

# ***AUDITING AND CORPORATE GOVERNANCE***

**VI SEMESTER**

**CORE COURSE: BCM6 B13**

**B.Com.**

**(2019 Admission onwards)**

**CBCSS**



***UNIVERSITY OF CALICUT***

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# **UNIVERSITY OF CALICUT**

## **School of Distance Education**

### **Study Material**

#### **VI Semester**

#### **Core Course (BCM6 B13)**

#### **B.Com.**

### ***AUDITING AND CORPORATE GOVERNANCE***

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## **MODULE 1**

### **MEANING AND DEFINITION OF AUDITING**

The word audit is derived from Latin word *audire* which means 'to hear'. Auditing is a critical examination of the records and books of account of a business by an independent qualified person for ascertaining the authenticity and the accuracy of entries appearing in the books of account and financial statement. Spicer and Pegler have defined audit as “such an examination of the books, accounts and vouchers of a business as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and whether the profit and loss account gives a true and fair view of the profit or loss for the financial period, according to the best of his information and explanation given to him and is shown by the books and if not in what respect he is not satisfied.” Montgomery defined auditing as examination of the books and records of a business in order to ascertain or verify and report up on the facts regarding the financial operations and the results thereof.”

### **ORIGIN AND EVOLUTION**

The term audit is derived from the Latin word '*audire*', which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt, Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya had emphasized the importance of

accounting and auditing. The original objective of auditing was to detect and prevent errors and frauds. Auditing evolved and grew rapidly after the industrial revolution in the 18th century with the growth of the joint stock companies the ownership and management became separate. The shareholders who were the owners needed a report from an independent expert on the accounts of the company managed by the board of directors who were the employees. The objective of audit shifted and audit was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds. In India, the companies Act 1913 made audit of company accounts compulsory with the increase in the size of the companies and the volume of transactions. The main objective of audit shifted to ascertaining whether the accounts were true and fair rather than true and correct. Hence the emphasis was not on arithmetical accuracy but on a fair representation of the financial efforts.

The companies Act.1913 also prescribed for the first time the qualification of auditors. The International Accounting Standards Committee and the Accounting Standard board of the Institute of Chartered Accountants of India have developed standard accounting and auditing practices to guide the accountants and auditors in the day to day work. The later developments in auditing pertain to the use of computers in accounting and auditing. In conclusion it can be said that auditing has come a long way from hearing of accounts to taking the help of computers to examine computerized accounts.

## **Objectives of Auditing**

The objective of an audit may be classified as

1. **Primary Objective**

2.      Subsidiary Objective

3.      Specific Objective

### **Primary Objective or Main Objective**

The main objective of auditing is to verify the accounts and records and to report to the owners of the business whether the profit and loss account and the Balance sheet have been properly drawn up according to the requirements of law, and whether they exhibit a true and fair view of the profit and the financial position of the business. To ensure that the primary objective of audit is achieved, an auditor must:

- ✓      Examine the Internal Control and Internal Check.
- ✓      Verify whether all the books of accounts as required by law are kept.
- ✓      Verify whether proper accounting principles and procedures are followed.
- ✓      Check the arithmetical accuracy of the books of accounts.
- ✓      Verify the authenticity and validity of the transactions.
- ✓      Confirm the existence and the values of the assets and liabilities by physical verification.
- ✓      Find out whether the financial statement is properly drawn up.
- ✓      Report whether the profit and loss gives a true and fair view of the profit or loss for the year and Balance sheet gives a

true and fair view of the financial position of the business at the end of the financial year.

### **Subsidiary or Ancillary objectives**

Subsidiary objectives of auditing are

1. Detection and prevention of errors.
2. Detection and prevention of frauds.

### **Detection and prevention of Errors**

Errors refer to unintentional misstatements in the records or books. Errors are two types namely

- Clerical or technical errors and
- Errors of principle.

### **Clerical Errors**

Clerical errors refer to all types of errors committed on account of clerical mistakes. They are

- Errors of omission
- Errors of Commission
- Compensating errors and
- Errors of duplication.

### **Errors of Omission**

An error of omission is one which arises when a transaction has been omitted to be recorded in the books of accounts either wholly or partially. An error of omission may be



an error of complete omission or an error of partial omission. An error of complete omission does not affect the agreement of the trial balance, as both the aspects of the transaction are omitted from the trial balance, they cannot be detected easily. They can be detected only by an intensive checking of the subsidiary books, and the postings from the subsidiary books to the ledger. On the other hand, an error of partial omission affects the agreements of the trial balance, as only one of the aspects of the transactions is omitted from the trial balance, it can be detected easily.

### **Errors of Commission**

Errors of commission refer to errors committed in the process of posting from the subsidiary books to the ledger accounts, casting, carry forward and balancing of ledger accounts. Some of the errors of commission will not affect the agreement of the trial balance. They cannot be detected easily. Only a thorough checking of the subsidiary books and posting to the ledger can help to detect these errors.

### **Compensating errors**

When the effect of one error is counter balanced, set off or compensated by another error, the errors are known as compensating errors or offsetting errors. Compensating errors do not affect the agreement of the trial balance, as they are counter balanced or set off.

### **Errors of Duplication**

Errors of duplication arise when an entry in a book of original entry has been made twice and also been posted twice.

## **Errors of Principle**

An error of principle arises when the generally accepted principles of accountancy are not observed, while recording a transaction in the books of account. In other words, if a transaction is recorded in the books of account against the generally accepted principles of accountancy, the error is known as an error of principle. Capital expenditure recorded as revenue expenditure or vice versa, capital receipt recorded as revenue receipt or vice versa is examples of errors of principle. Errors of principle will not affect the agreement of the trial balance. Only a detailed and intensive checking will reveal these errors.

## **Detection and prevention of frauds**

It is intentional or willful representation or deliberate concealment of material fact with a view to deceive, cheat or mislead somebody. Fraud may be broadly classified into three types. They are

1. Misappropriation of cash
2. Misappropriation of goods
3. Manipulation of accounts

**Misappropriation, Defalcation or Embezzlement of Cash:** - Misappropriation of cash means the fraudulent appropriation of cash belonging to another person by whom it has been entrusted.

Misappropriation of cash may take place in any of the following ways:

- (a) Suppression or non disclosure of Cash receipts :

The following are examples of suppression of cash receipts:

- ✱ By misappropriating the receipt by not recording the same in the Cashbook.
- ✱ By entering lesser amount on the counterfoil and misappropriating. The difference between money actually-received and the amount entered on the counterfoil of the receipt book.
- ✱ By not recording the receipt of sale of a casual nature for example Sale of scrap, sale of old newspapers etc.
- ✱ By omitting to record cash donations received by non-profit making charitable institutions.
- ✱ By misappropriating the cash received on discounting the bills Receivable and showing them as bills outstanding on hand.
- ✱ By misappropriating cash received from debtors and concealing the same by giving artificial credit to the debtors in the form of bad debts, Discount or sales return etc.
- ✱ By adopting the method of "teeming and lading" or "lapping process". This is one of the methods of misappropriation of cash. Under this method cash received from the first customer is misappropriated by the cashier. The money received from the second customer is credited to the account of the first customer, the money received from the third customer is credited to the account of second customer, and the money received from the fourth customer is credited to the account of third customer and so on. This process is carried out throughout the year.
- ✱ By suppressing the cash sales by not recording them or by treating the cash sales as credit sales.

✖ By misappropriating the sale proceeds of VPP sales or sales of Goods on approval basis by treating the transaction as goods Received or not approved.

✖ By under casting receipt side total of the cashbook.

(b) Inflating the payments or showing false cash payments: -

The following are examples of this type of misappropriation:

- Recording fictitious or false cash purchases and pocketing the amount.
- Inflating the cash purchases and pocketing the difference
- Recording payments to fictitious creditors for purchases and pocketing the money.
- Recording the payment to creditors at a figure higher than the actual amount and pocketing the difference.
- Recording payments to dummy workers and pocketing the money.
- Recording fictitious payments of expenses and pocketing the money.
- Recording payments of some accounts at figures higher than the actual payments and pocketing the difference.
- By showing credit purchases as cash purchases and misappropriating the amount.
- Recording personal expenses as business expenses

## **Manipulation of Accounts**

Manipulation of accounts means falsification of accounts without any misappropriation of cash or goods. It implies presentation of accounts more favorably than what they actually are. Manipulation of accounts may be done in any of the following ways:

1. Non provision of depreciation on fixed assets.
2. Provision of less depreciation on fixed assets
3. Provision of more depreciation on fixed assets
4. Over valuation of assets
5. Showing short term liabilities as long term liabilities.
6. Recording sales of the next year in the current year's revenue account.

### **Specific objectives**

There will be specific objective in respect of each type of specific audits. For example, in operational audit, the aim of audit is to evaluate the existing operations of the entity in order to give expert advice to improve their efficiency. The cost audit is to check the cost records of the entity in order to make a report on the proper ascertainment of cost of production of goods or services. Depending upon the nature of specific audit, there may be different objective in respect of each specific audit.

## **PROCEDURE TO BE FOLLOWED TO DETECT ERRORS**

Following procedures may be adopted by the auditor to detect the errors.

1. Check the opening balances from the balance sheet of the last year.
2. Check the posting into respective ledger accounts
3. Check the total of the subsidiary books.
4. Verify all the castings and the carry forwards.
5. Ensure that the list of debtors and creditors tally with the ledger accounts.
6. Make sure that all accounts from the ledger are taken into accounts.
7. Verify the total of the trial balance.
8. Compare the various items from the trial balance with that of the previous year.
9. Find out the amount of difference and see whether an item of half or such amount is entered wrongly.
10. Check differences involving round figures as Rs. 1,000; Rs. 100 etc.
11. See where there is misplacement or transposition of figures that is 45 for 54; or 81 for 18 etc.
12. Ultimately careful scrutiny is the only remedy for detection of errors.

## **The AUDITOR's Position and duty in regard to detection and prevention of errors and frauds**

1. Examine all aspects of the finance.
2. Vouch all the receipts from the counterfoils or carbon copies or cash Memos, sales mart reports etc.
3. Check thoroughly the salary and wages register.
4. Verify the methods of valuation of stocks.
5. Check up stock register, goods inwards notes, goods outwards books and delivery challans etc
6. Calculate various ratios in order to detect fraudulent manipulation of accounts
7. Go through the details of unusual items
8. Probe into the details of the problems when there is a suspicion.
9. Exercise reasonable skill and care while performing the duty.
10. Make surprise visit to check the accounts.

An auditor's position and duty in relation to detection and prevention of errors and frauds had been beautifully explained in the case of Kingston Cotton Mill Company. In this case it was remarked, "An auditor is a watch dog and not a blood hound". The remark an auditor is a watch dog limits the audit examination to mere verification of accounts but does not cover detection of errors and frauds. But an effort to detect errors and frauds and suggest ways and means to prevent the

errors and frauds in the future. Verification of accounts also implies vigilance on

the part of the auditor to detect errors and frauds. As such while verifying the books of accounts, if an auditor smells some irregularities he must follow them. He should act honestly and takes reasonable skill and care in detecting errors and frauds. In India, the duty of an auditor has to detect errors and frauds have also been emphasized by the Council of Chartered Accountants. According to this council, an auditor should bear in mind the possibility the existence of fraud or other irregularities, because the financial position may be misstated as a result of errors and frauds. It is true that an auditor has to detect errors and frauds. But while performing his task of detection of errors and frauds, he need not be a blood hound. He is not required to take to task those staff that has been found guilty of committing errors and frauds. This view was upheld in the case of London Oil Storage Company Ltd VS Seeers Hasluck and Company. In this case it was held an auditor is not bound to assume when he comes to do his duty that he is dealing with fraudulent and dishonest people. If circumstances of suspicions arise, it is his duty to probe them to bottom. To sum up, an auditor is not an insurer against errors and frauds. That he does not guarantee that the books do not contain any errors and frauds. However, he has always to be very careful about errors and frauds. He must exercise reasonable care and skill in the detection of errors and frauds. Once he suspects the existence of errors and frauds, he must go in to the roots and unearth them. In short, an auditor is not just a watch dog. But, at the same time, he need not be blood hound.



## **ADVANTAGES OF AUDIT: -**

Audit offers several advantages. They are:

### **I. Advantages of Audit to the business enterprise and Management**

1. Audit ensures the accuracy or correctness of the books of accounts
2. Audit ensures the authenticity and reliability of the financial statements.
3. Audit helps in the detection and rectification of errors and frauds.
4. Audit helps the enterprise and management to ascertain whether the legal requirements are complied with.
5. Audit point out the weakness of the existing system of internal check and internal control.
6. Audit examination makes the employees in charge of accounts and records vigilant, regular and up- to –date in their work.
7. Loans and credit facilities can be easily obtained by a concern on the basis of audited accounts.
8. Liability of an enterprise as to income tax, wealth tax, and value added tax etc can be easily determined on the basis of audited accounts.
9. A business can enjoy better reputation, if its accounts are audited by an independent professional auditor.

10. Audited accounts are more reliable as evidence in courts of law.
11. Facilitates calculation of purchase consideration.
12. The insurance claim can be easily determined on the basis of audited accounts.
13. Audited accounts serve as a basis for solving the disputes as to higher wages.
14. Comparison of accounts from year to year becomes easier since the accounts are uniformly prepared.

## **II. Advantages of audit to the owners of the business**

1. In the case of a sole trader, auditing assures him that all business transactions have been duly accounted for and there are no errors or frauds. It also helps him to know the true facts about the business.
2. In the case of partnership firm, audited accounts serve as an evidence of proper management of the affairs of the business. Audited accounts are help in the valuation of goodwill and settlement of accounts on the admission, retirement or death of a partner. Again audited accounts minimize the chances of disputes among the partners.
3. In the case of a joint stock company, audit of accounts assures the shareholders that the affairs of their company are smoothly and their investment is safe. The shareholders of a company can value their shares on the basis of audited accounts.
4. In the case of a co – Op society or a trust, audit assures the members or the beneficiaries that the affairs of the society or

trust are conducted properly and their investment are looked after properly.

### **III. Advantages of Auditing to others**

1. Lenders can depend on audited financial statements while taking a decision to grant credit to the business concern.
2. Tax authorities can depend on audited statements in assessing sales tax, income tax and wealth tax of the business.
3. Audit of accounts safeguards the interests of the workers and is helpful in the settlement of claim for higher wages and bonus.
4. Insurance company can rely on audited accounts to settle claims in respect of damage or loss of any business asset by fire, theft etc.
5. The purchaser of a business can easily calculate the amount of purchase consideration on the basis of audited accounts.
6. Audited accounts create confidence in the minds of investors in a joint stock company.

### **Limitations of Auditing: -**

Generally following are the Limitations of auditing

1. **Non-detection of errors or frauds: -** Auditor may not be able to detect certain frauds which are committed by the clients.
2. **Dependence on explanation by others: -** Auditor has to depend on the explanation and information given by the

responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.

