement of the responsibility of the entity's management and the responsibility of the auditor;

(d) scope paragraph (describing the nature of an audit)

(i) a reference to the auditing standards generally accepted in india;

(ii) a description of the work performed by the auditor;

(e) opinion paragraph containing

(i) a reference to the financial reporting framework used to prepare the financial statements; and

(ii) an expression of opinion on the financial statements;

(f) date of the report;

(g) place of signature; and

(h) auditor's signature.

A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur.

A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report. In such a case, the auditor should incorporate in his audit report, the matters specified by the statute or regulator and/or report in the form prescribed by them.

19. NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations. Therefore, this definition of NGO would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide and as such can not be covered in a small definition. Some examples of NGOs operating in India include Child Relief and You (CRY), NORAD, UNICEF, Godhuli, Vidya, Concern India Foundation., etc.

Non-Governmental Organisations are generally incorporated as societies under the Societies Registration Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGOs can also be incorporated as a company under Section 25 of the Companies Act, 1956. None of the above mentioned Act warrant a mandatory registration under them for an NGO. But if an NGO is created as a trust and trust relates to immovable property worth more than one hundred rupees, the provision of Section 17(1) of the Registration Act, 1908 read with Section 123 of the Transfer of Property Act, 1882 must be complied with and the registration of trust becomes mandatory. In some States, such as the states of Maharashtra and Gujarat, where Public Trusts Acts have been passed, such as the Bombay Public Trusts Act 1950, all charitable trusts have to be registered under these specific Public Trusts Acts. Registration under the Income Tax Act, 1961 and the Foreign Contribution (Regulation) Act, 1976 would also be invoked in many cases.

NGOs registered under the Companies Act, 1956 must maintain their books of account under the accrual basis as required by the provisions of section 209(3)(b) of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 1956. The NGOs which are not registered under the Companies Act, 1956 are allowed to maintain accounts either an accrual basis or cash basis.

20. The function of an internal auditor being an integral part of the system of internal control, it is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor. As per the Companies (Auditors Report) Order, 2003 issued under Section 227(4A) of the Companies Act, the statutory auditor is required to comment (as amended by in Nov., 2004) on the internal audit system. For the purpose, he should examine the organisation of the Internal Audit Department, the strength of the internal audit staff, their qualification and their powers. Afterwards the procedures should be studied; also the scope of the audit examination carried out should be ascertained on referring to audit programmes, reports submitted, points raised in audit and how these had been dealt with subsequently. The extent of independence exhibited by the internal auditor in the discharge of his duties and his status in the organisation are important factors for determining the effectiveness of his audit. In a large business, it has been increasingly recognised that, if their functions and those of statutory auditors could be integrated, it might not be necessary for the statutory auditors to go over the same facts and figure as have been previously examined by a competent and trustworthy internal audit staff. But so far, the practice of audit being conducted jointly by the internal auditors are of great assistance to statutory auditors.

If the statutory auditor is satisfied on an examination of the work of the internal auditor, that the internal audit has been efficient and effective, he often decides to curtail his audit programme by dispensing with some of the detailed checking already carried out by the Internal Audit Department after or without testing the work already done. He, at times, also decides to entrust certain items of work to the internal auditor. Given below are items of audit work in regard to which the statutory auditor accepts the checking that has already been carried out by the internal auditor ;

(i) Verification of the system of internal control ;

(ii) Verification of assets, e.g., stock in trade, fixed assets, book debts, etc. ; and

(iii) Verification of amounts provided for expenses as well as amounts adjusted as prepaid expenses.

It must however be mentioned that the area of co-operation between the statutory and the internal auditor is limited by the fact that the statutory auditor and the internal auditor owe their allegiance to separate authorities, the shareholders in one case and the management in the other. Therefore, the former is not protected against the liability for negligence which may arise in such a case.