3. **Dependence on opinions of others:-** Auditor has to rely on the views or opinions given by different experts viz Lawyers, Solicitors, Engineers, Architects etc, he cannot be an expert in all the fields

4. **Conflict with others:** - Auditor may have differences of opinion with the accountants, management, engineers etc. In such a case personal judgement plays an important role. It differs from person to person.

5. **Effect of inflation :** - Financial statements may not disclose true picture even after audit due to inflationary trends.

6. **Corrupt practices to influence the auditors:** - The management may use corrupt practices to influence the auditors and get a favourable report about the state of affairs of the organisation.

7. **No assurance:** - Auditor cannot give any assurance about future profitability and prospects of the company.

8. **Inherent limitations of the financial statements:** - Financial statements do not reflect current values of the assets and liabilities. Many items are based on personal judgement of the owners. Certain non-monetary facts cannot be measured. Audited statements due to these limitations cannot exhibit true position.

9. **Detailed checking not possible:** - Auditor cannot check each and every transaction. He may be required to do test checking.

**10. Auditing is a post mortem examination of accounts.**

**AUDITING Vs INVESTIGATION:**

Investigation is an enquiry into the accounts and records of a business concern for a special purpose, say, to know the actual financial position of the concern or to know the real earning capacity of the business or to know the extent of fraud, if any. There are many differences between the two. They are:

Points of	Difference	Auditing Investigation
1.Objects	The object is to find out whether balance sheet and profit and loss account exhibit a true and fair view of business.	It is undertaken to know the essential facts about a matter under inquiry. It is done with some special purpose of view.
2.Period	It usually covers one accounting year.	It may cover more than one accounting year.
3.Conducted	It is conducted for proprietors only.	It is carried out on behalf of any party interested in the matter.
4. Scope	It is restricted to balance sheet and profit and loss account.	It is wider in scope. It may be carried out beyond balance sheet.
5. Compulsion	Audit is legally compulsory for companies.	It is voluntary. It is required under certain circumstances.

6. Time	It may be conducted at the end of the year.	It may be conducted at any time in case of suspicion about any transaction.
7. Report	Form of report is prescribed. It is presented to the shareholders.	Form of report is not prescribed. It is presented to the client.
8. Appointment	Owners appoint the auditors.	Even third party can appoint an investigator.
9. Qualifications	The statutory auditors must possess proper qualifications.	Even an employee preferably a chartered accountant may be appointed as investigator.
10. rework	Re - audit is not generally undertaken.	Re - investigation may be undertaken.

## **DISTINCTION BETWEEN ACCOUNTING AND AUDITING**

Point of difference	Accounting	Auditing
1. Meaning	It is recording of all the day to day transactions in the books of accounts	It is the critical examination of the transactions recorded in the books of accounts.

	leading to preparation of financial statements.	
2. Nature	It is concerned with finalization of accounts.	It is concerned with establishment of reliability of financial statements.
3. Objects	The object is to ascertain the trading results.	The object is to certify the correctness of financial statements.
4. Commencement	Accounting Commences when book keeping ends.	Auditing begins when Accounting ends.
5. Scope	It involves various financial statements. It involves maintenance of books of accounts.	It depends upon the agreement or upon the provisions of law. It goes beyond books of accounts.
6. Report	An accountant is not required to submit any report to the proprietor of the business.	An auditor is required to submit a report to the proprietor of the business.
7. period	Accountancy work is conducted continuously throughout the year.	Auditing work is generally, conducted at the end of the year or periodically.

8. Qualification	An accountant, who is in charge of accounting work, need not be a qualified person.	An auditor, who is in charge of auditing work, must be a qualified person.
9. Position	An accountant is an insider ie an employee of the undertaking.	An auditor is an outsider, not an employee of the undertaking.
10. Remuneration	An accountant being an employee of the concern is paid regular salary for his work.	An auditor is paid fixed fee for his work.

### **Difference Between Book Keeping And Auditing**

Book keeping	Auditing
➔ It is an art of recording business transactions.	➔ it verify the correctness of recorded transactions.
➔ Book keeping done by a junior clerk or an accountant	➔ Auditing work is done by a qualified auditor
➔ Book keeping does not require special knowledge and training in accounting	➔ it is a special knowledge and training for essential for audit
➔ Mechanical nature	➔ Analytical nature
➔ Book keeper does the	➔ Auditor does finishing work



preliminary accounting work	
➔ Book keeping work is done by a salaried employee in an organisation	➔ Auditing work is done by an outsider with qualified person
➔ Book keeping is a continous process	➔ Auditing work is done at the end of the accounting or finacial year
➔ Book keeping takes place before auditing	➔ Auditing work is done after completing book keeping work

## **Qualification and Qualities of an Auditor**

To be an efficient auditor, an auditor must possess certain professional qualifications and professional and personal qualities.

### **Professional qualification**

An auditor is a professional accountant. So he must possess certain professional qualifications. Under the Companies Act, an auditor of a joint stock Company must be a Chartered accountant within the meaning of the Chartered Accountants Act of 1949. To be a Chartered accountant, he must pass the C.A examination conducted by the Institute of Chartered Accountants. He must also obtain a certificate from the institute from the Institute of Chartered Accountants to take up public practice of accountancy.

## **Professional Qualities**

To perform his work efficiently, an auditor must possess certain professional qualities. They are:

- Knowledge of principles and practice of general accounting.
- Knowledge of Cost accounting
- Knowledge of Management accounting
- Thorough knowledge of techniques of auditing
- Knowledge of provisions relating to income tax , wealth tax, VAT etc.
- Knowledge of business laws.
- Knowledge of economics.
- Knowledge of Mathematics and Statistics
- Knowledge of Business Management and Organization and financial administration
- Knowledge of report writing.
- Knowledge of technical details of the business under audit.
- Knowledge of the accounts of the business under audit.

## **Personal Qualities or General Qualities**

Besides the professional qualities, an auditor must also have certain personal or general qualities to perform his work efficiently and smoothly. The requisite personal qualities are :

- ◆ Honesty and Integrity.
- ◆ Tactfulness
- ◆ Vigilance
- ◆ An enquiry mind
- ◆ Methodical
- ◆ Care and Skill
- ◆ Diligence
- ◆ Judgement.
- ◆ Responsibility
- ◆ Impartiality and independence.
- ◆ Common sense
- ◆ Ability to communicate
- ◆ Ability to work hard
- ◆ Patience
- ◆ Courtesy
- ◆ Ability to maintain secrets.

## **Classification of audit or types of audit**

Audit can be classified on different types:

1. Classification of Audit on the basis of Organization structure.
2. Classification of audit on the basis of Degree of independence of the auditor
3. Classification of Audit on the basis of method or approach to audit work or on the basis of extent of work to be performed or on the basis of conduct of audit.
4. Classification of audit on the basis specific objectives

### **Classification on the basis of organization or organization structure**

On the basis of organization structure, audit may be classified into three types.

They are:

- Statutory audit
- Government audit
- Private Audit

### **Statutory Audit**

Statutory audit refers to the audit of accounts of a business enterprises carried out compulsorily under the provisions of a statute or law. It is is the audit carried out compulsorily under any statute any law.

### **Features of statutory audit are:**

- Statutory audit is compulsory under law.
- Statutory audit is required to be conducted by a qualified auditor.
- In the case of Statutory audit, the rights, duties and liabilities of the auditor are governed by the statute or law applicable to the undertaking.
- Statutory audit is an independent audit. Statutory audit is an external audit.
- Statutory audit must be a complete or full audit. It cannot be partial. Statutory audit is carried out in a number of Organizations, such as
  - Joint stock Companies governed by the Companies Act of 1956.
  - Banking companies governed by the Banking Regulation Act of 1949.
  - Insurance companies governed by the Insurance Act of 1938.
  - Electricity supply companies governed by the electricity supply Act of 1948.
  - Co – operative societies registered under the Co –operative Societies Act.
  - Public and charitable trusts registered under Religious and Endowment Acts

## **Government audit**

Government audit refers to the audit of accounts of Government departments and offices, Government companies and statutory or public corporations.

### **The features of government audit are**

1. Government audit is prescribed for by law.
2. It is conducted either by the comptroller and Auditor General of India and his staff or professional chartered accountant approved by the Comptroller and Auditor General of India.
3. It is internal audit.
4. A government audit is a continuous audit.

### **Objectives of Government audit**

1. To ensure that all payment has been sanctioned by the competent authority.
2. To ensure that every payments is made as per the rules and regulations.
3. To see that the payments have been made to the right persons.
4. To ensure that the expenditure is not excessive.
5. To see that payments are properly classified as capital and revenue.
6. To verify the existence of stocks and stores.

7. To ensure that a proper system of stock taking has been adopted.

Government audit may be classified into three types. They are:

- Audit of government departments and offices.
- Audit of Government Companies.
- Audit of Statutory Corporations registered as statutory corporations.

### **Private audit or Voluntary audit**

Where an audit is not compulsory under any statute, but is undertaken by the owners voluntarily to get the benefit of audit, the audit is called private audit. In other words, private audit refers to the audit of accounts of private enterprises such as a sole trading concerns, partnership firms and other individuals and institutions.

### **Advantages of private audit**

1. Audit assures to the owners that the accounts of the business are properly maintained and there are no irregularities.
2. It provides a moral check on the employees.
3. It helps the owners of the business to know the real profitability and the state of affairs of their business.
4. Audited accounts serve as a basis for assessment of tax liability.

5. Audited accounts facilitate the process of raising loans from banks and other financial institutions.
6. Audited accounts help in the settlement of dispute and claims between the partners of a firm.

### **Classification of audit on the basis of Degree of Independence:-**

1. Internal audit
2. External audit

### **Internal audit**

Internal audit is a continuous and systematic review of the accounting, financial and other operations of a concern by the staff specially appointed for the purpose. In other words, it is the audit of accounts by the staff specially appointed for the purpose.

### **Objectives of Internal audit: -**

1. To ascertain whether internal check and accounting systems are adequate and effective.
2. To ascertain whether predetermined policies, plans and procedures have been complied with.
3. To ascertain the reliability of the accounting and other data.
4. To evaluate the performance of the personnel.
5. To ascertain whether the properties of the concern are safeguarded.



6. To suggest to the management the improvements desired in the internal check systems, accounting system etc.

### **Features of Internal audit: -**

1. It is generally undertaken by large concerns.
2. It is not compulsory.
3. The scope of internal audit may vary, depending upon the nature and size of the concern
4. It may be in addition to external audit.
5. It is conducted by the staff of the concern.
6. The techniques and methods of auditing employed in internal audit are the same as those in external audit
7. It is an integral part of internal control.
8. The staff engaged in internal audit is appointed by the management. They are responsible to the management.

### **Importance and advantages of internal audit**

1. It is helpful to the management to ascertain whether the internal check and accounting systems are adequate and effective to prevent errors and frauds.
2. It helps the management to ascertain whether the predetermined policies, plans and procedures have been complied with.
3. It is helpful to ascertain the reliability of the accounting and other data complied within the organization.

4. It is helpful to evaluate the performance of the personnel.
5. It helps to ascertain whether the properties of the concern are safeguarded.
6. It covers the review of accounting and non accounting matters.

### **Disadvantages**

1. It is conducted by staff who may not be a qualified one.
2. It is optional.
3. Quality depends upon the decisions of management.

### **External Audit**

Audit conducted by independent qualified person and examines the books of accounts and report to the management.

### **Difference between Government Audit and Commercial Audit**

<b>Government Audit</b>	<b>Commercial Audit</b>
1. It is adopted in government departments, government offices and Government Company.	1. It is conducted in private enterprise.
2. It is compulsory.	2. It is optional.
3. It is conducted by CAGI and his staff and qualified staff.	3. It is conducted by professionally qualified persons.

4. Continuous audit.	4. Periodical audit.
5. Disbursing officer is responsible for the work of audit.	5. Disbursing officer is not responsible.
6. Treasury officer undertake preliminary audit	6. There is no preliminary audit.

**On the basis of Conduct of audit or methods or approach to audit work**

**1. Continuous Audit.**

Continuous audit is one where the auditor's staff is occupied continuously on the accounts whole the year round and performs interim audit. It is an audit under which detailed examination of the books of accounts is conducted continuously throughout the year. It is continuous review of the accounts of the organization. It is generally applicable to banking company and insurance company.

**Advantages.**

- 1) Easy and quick discover of errors and frauds.
- 2) Technical knowledge.
- 3) Quick presentation of accounts.
- 4) Keep the client staff regular.
- 5) Moral check on the client's staff.
- 6) Efficient audit.
- 7) Preparation of interim accounts is very easy.

8) Audit staff can be kept busy.

**Limitations.**

- 1) Alteration of figures.
- 2) Dislocation of the work of the client staff.
- 3) Expensive.
- 4) Queries may remain outstanding
- 5) Extensive note taking may be necessary.
- 6) Chance for collusion between client staff and audit staff.
- 7) Mechanical and monotonous.

**Precautions or steps to be taken to overcome the drawbacks:**

- 1) Well dream up audit program should be followed by the auditor.
- 2) No alterations to be allowed after the accounts are audited.
- 3) If any alterations are made, it should be made in the rectification entries in the journal.
- 4) A note should be made in respect of queries asked.
- 5) If any alterations are made in figures before auditing, a special tick mark must be made.
- 6) Recommend surprise visit.
- 7) Rotate the audit work among auditors.

## **2. Final Audit or Annual or periodical audit**

It is an audit carried out after the preparation of financial statement. It is an audit where the auditor takes up his work of checking the books of accounts only at the end of the accounting year. In this case, the audit work is commenced and completed in a single uninterrupted session.

### **Advantages:**

- 1) Cost of audit is less than that of continuous audit.
- 2) Audit work is completed in one continuous sitting.
- 3) Not causing any dislocation of client work.
- 4) No possibility of alteration of figures.
- 5) It is not mechanical and monotonous.
- 6) Less chance for collusion between client staff and audit staff.
- 7) There is no lose the thread of the work.

### **Limitations**

- 1) Errors and frauds remains in the accounts for long period of time.
- 2) Postmortem examination of accounts.
- 3) Little time for checking.
- 4) Rely upon test checking.
- 5) Not suitable for imposing moral check on the client staff.
- 6) Not helpful for preparing interim accounts.

7) Not suitable for large size organizations.

### **3.Interim Audit.**

It is an audit conducted between two annual audits. In other words, it is the audit conducted in the middle of the financial year. It is carried out for some specific purpose for declaring interim dividend, ascertaining interim profit.

#### **Advantages.**

- 1) Quick discovery of errors and frauds.
- 2) Imposes moral check on client staff.
- 3) Helpful for speedup the final audit.
- 4) Useful for publication of interim figures.
- 5) Audit becomes easy and can be completed without lapse of time.

**4. Balance sheet audit :** - Balance sheet audit is a type audit which concentrates mainly on the verification of the items in the balance sheet such as capital, reserves, profit and loss account balance, liabilities and provisions and all the assets of the business.

**5. Occasional Audit:-** An occasional audit is an audit which is conducted once a while, whenever the need arises. In other words , it is a kind of audit which is not conducted on regular basis, but is conducted for a special event, time or purpose.

**6. Complete Audit :** - Complete audit is a kind of audit under which all the records and books of accounts are audited by an auditor.

**7. Partial Audit:** - It is a kind of audit the scope of which is limited one. It is carried out in respect of only a part of the books of accounts of a business, for a part of whole of the period.

**4. Classification of audit on the basis of specific objectives: -**

1. Cash Audit: - It is a type of partial audit which is undertaken for only cash receipts and cash payment.

2. Special Audit:- It is a kind of audit with some special object in view. It is a fact finding enquiry.

3. Operational Audit: - It is an efficient examination of the various operations of the different functional area of business.

4. Proprietary Audit: - It is an audit in which various actions and decisions are examined to find out whether in public interest and whether they meet the standard of conduct.

5. Efficient Audit: - It is an evaluation of overall efficiency and performance of an organization.

6. Tax Audit: - It means audit for tax purpose. Audit required to be carried out of income tax act of 1961. It is conducted by certified Chartered Accountant. There are certain circumstances in which tax audit is necessary.

1. Compulsory tax audit under section 44 AB of the Income tax Act 1961

2. Tax audit for claiming deductions and Reliefs under the Income Tax Act.

3. Tax audit for Tax Consultancy and Representation.

## **7. Cost Audit.**

It is a thorough examination of the cost accounting records of a company by a cost auditor to ensure that they are accurate and they also follow to the cost accounting principles, procedures and plans.

### **Objectives.**

- 1) Verifying the accounting entries related in the cost books.
- 2) To find out whether the cost records have been properly maintained.
- 3) To verify whether the cost accounting principles are complied with.
- 4) To find out whether the cost statements are properly dream up.
- 5) To verify the items of cost expenditure are correctly incurred.
- 6) To find out the efficiency and inefficiency of handling of material, labour and other expenses.
- 7) To check up the overall working of the cost accountant.
- 8) To reduce the volume of work of the external auditor.
- 9) To detect errors and frauds.

## **8. Management Audit.**

It is the critical examination, scrutiny and appraisal of plans, policies, procedures, objectives, means and operational area of the organization. It is the audit of managerial actions and



decisions. It is the audit of activities of various level of the managers.

Objectives of Management audit: -

1. To identify the overall objectives of an organization.
2. To pinpoint the deficiencies and defects in functional areas and suggest remedies for improvement.
3. To assist the various level of management in discharge their duties.
4. To help the management in achieving co- ordination among the various departments.
5. To ensure that management objectives are achieved.

Advantages of Management Accounting: -

1. It identifies the overall objectives of the organization.
2. It reviews plans, policies, procedures and controls.
3. It assesses the performance in each functional area
4. It also ascertains the motivational system in operation in the business.
5. Suggesting ways and means for the attainment of management goals.

Criticism against management audit: -

1. It is argued by some managers and accountant that management audit is a vague concept and so, it serves no material purpose.

2. Management audit may discourage the managers from undertaking tasks which are useful to the organization.

3. It is argued that it will adversely affect to the efficiency and production.

**9. Social Audit:** - Social audit is a systematic study and evaluation of a business enterprise's social performance as distinguished from its economic performance. Social audit is intended to evaluate the social performance or social contribution of a business organization. TISCO firstly adopted social audit.

**Preliminary stage of audit work or Preplanned activities of the audit work or Steps to be taken by the auditor before commencement of the audit or audit planning : -**

An auditor must prepare well before he actually commences a new audit. He has to take certain steps or bear in mind certain considerations before commencing a new audit. These steps are known as preliminary steps or general steps.

The following are the important preliminary or general steps to be taken by an auditor in all types of concerns before the commencement of a new audit:

I. Obtaining letter of appointment.

Auditor should satisfy himself that he has properly appointed.

II. Knowing the scope of his studies.

III. Ascertaining the nature of the business undertaken by the client enterprise.

IV. Knowledge of the organizational structure of the client business.

Pattern of authority and responsibility are revealed through the organizational structure.

V. Obtaining the list of principal officers of the client business.

VI. Knowledge of internal check, internal control and internal audit

VII. Knowledge of system of accounting of the client business.

VIII. List of books maintained in the organization.

IX. Detailed study of important documents of the organization.

X. Study of prospectus, preliminary contracts etc of the organization.

XI. Study of the previous year financial statements.

XII. Enquiry about the reason for the change of the auditor.

XIII. Giving instructions to the client.

a) The books should be closed before the audit.

b) Voucher should arranged date wise.

c) Schedules should be kept for ready reference such as schedules of debtors and creditors, list of bad and doubtful debts, schedule of investment, schedule of depreciation etc..

XIV. Division of audit work among the auditors.

XV. Preparation of audit program.

## **Audit techniques**

Techniques of audit are the methods or means adopted by an auditor for the collection and evaluation of audit evidences for his audit work. Important audit techniques are

1) Vouching

2) Confirmation

It is the technique through which an auditor communicates with outside parties.

3) Enquiry

Enquiry is the technique of making enquiries with the responsible officials of the client and obtaining in depth information.

4) Reconciliation

It is the technique of identification and explanation of the items which cause the difference between two related items.

5) Physical examination

It is the technique of ascertaining the actual existence.

6) Test checking

7) Analysis of financial statements

8) Scrutiny or scanning

It is the technique of making a quick and overall examination of books of accounts to verify whether the transactions are correctly and completely recorded in the books of account.

#### 9) Extension verification

It is the technique of multiplying two or more amounts to verify whether the totals have been correctly arrived at.

#### 10) Posting verification

#### 11) Documentary examination

#### 12) Observation

It is the technique by which an auditor observes or witnesses an act performed by others.

#### 13) Footing

Footing is the technique of adding the columns of different accounting figures to test the accuracy of the total.

#### 14) Flow charting

It is the technique of using flow chart to describe graphically the cause of the transactions through different stages from the beginning to the end.

**Auditing and Assurance standards:** - An auditor Should have a thorough understanding of the auditing practices that are generally accepted as standards to conduct his audit effectively. For this purpose, he has to study and understand the professional announcement on auditing. The objective of auditing and assurance standards issued by the ICAI is to secure compliance by the members of the institute on matters which are important for the proper discharge of their audit work.

Various Auditing and Assurance Standards issued by ICAI :

1. AAS 1 : Basic principles governing audit
2. AAS 2 : Objective and Scope of financial Audit
3. AAS 3: Documentation
4. AAS 4: Fraud and error
5. AAS 5 : Audit Evidence
6. AAS 6 : Risk Assessment and Internal Control
7. AAS 7 : Relying upon work of an Internal Auditor
8. AAS 8 : Audit planning
9. AAS 9: Using the Work of an Expert.
10. AAS 10 : Using the work of another Auditor.
11. AAS 11 : Representation by Management.
12. AAS 12 : Responsibility by joint Auditors.
13. AAS 13 : Audit Materiality
14. AAS 14: Analytical Procedures.
15. AAS 15 : Audit Sampling.
16. AAS 16: Going Concern Assumption.
17. AAS 17: Quality Control for Audit work.
18. AAS 18 : Audit of Accounting Estimate
19. AAS 19 : Subsequent events.

20. AAS 20 : Knowledge of the Business

21. AAS 21: Consideration of Laws and regulations in an Audit of Financial Statement.

22. AAS 22 : Initial Engagement

23. AAS 23 : Related Parties

24. AAS 24: Audit Consideration relating to Entities using Service Organisations.

25. AAS 25: Comparatives

26. AAS 26 : Terms of Audit Engagement

27. AAS 27 : Communication of Audit Matters with those entrusted with Governance.

28. AAS 28 : Auditor's Report on Financial Statements.

29. Audit in Computer information system Environment

AAS – 1 :Basic principles governing an audit: - The basic principles governing an audit are:

1. Integrity, objectivity and independence: - This principle suggests that an auditor must be straight forward, honest sincere, fair and objective in the performance of his professional duties.

2. Confidentiality: - This principle implies that the auditor must not disclose any information acquired by him in the course of his audit work to any person.

3. Skills and Competence: - This principle means that an audit should be performed and the audit report should be prepared

with due professional care by persons who have adequate training, experience and competence in auditing.

4. Work performed by Others: - This principle implies that when an auditor delegates his work to his assistants or uses the work performed by other auditors and experts, he will continue to be responsible for performing and expressing his opinion on the financial statement.

5. Documentation : - This principle implies that all matters which are important in providing evidence that audit was carried out in accordance with basic principles should be adequately documented.

6. Planning : - This principle suggests that an auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.

7. Audit evidence : - This principle implies that an auditor should obtain sufficient appropriate evidence to draw reasonable conclusions.

8. Accounting system and Internal Control : - This principle suggests that an auditor should reasonably assure himself that the accounting system and internal control are adequate.

9. Audit conclusion and reporting : - This principle implies that an auditor should review and assess the conclusions drawn from the audit evidence obtained.

AAS – 2: Objective and scope of Financial Audit: - This Standard deals with ( a) the objective of an audit, namely, the expression of an opinion on the financial statements and ( b) the scope of audit, which is determined by the terms of the engagement, requirement of the law and the pronouncements of



the ICAI. As per these standards an auditor is required to satisfy himself as to reliability and sufficiency of information as contained in the accounting records.

AAS – 3: Documentation: - This standards deals with documentation of important evidentiary matters. It provides detailed guidance on the form, content and custody of working papers. Working papers are the written private materials which an auditor prepares for each audit. They describe the accounting information which he has received from his client, the method of examinations used and conclusions about the financial statement

AAS – 4 : Fraud and Error : - This standard deals with an auditor's responsibility for detection of fraud and error, while carrying out an audit.

AAS – 5: Audit evidences: - This standard deals with an auditor's duty to obtain sufficient appropriate evidence which enables him to draw reasonable conclusions.

AAS-6: Risk Assessment and internal control: - This standard deals with the procedures to be followed by an auditor to obtain an understanding of the accounting and internal control system and audit risk.

AAS – 7 : Relying upon work of internal auditor: - This standards seeks to provide guidance regarding the procedures to be followed by the external auditor in assessing the work of an internal auditor.

AAS – 8 : Audit Planning : - This standards lists the advantage of audit planning which is necessarily to conduct an effective audit in an efficient manner.

AAS – 9 : Using the work of an expert: - This standard recognizes the need for an auditor to use the work of an expert for any work.

AAS – 10: Using the work of another auditor: This standard highlights the procedure to be followed by principal auditor while using the work .

## **MODULE 2**

### **PROCEDURE OF AUDIT**

Audit procedure refers to the way in which the audit work should be conducted. It is the procedure followed by an auditor for the actual conduct of his audit work. There are certain aspects of audit procedure which are common in all audit works. They are:

1. **Routine checking:-** The checking of castings and postings of the common books of the organization is called routine checking. In other words it is the checking of subsidiary books and ledger accounts by an auditor. Routine checking involve the following operations,

- Checking of the castings, sub castings, carry forward and other calculations in the books of original entry
- Checking of the postings into the ledgers
- Checking of the casting and balances in the ledgers
- Checking of the transfer of the balances from the ledgers to the trial balance.

Generally, routine checking is conducted for the following books

- ✕ Cash book
- ✕ Petty cash book

×	Purchase book
×	Sales book
×	Purchase return book
×	Sales return book
×	Bills receivable book
×	Bills payable book
×	Journal proper
×	Sales ledger
×	Purchase ledger
×	Private ledger
×	Wages and salaries book
×	Stock sheet

### **Advantages of routine checking**

1. It facilitates thorough checking of the books original entry
2. Under routine checking, postings are completely checked
3. It helps in verifying arithmetical accuracy of the entries in the books of accounts
4. Clerical errors and simple frauds are located by routine checking

5. Checking of posting and casting is helpful in preparation of trial balance
6. It is easy and simple job which can be done by any audit clerk

### **Disadvantages of routine checking**

1. It can reveal only arithmetical errors and ordinary fraud
2. It is a mechanical checking, so it causes monotony
3. It is not important in the audit of a concern where self balancing system is in operation

### **II. Test checking or sample checking or selective verification:-**

Test checking means checking by an auditor, a few transactions selected at random here and there so as to form his final judgement on the whole set of transactions. It means to select and examine representative sample from a large number of similar items. Test checking involves sampling. One objective of test checking is to arrive at characteristics present in the mass transactions from the checking of representative sample.

### **Conditions or essentials or precautions of test checking:-**

1. The success of test checking largely depends upon the system of internal check in operations the business.
2. The sample selected for test checking should be at random.
3. It should be applied only to homogeneous transactions.

4. The sample of test checking should be selected without bias.
5. One selection of sample should be made in such a way that it covers the work of each of the staff of the client.

Test checking should not be applied to cash book items. No indication should be given to client as regards the method of test checking. One sample for test checking should be selected by the auditor himself. There are certain transactions which are not suitable for test checking. They are;

1. Opening and closing entries.
2. Cash book entries.
3. Transactions of seasonal industry.
4. Non recurring transactions.
5. Bank reconciliation statement.
6. Items which are significant.
7. Transactions which are required by law is to be checked carefully.

**Advantages:-**

1. It helps the auditor to complete the audit work in a short time.
2. It helps in reducing the cost of audit.
3. It enables the auditor to undertake the audit of many concerns simultaneously.

4. It keeps the client staff alert and conscious.
5. If selection is done intelligently, test checking ensures the accuracy of books of account.
6. It ensures the periodic examination of the system of internal check.

### **Disadvantages:-**

1. Test checking may fail to detect errors and frauds, if selection is not done intelligently.
2. Test checking increases the responsibility of the auditor.
3. Where there is test checking, the staff of the client may become careless.
4. Through test checking, an auditor may not get a true position of the financial state of affairs of an undertaking.

### **Surprise checks**

Surprise checks constitute a system under which an auditor makes a surprise checking of some of the important items. Surprise check, wholly cover;

1. Verification of cash.
2. Verification of investment.
3. Verification of records relating to stocks and stores.
4. Verification of books of original entry.

## **Audit in Depth:-**

Audit in depth means the examination of the selected items in depth or in detail from the origin of the transactions to fair conclusions. In other words, it means step by step verification of selected items or transactions from the beginning to the end.

## **Adoption of distinctive ticks ,tick ,marks or check marks:-**

In the cause of audit work, an auditor uses variety of marks or symbols to indicate the work that has been done. These marks or symbols are known as ticks or check marks or check signs. Ticks are much significant to an auditor. They are useful to the auditor in the following respects;

- Ticks help the auditor to know the checking that has been done by the earlier.
- By means of ticks made earlier, an auditor can easily find out the alterations in the books account made subsequent to the audit.
- Ticks facilitates tracing of processes and documents connected with the transactions and thereby increase the efficiency of audit.

## **Points to be noted or precautions to be taken while using ticks:-**

- 1) Different types of ticks should be used for different audit works.
- 2) Ticks should be small.
- 3) It should be clear.



- 4) It is advisable to use only pens or ball pens.
- 5) It is advisable to use ticks of different colours for different purposes.
- 6) Tick should not get mixed up with the figures shown in the books of account.
- 7) Ticks used by the client staff are not used by the audit staff.
- 8) Special ticks must be used for items which require special attention.

### **Vouching:-**

Vouching is the act of checking or examining the entries made in the books of account with the supporting the documentary evidences or vouchers. In the words of .L.R DICKSEE ,”Vouching is an act of comparing entries in the books of account with the documentary evidence in support thereof”.

### **Objectives of vouching:-**

- 1) The principal objective of vouching is to ensure that the transactions, as recorded in the books of accounts, are acceptable, genuine, properly authorised and correctly recorded.
- 2) Another objective of vouching is to ensure that all the entries made in the books are supported by necessary documentary evidence.
- 3) To see that all the transactions connected with the business have been recorded in the appropriate books of account.
- 4) To ensure that no transactions, which is not connected with the business, has been recorded in the books of accounts.

5) Detection of errors and frauds.

**Importance of vouching:-**

Vouching constitutes the foundation upon which the super structure of auditing is erected. It is the back bone of auditing. In the words of F.R.M De Paula, vouching is the essence of audit. Vouching can be regarded as the essence or back bone of auditing for the following reasons.

- a) The success of an audit largely depends upon the care and attention with which vouching is accomplished.
- b) Vouching is the most potent tool in the hands of an auditor to ascertain the accuracy of the transactions recorded in the books of account.
- c) To see that all the transactions connected with the business have been recorded in the appropriate books of account.
- d) To ensure that there are no transactions, which are not connected with the business, has been recorded in the books of accounts.
- e) Detection of errors and frauds
- f) Vouching ensures the arithmetical accuracy of the books of account.
- g) If vouching is done with care and caution, the auditor can smoothly proceed further in his work.

**Vouchers:-**

A voucher is the documentary evidence in support of a transaction recorded in the books of account. It is a documentary

evidence of an entry in a book of account. The following are the some of the examples of vouchers:

- a) Receipt obtained from a payee.
- b) Counter foil of a receipt.
- c) Purchase invoice.
- d) Sales invoice.
- e) Cash memo.
- f) Bank pay-in-slip.
- g) A contract or an agreement.
- h) A resolution passed at the meeting of the board of directors.
- i) Minutes of a meeting.
- j) Bought notes.
- k) Sold notes.
- l) Debt note.
- m) Credit note.
- n) Wages sheet.
- o) Salary register
- p) Goods inward book.
- q) Goods outward book.

### **Types of vouchers:-**

1) Primary vouchers:- a primary voucher is written evident in original. Purchase invoice, cash memos for goods purchased etc. are examples.

2) Collateral or secondary vouchers:- even evidences in original are not available, copies of the evidences are produced in support. Again, sometimes, subsidiary evidences are also provided for the purpose of audit. Such vouchers are usually known as collateral or secondary vouchers.

### **Essentials of vouchers or points to be noted by the auditor while vouching**

#### **the vouchers:-**

1) Vouchers are consecutively numbered, arranged serially in the order of the entries and are properly filed.

2) Vouchers are in the name of the client.

3) See the teach voucher is genuine on its face.

4) Voucher is certified as correct by a responsible official.

5) The amount of each voucher is written in words and figures.

6) Every voucher, which is a receipt for cash payment over Rs 5000 bears a revenue stamp of Rs1

7) Alteration made in a voucher is properly signed by the maker and approved by a responsible official.

8) Any explanation is desired with to any voucher, the same should be noted in the audit note book.

9) Missing vouchers produced, the auditor should do,

a) Prepare a list of all such missing vouchers

b) Call for explanation from the concerned official from the loss of original vouchers

10) If any voucher requires a special scrutiny, the auditor should proceed cautiously and use special ticks for checking.

11) As far as possible the auditor should complete the vouching work relating to a particular period in continuous sitting.

12) The auditor should not take the help of any staff while vouching the vouchers.

13) Test checking may be resorted only in exceptional circumstances.

### **Vouching of cash book or cash transactions.**

Cash transactions take place almost every day in business. An auditor should give care and attention to the vouching of cash transactions. The main objectives of vouching of cash transactions are,

1) To ensure that all receipts of cash are duly accounted for.

2) To ensure that no improper payments are made.

3) To see that all receipts and payments of cash are actually and properly recorded.

4) To see that all payments have been made to proper persons and the payments are true payments.

5) To see that cash and bank balance correct and really exist.

Vouching of cash book or cash transaction covers the vouching of receipt side and vouching of payment side.

### **Vouching of receipt side or debit side of cashbook or cash receipt**

#### **transactions:-**

Vouching of cash receipt transactions is more difficult than that of cash payment transactions, since there is greater chance of manipulation in regard to cash receipt. The auditor should bear in mind the following points, while vouching the cash receipt transactions.

- 1) The auditor should carefully examine the system of internal check in operation with regard to cash receipt transactions.
- 2) An auditor can resort to test checking only if he has satisfied himself that there is an efficient system of internal check.
- 3) He should ascertain whether a diary of cash receipt or rough cash book has been in use. If a rough cash book has been in use, he should examine the entries in the rough cash book and compare with the entries in the ash book.
- 4) He should examine the methods of depositing daily receipts into the bank.
- 5) He should check the bank pass book with the entries in the cash book.
- 6) He should vouch cash receipts by reference to documentary evidences.
- 7) He should enquire into the system of allowing documents, the rate of discount allowed etc.

8) He should enquire into the bad debts written off. He should satisfy himself the bad debt written off are authorized by a responsible person. He should ensure whether there is a proper control over use of receipt book. In this context, he should keep in mind the following points:

- a) All receipts are on printed forms.
- b) See that receipt book should be consecutively numbered.
- c) The receipts have to be signed by a responsible officer.
- d) The unused receipt book should be kept in safe custody.
- e) All spoilt receipts should remain attached to the counter foils.

**Vouching of the important items on the debit side of the cashbook or cash receipt transactions.**

**1) Opening balance:-**

The opening balance of the cash book should be vouched by comparing it with the closing balance of cash book as shown in the audited copy of the balance sheet of the previous year,

**2) Cash sales:-**

The vouching procedure in regard to cash sales should be on the following lines:

1. He should examine the system of internal check in operation in regard to cash sales.
2. After ascertaining the efficiency of the internal check system as regards cash sales, auditor should vouch the cash sales as follows:

- a) Cash memos written by the salesman should be checked with the summery sales prepared at the end of the day.
- b) He should examine the rough cash book, if any.
- c) He should check up the rough cash book with the main cash book.
- d) The summaries of daily sales should be checked with the entries in the stock register.
- e) He should verify the daily deposit of cash received into the bank, pay-in slip also should be vouched.

### **3) Receipts from debtors:-**

While vouching the receipts from debtors, an auditor should bear in mind the following points:

1. He should enquire into the system of internal check in operation in regard to the receipt from debtors.
2. After satisfying himself about the efficiency of internal check in operation in regard to the receipt from the debtors, the auditor should conduct the vouching of receipts on the debtors on the following lines:
  - a) He should check the total cash received from the debtors by verifying the rough cash book with the counter foils of the receipts issued to customers.
  - b) He should check the cash book with the rough cash book.
  - c) He should check the details of cash and cheques paid into the bank.



- d) He should enquire into whether bad debts are written off by a competent authority.
- e) He should verify the balances due as per the schedule of debtors with letters of confirmation received.
- f) He should be alert to the possibility of teeming and lading.

#### **4). Receipts from bills receivable:-**

Bills receivable include bills of exchange, promissory notes, and I.O.U's received from debtors. The receipts from bills receivable can be in two ways:

##### **1). Receipts from bills discounted**

The vouching of receipts from bills discounted should be as follows:

- a) The amount of cash received from bills discounted should be checked by comparing the bills discounted book with the cash book, pass book, B/R book.
- b) See that proper records have been made in the books for discount on bills discounted.
- c) He should determine the contingent liability in respect of bills discounted but not matured on the date of the balance sheet.

##### **2). Receipts from bills matured**

- a) The auditor should check the cash received from bills matured by comparing the bills receivable book with the cash book and the pass book.
- b) Special attention should be given to bills which have matured but remain unpaid.

### **5). Receipts from sale of investment**

Vouching of receipts from the sale of investment should be on the following lines:

- a) Investments are usually sold through brokers, as such, broker's sold notes or contract notes should be examined to vouch the amount from the sale of investments. If the sale of investment has been effected through the bank, then, the bank advice should be examined to vouch the amount received from the sale of investments.
- b) The sale proceeds of the investments should also be checked with the related investment account with the stock market quotations.
- c) If the investment has been sold cum-dividend, the auditor should see that the sale proceeds are properly apportioned between capital and revenue receipt.
- d) If the investment has been sold ex dividend, the auditor should see that the dividend is received and recorded.
- e) He should see that the profit or loss on the sale of investment is properly adjusted.
- f) If the investments are pertain to some ear marked funds, the auditor should see that the profit or loss on the sale is transferred to the ear marked fund a/c.

### **6). Receipt from the sale of fixed assets**

Vouching of receipts from the sale of fixed assets should be on the following lines:

- a) The auditor should see that the sale of fixed asset is properly sanctioned.
- b) If the sale of fixed assets is through a broker, the proceeds of the fixed assets sold should be vouched with the help of sold notes. In the case of sale of fixed assets is through an auctioneer, the sale proceeds should be vouched with the help of the auctioneer's note. He can verify the cash receipt in the cash book with the counter foil or carbon copy of the receipt issued to the party. He may also vouch the sale proceeds of fixed assets with the correspondence with the parties and the sale contracts and the fixed asset a/c.
- c) He should see that proper fixed asset a/c has been credited with the sale proceeds.
- d) If there is any profit, the auditor should see that it is credited to capital reserve.
- e) In the case of certain prepaid expenses in respect of fixed assets, the auditor should check whether suitable adjustments are made in the expenses accounts.

## **7). Loan received**

Vouching of loan received should be on the following lines:

- a) He should ascertain that whether client is empowered to borrow money.
- b) In the case of a joint stock company, he should verify whether the legal provisions have been complied with.
- c) He should verify the loan agreement to ascertain the terms and conditions on which the loan has been received.

- d) If the loan is secured, he should ascertain what security has been offered and the value of security offered.
- e) He should ensure that the loan amount received is recorded in the books of account.
- f) If the interest on loan is unpaid, the auditor should see that it is properly adjusted.

#### **8). Dividend on investment**

- a) The auditor should verify the dividend received is recorded in the cash book with the counter foils of the dividend warrants.
- b) To see that dividends have been received in the dates.
- c) If the dividend is sold ex-dividend, see that dividends are subsequently received are entered in the cash book and credited to dividend account.

#### **9). Subscription received**

#### **10). Insurance claim received**

#### **11). Commission received**

#### **12). Rent received**

#### **13). Royalty received**

### **Vouching of cash payments or credit side of the cash book.**

While vouching cash payments, an auditor should pay attention to the following points.

- 1) All vouchers relating to cash payments should be serially numbered and properly arranged.

- 2) He should insist that the vouchers are properly dated.
- 3) He should evaluate the system of internal check in operation with regard to cash payments and satisfy himself as to the efficiency of the internal check.
- 4) He should see that:
  - a) The cash payments are for the purpose of the business.
  - b) Payments are related to the period under audit.
  - c) The payments is properly sanctioned or authorized.
  - d) The payments are made to the right person.
  - e) The payments are supported by proper vouchers.
  - f) The payments are properly recorded in the cash book.
- 5). Examine the rough cash book items and compare it with the main cash book.
- 5) See that the payments made are posted to the concerned accounts.
- 6) See that the amount appears in the vouchers both in words and figures and it agrees with the amount in the cash book.
- 7) Ensure that the payments have been passed as correct by a responsible official.

## **Vouching of different items on the payment side or credit side of the cash book**

### **1) Opening credit balance**

The opening credit balance in the bank column can be verified from the previous year's audited balance sheet.

### **2) Cash purchases**

The vouching of the cash purchases should be on the following lines.

- 1) The auditor should examine entries in the cash book with the help of cash memos or invoices issued by the supplier and also goods inward book.
- 2) Special attention should be paid to trade discount, which should be deducted from purchase.
- 3) See that the cash paid for the goods have actually received.
- 4) He should see that the purchases are duly authorised.
- 5) He should see that the amount paid is debited to the appropriate account.
- 6) To ascertain whether payment made for cash purchases relates to the business.

### **3). Payments to creditors**

Vouching of payment to creditors should be on the following lines.

- 1) Payments to creditors may be vouched with the receipts issued by the creditors.

- 2) He should check the amount due to the creditors with the accounts of the creditors.
- 3) Examine the goods inward book and see that goods have actually been received.
- 4) The auditor should verify the periodical statement of accounts.
- 5) In the case of purchase made before the close of the year, see that goods not actually received are kept out of the closing stock of the year.

#### **4). Payment of bills payable**

Payment of bills payable on their maturity should be vouched on the following lines.

- 1) The payment of bills payable, as recorded in the cash book, should be vouched with the bills payable book and also with the bills payable returned by the payees.
- 2) If the bills payable are through the bank, the auditor should examine the bank pass book for the payment.
- 3) He should see that bills payable paid and returned by the payees are cancelled.

#### **5). Vouching of loans advanced**

Loans advanced should be vouched by the auditor on the following lines.

- 1) He should see that loans advanced are properly authorised.
- 2) He should examine the loan agreement.

3) He should vouch the loan advanced as recorded in the cash book with the loan agreement also with the receipt given by the borrower.

4) If the loan is advanced against any security, the auditor should examine the security and its title deeds.

5) Examine the mortgage deed, if the loan is advanced against mortgage.

6) See that the provisions of the companies Act as regards the granting of loans to directors and officers of the company are complied with.

#### **6). Purchase of investment**

Vouching of purchase of investment should be on the following lines.

1) The auditor should see that the purchase of investment is properly authorised.

2) If the investments are purchased through a broker, he should vouch the investments purchased with the broker's note.

3) If the investments are purchased through the bank, he should examine the bank pass book to check the payment.

4) He should make a physical verification of the investment purchased.

5) If the investments are purchased cum interest, he should see that the payment made is properly allocated between capital and revenue.



6) See that investments purchased are registered in the name of the client.

7) In the case of accompany, the auditor should see that investments have been purchased in accordance with the provisions of the companies Act.

### **7). Payment of capital expenditure**

The payment of capital expenditure refers to the payment made for the acquisition of the fixed assets such as land & building, plant & machinery, patent, copy right, furniture etc. Vouching of payment of capital expenditure should be on the following lines.

1) The auditor should see that the payment of capital expenditure is properly authorised.

2) He should examine the document pertaining to the purchase and ownership of the fixed assets.

3) He should examine the invoices and the receipts obtained from the suppliers to ensure that payments have been made.

4) He should see that all expenses incurred for the acquisition are capitalised.

5) He should see that repairs and maintenance expenses incurred are charged to revenue account.

6) He should physically examine the fixed assets purchased.

7) He should vouch the cash boom entries for the payment of capital expenditure with the concerned ledger account.

8) See that property purchased is registered in the name of the client.

## **Vouching of payment made for the acquisition of patents**

Vouching of payments made for the acquisition of patents should be on the following lines.

- 1) If the patent has been purchased, the auditor should vouch the payment made for the patent with the help of the contract for sale and the receipts for the payment obtained from the seller.
- 2) If the patent has been purchased through an agent, the auditor should vouch the agent commission with the help of agents account and receipt given by the agent. He should see that the agent's commission is capitalized.
- 3) He should see that expenses incurred on the purchase of the patent are capitalized.
- 4) Where the patent is acquired through research, the auditor should see that all the expenses incurred on the experiments and the research connected with patents are capitalized.
- 5) He should see that payments made towards the renewal fee are charged to revenue account.
- 6) He should actually see the patent.

## **Vouching of wages**

The object of vouching wages is to ensure that the payment for wages as recorded in wage sheet and cash book, were actually made properly authorized and were correctly maintained.

Vouching of payment of wages should be done in the following lines.

- 1) He should enquire into the system of internal check in force in regard to the maintenance of wage records, preparation of wage sheet and payment of wages.
- 2) If the internal check is effective, the auditor can conduct the vouching of wages on the following lines.
  - a) He should check a few items of wage sheets here and there to ensure that the calculations are correct.
  - b) He should check totals of wage sheet with the cash book.
  - c) He should see that the amount of cheque drawn for wages tallies with the totals of wage sheet.
  - d) He should see that deduction from wages have properly adjusted and recorded in the books.
  - e) He should see that wages recorded in the cash book have actually been paid.
  - f) He should examine the system of employment of casual labour and check the payment made to casual labour.
  - g) He should see that proper record is maintained for unpaid wages.
  - h) Wages for the current months should be compared with the wages of the previous month. If there is a material difference, the auditor should enquire into the reason for the difference.

### **Vouching of salaries**

Vouching of payment made for salary should be on the following lines.

- 1) An auditor should enquire into the system of internal check in operation in the concern in regard to the payment of salaries.
- 2) If the internal check system in regard to the payment of salaries is sound, an auditor can conduct the vouching of salaries on the following lines.
  - a) He should see that the salary bill is prepared with the sanction of a responsible officer.
  - b) He should see that the salary register is duly signed by each employee and counter signed by a responsible official.
  - c) He should check the salary register with the entries in the cash book.
  - d) He should see that the deduction for provident fund, life insurance premium, income tax etc have been correctly made and properly recorded in the books.
  - e) For vouching salaries of the secretary, manager and other important officials, the auditor should examine the board's minutes book.
  - f) He should check the attendance register.
  - g) He should compare the salary bill for the current month with the salary bill of the previous month. If there is any material difference, enquire into the reason for the difference.
  - h) He should see that the total of the salary book for a particular month agrees with the cheque drawn for salaries.

## **Vouching of petty cash book.**

Vouching of petty cash book should be on the following lines.

- 1) He should examine the system of internal check in force in the business in regard to the petty cash transactions.
- 2) If he finds that the system of internal check is sound, he should adopt the following lines.
  - a) He should find out find out the system of petty cash book.
  - b) He should ascertain the name of the petty cashier to the amount of the imprest.
  - c) He should check some petty cash payments at random with the vouchers to ensure the correctness of the petty cash payments.
  - d) He should see that all petty cash payments over a certain amount are supported by proper vouchers.
  - e) He should see that petty cash payments not supported by proper vouchers are supported by slips by the officer who have spent the amounts.
  - f) See that the petty cash book is periodically checked and initiated by some responsible officer.
  - g) See that the petty cash balance as shown in the petty cash book agrees with petty cash balance as shown by petty cash account.
  - h) He should check the casting of total payment column and the individual expenses column.

- i) He should physically count the petty cash balances on the balance sheet date. If he fails to do so, he will be held liable for damages. This was upheld in the case of London Oil Storage Company Limited v/s Sears Hasluck and Company.
- j) He should see that I.O.U.s are not included in the petty cash balances.

### **Vouching of trading transactions**

Vouching of trading transaction is concerned with credit purchases, credit sales, purchase returns, and sales returns are entered in the purchase book, sales book, purchase return book and sales return book respectively. So vouching of trading transactions also means that vouching of purchase book, sales book, purchase return book, and sales return book. One main object of vouching of trading transaction is to detect misappropriation of goods, if any.

### **Vouching of credit purchases or vouching of purchase book.**

The main objective of vouching of purchase book or credit purchases is to ensure that all purchase invoices are entered in purchase book, that goods entered in the purchase book are actually received and the business pays only for those goods which are delivered by the suppliers. Firstly, an auditor should examine the system of internal check in force in the business in regard to credit purchases. If the system of internal check is not sound, he should check all the entries in the purchase book in detail. If the system of internal check is sound, he need not check all the entries in the purchase book in detail. He has to vouch the credit purchases on the following lines:

1) He should examine the inward invoices from which entries are made in the purchase book. While examining an inward invoice, an auditor should pay attention to the following points:

- a) The invoice is in the name of the client.
  - b) The date given in the invoice relate to the period under audit.
  - c) The invoice is related to the business in which the concern deals.
  - d) The invoice is initiated by a responsible officer.
  - e) The trade discount has been deducted from the amount of invoice and then only net amount has been entered.
  - f) Quantity mentioned in the purchase invoice tallies with the quantity recorded in the purchase book.
- 2) He should check the purchase invoices with the purchase book, where the credit purchases are recorded.
- 3) He should see that only credit purchases are recorded in the purchase book.
- 4) He should see that purchases not made for the business are not recorded in the purchase book.
- 5) He should see that purchases of capitals assets are not included in the purchase book.
- 6) He should see that all goods received prior to the date of closing and taken into stock are recorded in the purchase book.
- 7) He should see that goods entered in the purchase book but not received are included in the closing stock.

- 8) He should verify some of the purchase invoices with the goods inward book, stock records and the challans from the suppliers to see that the goods have actually received.
- 9) He should compare some of the entries in the purchase book with the order book and goods inward book to ensure that no fictitious purchases are recorded and no invoice is entered twice.
- 10) To ensure that all invoices are included in the purchase book, the auditor should obtain the statement of accounts from the creditors and examine them.
- 11) He should make a list of all invoices missing or not available.
- 12) Where contracts for forward purchases are entered into, the auditor should see that they are not abnormal. If they are abnormal in amount, he should see that it is mentioned in the balance sheet by way of note.
- 13) He should check the casts and carry forwards to the purchase book.
- 14) He should check the postings from the purchase book to the purchase account as well as to the creditors account.
- 15) He should check carefully the purchase made in the first month and the last month of the accounting year, because, sometimes, purchases made in the last month of the last year may be included in the purchase of the current year or purchase made in the last month of the current year may be included in the purchases of the first month of next year.



## **Vouching of credit sales or vouching of sales book.**

Outward invoices, which are the vouchers for the credit sales, are not completely reliable, as they are prepared by the staff of the business. So an auditor has to be very careful in vouching credit sales. Firstly he should examine the following lines:

1) He should examine the outward invoices from which entries are made in the sales book. While examining the outward invoices, he should pay attention to the following points:

a) See that name of the customer stated in the outward invoice agrees with the entry in the sales book.

b) The date given in the outward invoice relate to the period under audit.

c) The invoice is initiated by a responsible officer.

d) See that trade discount allowed is deducted from the sales price and net amount has been entered.

2) He should check the outward invoices with the sales book, where the credit sales are recorded.

3) He should check the sales book with the order received book and see that the sales are genuine and all the sales are included in the sales book.

4) After the examination of outward invoices, the auditor should see that they are cancelled by stamping out and all the cancelled invoices are kept together for verification.

5) He should see that only credit sales are recorded in the sales book.

- 6) He should see that sales of capital assets are not included in the sales book.
- 7) See that good sent on sales or return or on consignment are not entered in the sales book.
- 8) He should see that good sold, but not delivered are not included in the closing stock.
- 9) He should check the casts and carry forwards of the sales book.
- 10) He should check the postings from the sales book to the sales account and customer accounts in the ledger.
- 11) He should check carefully the sales made in the first month and the last month of the accounting year, because, sometimes, sales made in the last month of the last year may be included in the sale of the current year or sale made in the last month of the current year may be included in the sales of the first month of next year.
- 12) If the trade discount allowed during the current year is exceptionally high, the auditor should enquire in to the reasons for the same.
- 13) Where the sales are subject to sales tax, the auditor should see that the sales tax collected is separated from the sales price, and is shown in a separate column in the sales book.
- 14) Sometimes, fictitious sales are included in the sales book to inflate the sales and the gross profit, an auditor has to take necessary steps to discover such fictitious sales.

### **Vouching purchase returns or purchase returns book.**

An auditor should undertake vouching of purchase returns on the following lines:

- 1) He should enquire into the system of recording of purchase returns.
- 2) He should vouch the purchases returns book with the credit notes received from the creditors.
- 3) He should examine the goods outward book and the related correspondence to ensure that there is no suppression of purchase returns.
- 4) He should check the casts and carry forwards of purchase returns book.
- 5) He should check the postings from the purchase returns book to the purchase returns account and customers account in the ledger.
- 6) He should check carefully the entries in the purchase returns book for the first month and for the last month of the year to ensure that there is no manipulation of accounts.

### **Vouching of sales returns or sales returns book**

- 1) He should enquire into the system of recording sales returns.
- 2) He should vouch the sales returns book with the credit notes issued.
- 3) He should examine the goods inward book and the related correspondence to ensure that there is no suppression of sales returns.

- 4) He should check the casts and carry forwards of sales returns book.
- 5) He should check the postings from the sales returns book to the sales returns account and customers account in the ledger.
- 6) He should check carefully the entries in the sales returns book for the first month and for the last month of the year to ensure that there is no manipulation of accounts.

### **Vouching of journal proper**

Journal proper is meant for recording all those transactions which cannot be recorded in the other subsidiary books viz purchase book, sales book, purchase return book, sales return book, cash book, B/R book, B/P book. The following entries are recorded in the journal proper:

- 1) Adjusting entries.
- 2) Transfer entries.
- 3) Closing entries.
- 4) Rectification entries.
- 5) Entries for purchase and sale of assets on credit.
- 6) Opening entries.
- 7) Entries for consignment.
- 8) Entries for application for shares, allotment on shares and calls on shares.

An auditor should vouch the journal proper on the following lines:

- 1) He should see that every entry in the journal proper is supported by a voucher or evidence.
- 2) He should see that every entry in the journal proper is explained by narration.
- 3) When the evidences are not available for some entries in the journal proper, the auditor should check those entries from the evidence of parties.

### **Verification of assets and liabilities.**

Verification means ‘proving the truth’ or ‘confirmation of the truth’. Verification of assets and liabilities means proving the truth about the existence and the correctness of the money value of the assets and liabilities appearing in the balance sheet of the business. In other words, it means establishing the actual existence of the assets and liabilities appearing the balance sheet, ownership and possession of the assets and proper classification and valuation of assets and liabilities.

### **Objects of verification of assets and liabilities.**

- 1) To find out whether assets and liabilities shown in the balance sheet actually exist.
- 2) To ascertain whether the assets and liabilities appearing in the balance sheet are shown at their correct values.
- 3) To confirm the possession and ownership of the assets appearing in the balance sheet.
- 4) To find out whether there is proper classification of assets and liabilities.
- 5) To check the arithmetical accuracy of the books of accounts.

6) To ascertain whether the balance sheet gives a true and fair view of the financial position of the business.

### **Difference between vouching and verification.**

1) **Nature:-** vouching is the examination of the business transactions recorded in the books of original entry, whereas verification is the examination of assets and liabilities appearing in the balance sheet.

2) **Objectives:-** vouching is done to examine the correctness and the authenticity of the business transactions recorded in the books of original entry. But verification is undertaken to confirm the values of assets and liabilities of the business as shown in the balance sheet.

3) **Work begins:-** verification of assets and liabilities are undertaken after the vouching of the books of accounts. In other words, verification begins where vouching ends.

4) **Time:-** vouching is done throughout the year, whereas verification is done at the end of the year after the balance sheet is prepared.

5) **Scope:-** vouching does not include valuation of assets. But verification of assets includes the valuation of assets.

6) **Utility:-** vouching of books would only indicate that a particular asset or liability ought to exist. It does not indicate whether a particular asset or liability really exists at the date of the balance sheet. But verification proves whether the assets or liabilities really exist at the date of the balance sheet.

7) **Basis:** -vouching is based on documentary examination. On the other hand verification is based on physical as well as documentary examination

8) **Personnel:-** vouching is done by the staff of the auditor. But verification is done mostly by the auditor himself.

### **Valuation of assets.**

Valuation of assets means the determination of or the ascertainment of the money value at which the assets are shown in the balance sheet. However in audit it implies critical examination and testing of the determined values of the assets on the basis of generally accepted accounting principles. In short, it is the process of ensuring that the money value of the asset as shown in the balance sheet has been properly determined.

### **Objectives.**

- 1) To verify whether the assets shown in the balance sheet have been properly valued.
- 2) To indicate that the balance sheet represents a true and fair view of the financial position of the business.
- 3) To indicate that there is no manipulation of account to inflate or reduce the profit.

### **Auditors duty in regard to valuation of assets**

Valuation of assets is a difficult task. It requires technical knowledge. But an auditor has neither technical knowledge nor the time required for the valuation of assets. So an auditor can't be expected to do the valuation of assets. In short an auditor is not a valuer. The valuation of assets is done by the officials of

the business. Auditor has only to make an enquiry into the valuation of assets and satisfy himself that the value of assets are properly determined. This view was upheld in many cases. For example, the Kingston Cotton Mills company's case, it was held, it is no part of an auditor's duty to take stock. He must rely on other people for the details of the stock. An auditor has to critically examine the valuation and satisfy himself that valuation of assets has been properly made to satisfy himself that the values of assets are correct, an auditor should do the following:-

- 1) He should obtain all information available in respect of the valuation of assets.
- 2) He should critically examine and analyze the all figures of the valuation of assets.
- 3) He should verify whether the principles and practice of valuation of assets have been consistent from year to year.
- 4) He should verify whether the value of assets have been determined properly in accordance with the generally accepted accounting principles.
- 5) Wherever necessary he should take the assistance of technical experts for valuing the assets.
- 6) He should ascertain whether current values of assets are fair and reasonable. If the auditor does not exercise proper care and skill in the matter of enquiry into the valuation of assets. He will be held guilty of negligent or fraud. This was upheld in many cases- For example, in the case of Lease Estate Building & investment v/s shepherd, the auditor was held liable for the dividend paid out of the capital for several years, based on the wrong financial statement.



## **Classification of assets/types of assets for the purpose of valuation & mode of valuation**

### **1) Fixed assets**

They are acquired for permanent use in the business. It is not for resale in the ordinary course of business but for the purpose of enabling the business to earn profit. These assets will be in use for a pretty long period. Examples are land, building, plant, machinery, etc. Fixed assets are to be valued at original or historical cost less total depreciation written off (Going concern value).

### **2) Current assets (circulating or floating assets)**

Current assets are those assets, which are acquired for resale or produced for the purpose of sale or converting them into cash. Examples are stock, semi-finished goods, book debts, cash and bank balance, etc.....

Cash and bank balance- no valuation required

Book debts and bills receivable- valued at book value

Raw materials- first in first out or last in first out or average cost method

Closing stock-at cost price or market price whichever is lower.

### **3) Intangible assets**

Intangible assets are those assets, which cannot be seen or touched. Examples are good will, copy rights, patent etc. these assets are shown at cost price.

#### **4) Wasting assets**

Wasting assets are of fixed nature, which are depleted gradually or exhausted in the process of earning income. Examples are mines, quarries, oil wells etc. These assets are valued at original cost less provision for depletion.

#### **5) Fictitious assets**

These are neither physically visible nor realizable into cash. They are revenue expenditure that have been temporarily capitalized with the object of generating the amount over a period of years the benefit of which accrues. Examples are preliminary expenses, discount on issue of shares, advertisement suspense account etc.

#### **6) Contingent assets**

These are assets the existence, values and ownership of which depends up on the occurrence of a specified event. Examples are claim for refund of income tax, sales tax.

#### **Various values used for valuation.**

- 1) Cost price.
- 2) Market price.
- 3) Replacement.
- 4) Realized value.
- 5) Book value.
- 6) Breakup value.
- 7) Going concern value.

## **Difference between verification and valuation**

Nature: - In verification of assets, an auditor verify not only the actual existence of the assets but also their proper valuation. But in the case of valuation of assets, an auditor has to merely ensure that the values of the assets as shown in the balance sheet is correct.

1) Scope: - Verification includes valuation also. Valuation is a part of verification of assets.

2) Work begins: - Verification of assets comes in before the valuation of assets but valuation of assets follows verification of assets.

3) Responsibility: - In the case of verification of assets, the auditor is entirely responsible for the work. But in the case of valuation of assets is done by the owners. The auditor merely ensures that the values of the assets as shown in the balance sheet are correct.

4) Guarantee: - In the case of verification of assets, the auditor gives guarantee that the assets have been properly verified. But in the case of valuation of assets he does not give any guarantee.

5) Basis : -Verification of assets can be made by an auditor on the basis of physical inspection as well as documentary evidences. But for valuation of assets, he depends up on the estimates of the proprietor.

6) Chance of fraud : -In verification of assets, the chances of manipulation of accounts to inflate or deflate profit is less, but in valuation of assets, there is more chance of such frauds.

## **Classification of liabilities for valuation.**

### **Current liabilities**

Current liabilities are those liabilities of the business, which are short-term liabilities. They are to be settled within a period of one year. Examples are trade creditors, bills payable, outstanding expenses.

### **Fixed liabilities**

These are of long-term nature. Examples are long term loans borrowed, long term deposit received.

### **Contingent liability**

It is not an actual liability. It may become a liability on the happening or non happening of certain events in future. In short it is a liability which may or may not arise in the future for payment. Examples are liabilities in respect of bills discounted, guarantee given, compensation pending.

## **Verification and valuation of different assets.**

### **1) Freehold property**

Freehold property refers to the land and building which is absolutely the property of the business.

While undertaking the verification and valuation of freehold property an auditor should observe the following points:

#### **1) Examine the title deeds**

He should examine the title deed relating to freehold land & building to ensure that they are in the name of the client. If there

is any doubt relating to title of property, he should consult solicitors of the client.

2) Examine the conveyance or brokers account If the freehold property has been purchased, he should examine the correspondence, conveyance deed and broker's or auctioneer's account If the freehold property is consist of building constructed by the client the auditor should ask for and examine the architect's and the builder's certificates.

3) Capitalization of expenses He should see that if legal expenses, brokerage and other expenses are incurred for the acquisition of freehold property, they are capitalized.

#### 4) Mortgage of freehold property

If the freehold property mortgaged, auditor should get a certificate from mortgagee stating that the title deed are in his possession He should also make proper enquiry to ensure that there is no second mortgage on the freehold property If the title deeds of the freehold property are with a bank or solicitors for safe custody the auditor should get a certificate from the bank or the solicitor stating that they are held by him for safe custody and not as a security for any loan.

#### 5) Additions to free hold property

He should check additions to the freehold property, if any, made during the

year with the help of relevant vouchers. He should also see that the cost of

additions is capitalized.

#### 6) Sale of freehold property

If any freehold property sold during the year, an auditor should check such sales and see that profit or loss thereon is correctly dealt within the accounts.

#### 7) Repairs and renewals

He should see that repairs and renewals of freehold property are charged to revenue account.

#### 8) Provision for depreciation

He should examine the adequacy of provision for depreciation on free hold building.

#### 9) Appreciation of freehold building

If any appreciation of freehold building is taken into account, the auditor should see that appreciated value is clearly disclosed in the balance sheet. He should also obtain a certified copy of valuation of the property from a professional valuer.

10) Shown in the balance sheet See that the freehold property are shown separately in the balance sheet under the head fixed asset He should also see that freehold property are shown cost less depreciation In case freehold property is shown in the balance sheet in market value, the auditor must see that they are clearly mentioned in the balance sheet.

### 2). **Leasehold property**

Lease hold property refers to land and building acquired by a business for a fixed period on lease. While undertaking the verification and valuation of lease hold property an auditor should observe the following points.

1) Examine the lease deed He should examine the lease deed to ascertain the cost of leasehold property, the duration of the lease, terms and condition of the lease.

2) Registered If the lease is for more than one year the auditor should see that the lease deed is registered.

3) Amount capitalized

He should see that amount paid for lease property is capitalized.

4) Examine the receipt for the lease

He should see that the lease rent is paid regularly and lease is existing. For this purpose he should examine the last receipt of the payment of rent.

5) Examine the agreement with subtenant

He should see that the agreement with the subtenant is if it is sublet to others.

6) Addition to lease hold property: -

Verified with relevant vouchers that see that amount paid is capitalized.

7) Repairs and Renewals: - See that it is charged to revenue.

8) Provision for depreciation

9) Shown in the balance sheet

### **3). Plant and machinery**

While undertaking the verification and valuation of plant and machinery an auditor should observe the following points.

1) Examine the plant register

He should examine the plant register if it is maintained by concern.

2) Examine the schedule of plant and machinery

He should call for and examine the schedule of plant and machinery signed by the engineer.

3) Verify the plant and machinery purchased

He should verify the plant and machinery verified, plant and machinery purchased with the original invoice -----  
----- and agreement with the ventures.

4) Check the plant register with plant and machinery account

To ensure plant and machinery account and satisfy himself as to the value of plant and machinery.

5) Addition to the plant machinery

6) Sale and plant and machinery

7) Repairs and renewals

8) Provision for depreciation

9) Shown in the balance sheet

**4). Furniture and fixtures**

While undertaking the verification and valuation of furniture and fixtures an auditor should observe the following points.

1) Examine furniture stock register



2) Verify the price of furniture purchased with invoices and receipts

3) Physical verification

He should verify the physical existence of furniture by personal inspection.

4) Addition to the furniture and fixture

5) Sale of furniture and fixtures

6) Provision for depreciation

7) Method of depreciation

He should enquire into the method of depreciation as the amount on depreciation depends upon the use of the asset and the method of depreciation adopted.

8) Unserviceable furniture written off

He should see that the unserviceable furniture and fixtures are written off under proper authority.

9) Shown in the balance sheet

#### **4) Valuation of goodwill**

Goodwill is the value of reputation of an organization which enables the business to earn more than the normal rate of profit. While under taking verification and valuation of goodwill an auditor should observe the following points;

1) Goodwill purchased along with running business

When goodwill has been purchased along with running business from some vendors the amount of goodwill should be verified by the auditors from the purchase agreement with vendors, showing the price paid for the goodwill. Where the price paid for the goodwill is not specifically fixed, auditor should ensure that the amount of goodwill taken into account is the amount of purchase consideration, i.e, amount of purchase consideration over net assets taken over.

## 2) Goodwill arise by writing up the value of assets

When goodwill account has been arise by a company by writing up the value of its assets or the revaluation of assets, the auditor should examine the basis on which assets have been revalued and satisfy himself that the amount of goodwill brought into account is proper.

## 3) Goodwill created in the books of partnership firm

The amount of goodwill created in the book of partnership firm on the admission of a new partner or on the retirement or on death of an existing partner, should be verified by the auditor with the help of with the help of the partnership deed. The auditor can also verify the changes made in the goodwill account from time to time on the basis of the provisions of the partnership deed.

## 4) Valuation of goodwill

Valuation of goodwill is a matter of financial policy, to be decided by the management of the business. The auditor can't interfere in the valuation of goodwill, though he may give his advise on the valuation of goodwill. For the valuation of goodwill the auditor is just to see that the goodwill is shown in the balance sheet at its proper value.

5) Insist upon writing off goodwill

If it appears to him that the future benefit associated with the goodwill does not exist, he should insist on writing off the goodwill.

6) Shown in the balance sheet

An auditor should see that goodwill valued at cost less amount written off and shown in the balance sheet.

**7) Verification and valuation of patent right**

1) Examine the schedule or list of patent right.

2) Verify the patent right with the help of certificates of patents.

3) Ensure that the patents have registered in the name of the client.

4) Patent right are developed by the research work

If the patent right are developed by concern by doing some research work, the cost of research and development should be capitalized. Similarly if the patent right have been purchased, the cost of purchases of patent should be capitalized.

5) Renewal fee should be charged to revenue.

6) Cost of patent written off

An auditor should see that the cost of patent written off. If a patent becomes obsolete, the entire book value should be written off.

7) Shown in the balance sheet.

See that the patents are shown in balance sheet

## **7). Verification of investment**

### **1) Examine the schedule of investment**

He should call for and examine the schedule of investment held by the client with reference to the relevant ledger accounts.

### **2) Physical verification**

If investment is in the hand of the client, auditor should verify the existence of the investment by personal inspection. If it is entrusted to a bank for safe custody, he should get a certificate from the bank, giving the details of the security in its hand and stating that they are free from any charge.

If an investment is held by a trustee on behalf of the company, the auditor should call for and examine the trust deed. If the securities are held by the client brokers, the auditor should call for securities for personal inspection. If the securities deposited with bank or any other creditor as a security towards loans borrowed, an auditor should get a certificate from bank or creditor to this effect.

### **3) Purchase of investment**

If securities are purchased during the year, he should verify the purchase by examining the certificate. If no certificate is available he should examine purchase with the help of transfer deed and broker's bought note.

### **4) Transfer fee, stamp duty etc.**

He should see that transfer fee, stamp duty etc incurred on the purchase of investment are properly capitalized.

#### 5) Sale of investment

If the securities are sold during the year, the auditor verify the sale price with the help of broker's sold note. See that the sale is approved by board of directors. See that whether the profit or loss made on sale is properly adjusted in the accounts.

#### 6) Registered in the name of the client

He should ensure that the investment is registered in the name of the client and they are free from charges other than those disclosed.

7) Properly valued Satisfy himself that investment is properly valued.

#### 8) Shown in balance sheet

See that the investments are shown in balance sheet at market or cost price

### **9) Verification of cash in hand**

#### 1) Physically count the cash in hand

The auditor should actually count the cash in hand by attending the business premise on the last day of the financial year. Actual verification of cash in hand has been considered to be the most important part of an auditor's duty. It was upheld in many cases. For instance, London oil storage company ltd v/s Secer Husluck & co. In this case it was held that the auditor has committed a breach of duty in verifying the existence of the pretty cash balance.

#### 2) Surprise visit to business premises

To prevent manipulations & fraud the auditor can pay a surprise visit to the business premises of the client.

3) Count different kinds of cash balances simultaneously

If there are different kinds of cash balances say petty cash in hand and cash in hand, the auditor should count them simultaneously. Shortage on one account may not be made up from another account.

4) Count currency notes, coins, stamps and I.O.U.s

He should count on closing date not only currency notes and coins but also the stamp and I.O.U.s in hand, as they are also part of cash balance.

5) See that I.O.U.s are genuine.

6) Physically count the stock of the unsold canteen tickets, lunch coupons etc as they are likely to be converted into cash.

7) Compare the cash in hand as revealed by physical counting with the cash balance as shown by the cash flow.

8) Verify cash transactions with the proper documentary evidences and correspondence.

9) Shown in the balance sheet.

**9). Verification of cash at bank**

1) Compare bank balance as shown by the cash book with the bank balance as shown by the bank pass book.

2) Preparation of bank reconciliation statements

If there is some difference between these two balances, he should prepare a bank reconciliation statement.

3) Obtain separate certificate for fixed deposit account, savings bank account,

current account etc...

He should obtain separate certificate from the bank to verify balances of the different types of bank accounts.

4) Verify all of the bank accounts individually In case there are accounts with more than one bank the auditor should verify them individually.

5) See that necessary adjustments are made in respect of interest accrued on fixed deposit.

6) See that Cheques not yet collected are genuine.

7) In case money is kept with other agencies, the nature of interest and the name of the agencies should be disclosed by the auditor in his audit report.

8) Where large amounts are held in foreign banks, the fact should be disclosed by the auditor in his audit report.

9) Shown in the balance sheet

#### **10). Verification of bills receivable**

1) Examine each bill in hand to ensure that it is properly drawn, sufficiently stamped and duly accepted by the acceptor.

2) Verify the bills receivable given in the balance sheet by obtaining certified schedule of bills in hand.

3) Compare the schedule of bills in hand with bills receivable book and bills receivable account.

4) See that overdue bills are not included in the bills in hand.

5) Bills discounted should be examined by referring the cash book and pass book.

6) See that bills discounted or endorsed but not yet met are treated as a contingent liability and are indicated by way of foot note in the balance sheet.

7) See that proper provisions are made for contingent liability on bills discounted.

8) Shown in the balance sheet

#### **11). Verification of debtors**

1) Examine the schedule of debtors.

2) Verify the schedule of debtors with the help of sales ledger or debtor's ledger.

3) Verify the sales ledger balances with the help of sales book, sales returns book, cash book etc.

4) See that the book debt shown in the balance sheet is recoverable.

5) Obtain a certificate from a responsible officer in respect of statement of book debt.

6) See that adequate provisions are made against book debt. The adequacy of the provisions for the bad & doubtful debt made by the management can be checked by the auditor by considering the following points,



- Age of debt
- Regular payment
- Heavy dishonoured bills
- Comparison of actual bad debt with budgeted bad debt

7) See that proper provision is made for discount on debtors.

8) In case, where certain amounts of debts are written off, the auditor should enquire into the details.

9) Debts due from subsidiary company should be carefully inspected by the auditor.

10) In case of debt in a foreign company, the auditor should find out, by converting the amount into home currency.

11) In case the client is a company, the auditor should see that the book debts are classified for balance sheet purpose as required by the companies Act

1956. That is book debts are classified as follows,

- Debts considered good in respect of the company is fully secured.
- Debts considered good for which the company holds no security other than the debtor's personal security.
- Debt considered doubtful.

Further debt due by directors or officials of the company either severally or jointly with any other person shown separately. Again debt due from other company under the same

management should be disclosed with the names of the companies.

## **12) Verification of loans advanced**

Generally loans advanced will be of the following types:-

- 1) Loans against the security of land & building.
- 2) Loans against the security of stock & shares.
- 3) Loans against the security of goods.
- 4) Loans against the security of life policies.
- 5) Loans against the security of guaranty of a third party.
- 6) Loans against the personal security of the borrower.

While verifying the loan advanced, an auditor should keep in mind the following points:-

- 1) Examine the schedule of loans granted.
- 2) Verify the loans advanced with the help of loan agreement, application of loans, acknowledgements of receipts, and loan account in the ledger.
- 3) Examine the authority of person granting the loans.

Ensure that the loans advanced are within the powers of the person granting the loans.

- 4) Ascertain the worth of the securities

In the case of secured loans, the auditor should ascertain the worth of securities offered and see that sufficient margin is maintained.

5) Examine the credit worthiness of the borrower

In the case of unsecured loans, the auditor should examine the credit worthiness of the borrower and ascertain the possibility of their recovery.

6) See that outstanding loans are confirmed by the borrowers.

7) See that interests on loans are regularly collected.

8) See that provisions are made for doubtful loans.

9) In the case of joint stock Company, the auditor should see that the loans are properly classified.

10) See that loans to directors and officials of the company are shown separately in the balance sheet.

11) See that the advances to subsidiary companies are shown separately in the balance sheet.

12) See that loans are shown separately in the balance sheet.

*1) Loans against the security of land and building*

2) Examine the loans granted with the help of loan agreements.

3) Examine the powers of the person granting the loan.

4) Examine the memorandum and articles of association, in the case of joint stock companies.

5) Inspect the minutes of meeting of the board of directors and see that loans are properly sanctioned.

6) Verify the details of the loan.

7) See that outstanding loans are confirmed by the borrowers.

8) Examine the title deed relating to the property mortgaged.

9) Interests on loans are collected regularly.

*2) Loans against the security of stock & shares*

1) Examine the loans granted with the help of loan agreements.

2) Examine the list of stocks and shares held by the company.

3) See that shares offered as security is transferred to his client.

4) Check the value and see that there is sufficient margin between the loan and the present value of the security.

5) See that shares accepted as security are fully paid up.

*3) Loans against the security of goods*

1) Examine the loans granted with the help of loan agreements.

2) Examine the powers of the person granting the loan.

3) Examine the godown keeper's receipt, dock warrant if loans are advanced against the goods lying in warehouse.

4) See that godown rent is paid regularly by the borrower.

5) See that goods offered as security are fully insured.

6) See that goods offered as security are easily saleable.

*4) Loans against the security of life policies*

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Enquire into the class of insurance policy.
- 4) Examine the last receipt for the payment of insurance premium.
- 5) Ascertain the surrender value of the life insurance policy.

*6) Loans against the guaranty of a third party*

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Examine the guaranty.
- 4) Enquire into the financial position of surety.

*5) Loans against the personal security of the borrower*

- 1) Examine the loans granted with the help of loan agreements.
- 2) Examine the powers of the person granting the loan.
- 3) Examine the credit worthiness of the borrower.
- 4) Finally auditor should discourage the client granting of such loans.

**13). Verification and valuation of stock in trade**

The work of verification and valuation of stock in trade consist of two elements,

1) Verification of stock in trade.

2) Valuation of stock in trade.

i) Verification of stock in trade does not mean merely the checking of stock statements. It is much more than this. It includes the following,

- Verification of physical existence of stock in trade.
- Verification of ownership of stock in trade.
- Verification of guaranties in the statement of stock.
- Examine the organization's transactions that results in stock in trade.
- Ensuring that receipts and issues are properly recorded.
- Ensure that the provision is made for obsolete stock.
- Examination of system of internal control.
- Verification of arithmetical accuracy of statement of stock.

While verifying stock in trade, an auditor should keep in mind the following points,

1) Examine the system of internal check with regard to the verification of stock in trade.

2) Obtain copies of physical layout of all plant, giving names and descriptions of all departments where stocks are held.

3) Obtain details as to the quantity and value of stock with each department.

- 4) Secure a copy of stock taking instructions issued to the staff.
  - 5) Ensure that proper and adequate records of stocks have been maintained.
  - 6) See that goods which are not related to the business are not included in the stock.
  - 7) See that goods sold prior to the closing date are not included in the stock.
  - 8) See that items of capital nature are excluded from the stock.
  - 9) He should test check physical existence at least 5 % of items.
  - 10) See that stock held by third party is included in the stock sheet.
  - 11) Compute Work out ratio between gross profit and sales of current year and compare it with that of the previous year.
  - 12) Compare stock sheet of current year with that of previous year.
  - 13) Check calculations, additions and castings in the stock sheet.
  - 14) See that stock sheet is initiated by a responsible person.
  - 15) See that goods taken into stock sheet are passed through the purchase book.
- j) Valuation of stock in trade

Following points are to be noted while valuing stock in trade:

- 1) An auditor should enquire into the basis of valuation.

- 2) See that basis of valuation has been consistently adopted from year to year.
- 3) Check the values of few items in the stock sheet with the corresponding invoice prices and current selling prices.
- 4) See that the totals of stock sheet are correct.
- 5) Compare the percentage of gross profit of current year with that of previous year.
- 6) See that calculations, additions and castings are correct.
- 7) See that stock sheet is signed by a responsible officer.

### **Methods of valuation of stock in trade**

- Actual cost price method
- Simple average cost method
- Weighted average cost method
- FIFO
- LIFO
- Base stock method
- Standard cost method
- Market price method
- Net realized value method



## **Valuation of different items of stock in trade**

- 1) Raw materials are valued at cost price plus proportionate freight and import duty.
- 2) Work in progress: cost price of raw materials plus proportionate amount of manufacturing expenses plus a percentage to cover the establishment charges relating to manufacture.
- 3) Finished goods: principal of “cost price or market price whichever is lower” is applied.
- 4) Spare parts: cost price
- 5) Stores articles: cost price
- 6) Stock of special trade: cost price plus interest at remarkable rate plus expenses of maintaining stock.

## **Verification and Valuation of liabilities**

1. See that the liabilities are neither deliberately omitted nor under stated nor overvalued.
2. See that the liabilities are shown in balance sheet at their correct amount.
3. Obtain a certificate from responsible officer as to the correctness of the amount of different liabilities.

### **1) Verification of sundry creditors**

While verifying sundry creditors an auditor should bare in mind the following points:

- 1) Obtain a list of creditors.

He should get a schedule or list of creditors from the management and verify whether the schedule contains all the details about creditors.

2) Check the schedule of creditors with the balance in the creditor's ledger.

3) Obtain statement of account from creditors.

4) Check the purchase book and purchase return book with the help of invoices and credit notes.

5) Check the postings from subsidiary books to the creditors account in the ledger.

6) Examine the purchase invoices to ensure that these are related to current year.

7) Compare the percentage of gross profit of current year with that of the previous year.

8) Special attention to the entries made either at the beginning of the year or at the end of the year.

9) Check the provisions for the discount on creditors with the help of reference to the creditor's ledger. If the credited amount is unpaid for a long period, enquire the reasons.

10) See that creditor's amount shown in the balance sheet are correct.

2) Verification of bills payable

1) Obtain a schedule of bills payable

2) Check the total of schedule of bills payable with the bills payable book and the bills payable account.

- 3) Verify the payments made to the bills payable with the entries in the cash book.
- 4) Verify the bills payable returned under rebate.
- 5) Satisfy himself with the genuineness of bills payable.
- 6) See that the bills payable which have been paid are not shown as outstanding.
- 7) Check the bills payable paid after the balance sheet date but before the date of the audit with the entries made in the cash book.
- 8) See that the bills payable amount shown in the balance sheet are correct.

### **3). Verification of bank overdraft**

- 1) Examine the overdraft agreement with the bank.
- 2) Check the cash book with the bank pass book.
- 3) Obtain a certificate from the bank and verify the correctness.
- 4) Verify the outstanding interest, if any.
- 5) If bank overdraft is secured, see that the assets charged against such loans are clearly stated in the balance sheet.

### **4). Verification of loans & advances borrowed**

- 1) Examine the loan agreement.
- 2) Examine the loans and advances with the help of the correspondence and relevant documents.

- 3) Ensure that loans and advances are taken for the use in the business.
- 4) Check the amount of loans and advances with the confirmation letters received from lenders.
- 5) If the loans are secured examine the amount of secured loans, nature and value of securities.
- 6) See that interest on loan is paid or not.
- 7) See that loans are separately shown in the balance sheet as secured and unsecured.

#### **5). Verification of debentures**

- 1) Examine the memorandum and articles of association to ensure that the borrowing limit is not exceeded.
- 2) Examine the debenture account to verify the debentures issued.
- 3) Examine the debenture trust deed to verify amount of debenture issued and securities offered.
- 4) if debentures are issued at premium or discount, see that premium and discount are properly dealt with in the books of account.
- 5) If debentures are to be redeemed after some years, he should see that arrangements are made for the same.
- 6) See that debentures shown in the balance sheet are correct.

#### **6). Outstanding expenses**

- 1) Verify the outstanding expenses with the help of statement of outstanding expenses certified by a responsible officer.
- 2) Compare the outstanding expenses of current year with those of previous year to see whether there is any material difference.
- 3) See that outstanding expenses have been subsequently paid.
- 4) Verify the item of expenses such as salaries, wages, rent etc which remain outstanding.
- 5) See that outstanding expenses are clearly shown in the balance sheet.

#### **7). Income received in advance**

- 1) Verify the item of incomes which are normally received in advance with the help of list of incomes received in advance certified by a responsible official.
- 2) See that these are fully disclosed in the balance sheet.

## **MODULE 3**

### **INTERNAL CONTROL**

Internal control is the whole system of control established by the management for the proper conduct of various activities of the organization. It is not only internal check and internal audit but also the whole system of control financially and otherwise established by the organization in order to carry out the business in orderly and efficient manner. It is useful for the organization to safeguard the assets and serve the reliability of accounting records. In other words, it is the overall control adopted by the organization.

#### **Features: -**

- 1) It is the overall control adopted by the management.
- 2) It comprises of plans, methods and procedures for the effective control of the operations of the business.
- 3) It comprises of internal check, internal audit, accounting system and administrative control.
- 4) It is established by the management.
- 5) It intended to help the management to run the business efficiently.

#### **Objectives: -**

- 1) To ensure that transactions are recorded proper books of account.

- 2) See that all transactions are carried out only on account of a sanction of authority.
- 3) See that management policies and decisions are properly implemented.
- 4) To ensure efficient conduct of business.
- 5) To evaluate the efficiency of performance of the various personnel.
- 6) To safeguard the assets of the organization.
- 7) To safeguard the interest of the organization.
- 8) To ensure reliability of accounting records.
- 9) To ensure the periodical verification of assets.

### **Scope or Area of internal control.**

#### **1) Accounting Control.**

It ensures the reliability of accounting transactions. Accounting transactions are recorded by using accounting principles.

#### **2) Administrative Control.**

It is concerned with distribution of authority and decision making process of management. Overall operation efficiency of the organization is ensured.

### **Essentials of Good internal Control: -**

- 1) It should be clear and well developed plan of organization.

- 2) There should be competent and trust worthy personnel for the success of the business.
- 3) There should be segregation of duties: - Operational duties are separated from recording duties. Physical handling of asset must be separated from accounting records.
- 4) There should be administrative traditions and practices for the performance of the duties.
- 5) There should be well developed and adequate accounting system.
- 6) There should be a sound system of maintenance and recording of accounts.
- 7) There should be effective internal check system.
- 8) There should be good audit system.
- 9) Periodical review of internal control.

### **Advantages.**

#### **A. Advantages to the business.**

- 1) Provide accurate and reliable data to the management for taking correct decisions.
- 2) Ensure that policies and procedures are complied with.
- 3) Promotes operational efficiency.
- 4) Help to attain organizational goal.
- 5) To safeguard the assets of the organization.



6) To ensure the reliability of accounting records.

#### **B. Advantages to the auditors**

1) Helps the auditor in framing the audit program.

2) To ascertain extent of test check can apply.

#### **Limitations of Internal control**

1) Expensive.

2) Transactions of unusual nature may not be subject to internal control.

3) Human errors remain in any system of control.

4) Limitation of preventing frauds committed through collusion between persons.

5) It may not be keep pace with the change in the condition.

#### **Internal check**

It is an arrangement of accounting work under which the work of one person comes under the security of another person. So, that it is not possible to commit fraud without collusion between two or more persons. In other words, it is an arrangement of accounting system under which no one person is allowed to carry out one work completely. Specialization & division of work is important one. The work of one staff is automatically checked by another person in order to locate errors and frauds.

#### **Advantages.**

##### **A. Advantages to business**

1. Proper division of work
2. Fixation of responsibility
3. Greater efficiency of the staff.
4. Increased carrying capacity.
5. Early detection of errors and frauds.
6. Easy preparation of final account.
7. Truth and accuracy of accounting can be available.

**B. Advantages to Owners.**

1. Genuineness and accuracy of the account.
2. Overall efficiency, economy in operations, increased profit etc..

**C. Advantages to Auditor**

1. There is no need for detailed examination of book of accounts.
2. It reduces burden.

**Objectives.**

- 1) Proper division of work.
- 2) Minimization of errors and frauds.
- 3) Easily detection of errors and frauds.
- 4) Ensures the reliability of accounts.

5) Easily preparation of final accounts.

6) Simplification of the external auditors work

Limitations.

1) Suitable only for big concerns.

2) Sacrifice of quality for quickness.

3) Certain type of disorder, confusions etc... in the working of the organization.

4) Useful only when there is no collusion between employees.

5) Risky for the auditor.

Principles and essential of good internal check system.

1) Simple, easy workable and effective.

2) Not be too expensive.

3) Carefully devised and properly regulated.

4) Authority should be clearly defined.

5) Proper division of responsibility.

6) Division of work among the staff.

7) Work of similar nature should be entrusted with one person to ensure specialization.

8) No individual should be allowed to perform one work completely.

- 9) Work should be distributed in such a way that the work of one staff is automatically check another.
- 10) No employee should be allowed to remain a particular job for a long period.
- 11) No employee of the concern should be rely upon too much.
- 12) Proper reporting to the management.
- 13) Proper system of filing vouchers.
- 14) Safeguards should be prescribed for the safe custody of unused cheque book, securities etc...
- 15) There should be a self balancing ledger system.
- 16) All incoming letter should be opened by responsible officers.
- 17) The receipt of cash and disbursement should be entrusted to different personnel.
- 18) Cashier should have no access to ledger.
- 19) All remittance received should be deposited in a bank immediately.
- 20) All cash payments should be made by a cheque.
- 21) Cash and bank balance should be verified frequently.
- 22) Petty cash payment should be on imprest system.
- 23) There should be effective control of receipts and issue of goods.

24) There should be a perpetual inventory system.

### **Difference between internal control, internal check and internal audit**

Internal control	Internal check	Internal audit
It is the whole system of control established by management.	It is the arrangement of accounting work under which the work of one person comes under another.	Continuous review of records by staff appointed for the purpose.
Scope of internal control is very wide. it includes internal check and internal audit.	Scope of internal check is less.	Scope of internal audit is less than of internal control wider than internal check.
The objective is to safeguard the asset of enterprise.	Objective is to locate errors and frauds.	The object of internal audit is to assure the management that the system of internal control and internal check in operation are in effective in design and operation.
There is no separate staff.	There is no separate staff	It is conducted by the staff specially appointed for the purpose called as internal auditor.

Internal control is exercised when the work of employees in progress.	Internal check is exercised when the work of employee is in progress.	It is undertaken by the auditor after the work has been completed.
Any organization can adopt internal control.	Any organization can adopt internal check.	Internal audit is adopted only those concerns which really need it

### **Procedure of Audit: -**

The way in which the audit work should be conducted by the auditor.

- 1) Routine checking
- 2) Test checking
- 3) Surprise checking.
- 4) Audit in depth.
- 5) Adoption of distinctive tick mark, check mark etc...

#### **1. Routine checking.**

It is the checking and casting common books of accounts by the auditor. It involves following activities.

- a) Checking, casting and sub casting of such books.
- b) Checking of posting into ledger book.
- c) Checking the balances transferred from one book to another

## **Common Books.**

Sales ledger, private ledger, wage sheet , general ledger, debit note, credit note, all subsidiary books like cash book, purchase book, journal proper etc..

## **Advantages of routine checking**

- 1) It facilitate through checking of books of original entry.
- 2) Posting under routine checking, posting are completely checked.
- 3) Thorough checking of casting and posting are involved.
- 4) Verifying the arithmetical accuracy in the entries.
- 5) Clerical errors and ordinary frauds are located through routine checking.
- 6) It constitutes the basis of entire audit.
- 7) It ensures there is no alteration of figures.

## **Limitations of routine checking**

- 1) It is purely a mechanical checking.
- 2) It is not important in an organization where self balancing system is in operation.
- 3) Simple type of errors and frauds can be located

## **2. Test Checking.**

Testing of test checking means to select and examine a representative sample from large number of similar items. The

main objective of test checking is to select representative item and examining it and conclusion is drawn from all of the items.

### Essentials of Test Checking

- 1) The success of test checking depends upon the system of internal check in operation.
- 2) The sample should be selected at random.
- 3) Transaction should be selected only representative of the whole of the group.
- 4) Homogeneous transactions are taken into account.
- 5) Selection of sample should be made without bias.
- 6) Test checking is not applicable in cash book transactions.
- 7) No indication should be given to small organization.
- 8) It is not applicable to first month and last month transactions.
- 9) It is not applicable to checking of opening and closing balance.
- 10) If the transactions are non-recurring in nature it is not applicable.

### **Advantages.**

- 1) Complete the audit work in a short time.
- 2) The volume of work of the auditor is reduced to certain extent.



- 3) It ensures better accuracy of the book of account if selection is made on properly.
- 4) It ensures examination of efficiency of the internal check system of the organization.

### **Limitations**

- 1) All of the errors and frauds cannot be detected.
- 2) Test checking increase the responsibility of the auditor.
- 3) The staff of the client may become careless.
- 4) The current financial position cannot be revealed.

### **3. Surprise checking.**

A system under which the auditor make surprise visit to the organization and check the important items i.e. the verification of the cash book, investment, examination of entries related to stock and stock items and examine the book of original entry.

4. Auditing in depth: - Examination of selected item in depth or to the origin to conclusion. Generally it is adopted where internal control is not effective.
5. Adoption of distinctive tick mark, check mark etc: -

For the purpose of audit the auditor can use the ticks, tick marks, check marks etc to indicate the work done by the auditor.

- 1) Different type of tick should be used in different type of audit work.
- 2) It is better to use ballpoint pen instead of pencil.

- 3) Tick of different colours for different audit.
- 4) Tick should be too small.
- 5) Tick should be clear and simple.
- 6) Tick should not be mixed up with the figures shown in the book of account.
- 7) Clear instructions must be provided to the client for the use of tick mark
- 8) Tick of client staff and audit staff should be distinctive.

## **Rights and duties of an auditor**

### **1. Right of Access to Books of Accounts:**

Every auditor of a Company has a right of access at all times to the books of accounts and vouchers of the company whether kept at the head office of the company or elsewhere. Thus, the auditor may consult all the books, vouchers and documents whenever he so likes. This is his statutory right. He may pay a surprise visit without informing the Directors in advance but in practice, the auditors inform the Directors before they pay their visits.

### **2. Right to obtain Information and Explanations:**

He has a right to obtain from the Directors and officers of the company any information and explanation as he thinks necessary for the performance of his duties as an auditor. This is another important power in the hands of the auditor. He will, however, decide as to which information or explanations he thinks necessary to obtain. If the Directors or officers of the company refuse to supply some information on the ground that

in their opinion it is not necessary to furnish it, he has a right to mention the fact in his report.

### **3. Right to Correct any Wrong Statement:**

The auditor is required to make a report to the members of the company on the accounts examined by him and on every Balance Sheet and Profit and Loss Account and on every other document declared by this Act to be part of or annexed to the Balance Sheet or Profit and Loss Account which are laid before the company in General Meeting during his tenure of office. The Directors have a duty to prepare them and present them to the auditor.

The auditor cannot require but advise the Directors to amend their system of maintaining accounts if it is faulty. If his suggestions are not carried out, he has a right to refer the matter to the members. If the method of accounting is inadequate, he must state the fact in his report that proper books of accounts have not been kept by the company.

### **4. Right to visit Branches:**

According to section 228, if a company has a branch office, the accounts of the office shall be audited by the company's auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226. Where the Branch Accounts are not audited by a duly qualified auditor, the auditor has a right of access at all time to the books, accounts and vouchers of the company and thus, may visit the branch, if he deems it necessary.

**5. Right to Signature on Audit Report:**

Under section 229, only the person appointed as auditor of the company, or where a firm is so appointed, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

**6. Right to receive Notice and other Communications relating to General Meeting and attend them:**

Under section 231 an auditor of a company has a right to receive notices and other communications relating to General Meeting in the same way as a member of the company. He is also entitled to attend any General Meeting which he attends or any part of the business which concerns him as an auditor.

According to the power of the auditor, he may make any statement or explanation with regard to the accounts as he may desire. He need not, however, answer any questions. Ordinarily, it is not necessary for the auditor to attend every General Meeting, but it will be good for him to attend meetings in the following circumstances:

- (a) When his report contains important qualifications directly affecting the management, so that his remarks may not be misunderstood or misinterpreted.
- (b) When he has received a notice from the company that someone else is going to be proposed for appointment as auditor of the company at the Annual General Meeting.
- (c) When he has been specially asked by the management to be present.

## **7. Right of being indemnified:**

Under section 633, an auditor (being an officer of a company), has a right to be indemnified out of the assets of the company against any liability incurred by him defending himself against any civil and criminal proceedings by the company if it is proved that the auditor has acted honestly or the judgement delivered is in his favour.

## **8. Right to have Legal and Technical Advice:**

He has a right to seek the opinion of the experts and, thus, take legal and technical advice. This is necessary to give his opinion in his report. (Re. London and General Bank Case, 1895).

He has a right to receive his remuneration provided he has completed the work which he undertook to do.

## **Duties of an Auditor**

The duties of an auditor have been laid down by the Companies Act, 2013, provided in Section 143. The Act explains the duties in a simplified manner, although the list given is not exhaustive.

### **1. Prepare an Audit Report**

An audit report, in simple terms, is an appraisal of a business's financial position. The auditor is responsible for preparing an audit report based on the financial statements of the company. The books of accounts so examined by him should be maintained in accordance with the relevant laws. He must ensure that the financial statements comply with the relevant provisions of the Companies Act 2013, relevant Accounting Standards etc. In addition to this, it is imperative that he ensures

that the entity's financial statements depict a true and fair view of the company's financial position.

## **2. Form a negative opinion, where necessary**

The auditor's report has a high degree of assurance and reliability because it contains the auditor's opinion on the financial statements. Where the auditor feels that the statements do not depict a true and fair view of the financial position of the business, he is also entitled to form an adverse opinion on the same. Additionally, where he finds that he dissatisfied with the information provided and finds that he cannot express a proper opinion on the statements, he will issue a disclaimer of opinion. A disclaimer of opinion basically indicates that due to the lack of information available, the financial status of the entity cannot be determined. However, it is to be noted that the reasons for such negative opinion is also to be specified in the report.

## **3. Make inquiries**

One of the auditor's important duties is to make inquiries, as and when he finds it necessary. A few of the inquiries include:-

- a. Whether loans and advances made on the basis of security are properly secured and the terms relating to the same are fair.
- b. Whether any personal expenses (expenses not associated with the business) are charged to the Revenue Account.
- c. Where loans and advances are made, they are shown as deposits.
- d. Whether the financial statements comply with the relevant accounting standards

## **4. Lend assistance in case of a branch audit**

Where the auditor is the branch auditor and not the auditor of the company, he will lend assistance in the completion of the

branch audit. He shall prepare a report based on the accounts of the branch as examined by him and then send it across to the company auditor. The company auditor will then incorporate this report into the main audit report of the company. In addition to this, on request, if he wishes to, he may provide excerpts of his working papers to the company auditor to aid in the audit.

## **5. Comply with Auditing Standards**

The Auditing Standards are issued by the Central Government in consultation with the National Financial Reporting Authority. These standards aid the auditor in performing his audit duties with relevant ease and accuracy.

It is the duty of the auditor to comply with the standards while performing his duties as this increases his efficiency comparatively.

## **6. Reporting of fraud**

Generally, in the course of performing his duties, the auditor may have certain suspicions with regard to fraud that's taking place within the company, certain situations where the financial statements and the figures contained therein don't quite add up. When he finds himself to be in such situations, he will have to report the matter to the Central Government immediately and in the manner prescribed by the Act.

## **7. Adhere to the Code of Ethics and Code of Professional Conduct**

The auditor, being a professional, must adhere to the Code of Ethics and the Code of Professional Conduct. Part of this involves confidentiality and due care in the performance of his duties. Another important requisite is professional scepticism. In

simple words, the auditor must have a questioning mind, must be alert to possible mishaps, errors and frauds in the financial statements.

### **8. Assistance in an investigation**

In the case where the company is under the scope of an investigation, it is the duty of the auditor to provide assistance to the officers as required for the same.

Hence, it can be seen that the duties of the auditor are pretty diverse, it has an all-round and far-reaching impact. The level of assurance provided by a set of audited financial statements is comparatively far higher as compared to regular unaudited financial statements.



## **PART B**

### **CORPORATE GOVERNANCE**

#### **Module IV**

### **CONCEPTUAL FRAME WORK OF CORPORATE GOVERNANCE**

Corporate governance is the combination of rules, processes or laws by which businesses are operated, regulated or controlled. The term encompasses the internal and external factors that affect the interests of a company's stakeholders, including shareholders, customers, suppliers, government regulators and management. The board of directors is responsible for creating the framework for corporate governance that best aligns business conduct with objectives.

Specific processes that can be outlined in corporate governance include action plans, performance measurement, disclosure practices, executive compensation decisions, dividend policies, procedures for reconciling conflicts of interest and explicit or implicit contracts between the company and stakeholders.

An example of good corporate governance is a well-defined and enforced structure that works for the benefit of everyone concerned by ensuring that the enterprise adheres to accepted ethical standards, best practices and formal laws. Alternatively, bad corporate governance is seen as poorly-structured,

ambiguous and noncompliant, which could damage the image or financial health of a business.

## **Importance of Corporate Governance**

1. Changing Ownership Structure : In recent years, the ownership structure of companies has changed a lot. Public financial institutions, mutual funds, etc. are the single largest shareholder in most of the large companies. So, they have effective control on the management of the companies. They force the management to use corporate governance. That is, they put pressure on the management to become more efficient, transparent, accountable, etc. They also ask the management to make consumer-friendly policies, to protect all social groups and to protect the environment. So, the changing ownership structure has resulted in corporate governance.

2. Importance of Social Responsibility : Today, social responsibility is given a lot of importance. The Board of Directors have to protect the rights of the customers, employees, shareholders, suppliers, local communities, etc. This is possible only if they use corporate governance.

3. Growing Number of Scams : In recent years, many scams, frauds and corrupt practices have taken place. Misuse and misappropriation of public money are happening everyday in India and worldwide. It is happening in the stock market, banks, financial institutions, companies and government offices. In order to avoid these scams and financial irregularities, many companies have started corporate governance.

4. Indifference on the part of Shareholders : In general, shareholders are inactive in the management of their companies. They only attend the Annual general meeting. Postal ballot is

still absent in India. Proxies are not allowed to speak in the meetings. Shareholders associations are not strong. Therefore, directors misuse their power for their own benefits. So, there is a need for corporate governance to protect all the stakeholders of the company.

5.      Globalisation : Today most big companies are selling their goods in the global market. So, they have to attract foreign investor and foreign customers. They also have to follow foreign rules and regulations. All this requires corporate governance. Without Corporate governance, it is impossible to enter, survive and succeed the global market.

6.      Takeovers and Mergers : Today, there are many takeovers and mergers in the business world. Corporate governance is required to protect the interest of all the parties during takeovers and mergers.

7.      SEBI : SEBI has made corporate governance compulsory for certain companies. This is done to protect the interest of the investors and other stakeholders

## **Theories of Corporate governance**

There are many theories of corporate governance which addressed the challenges of governance of firms and companies from time to time. The **Corporate Governance** is the process of decision making and the process by which decisions are implemented in large businesses is known as Corporate Governance. There are various theories which describe the relationship between various stakeholders of the business while carrying out the activity of the business. following are the theories of corporate governance

- Agency Theory
- Stewardship Theory
- Resource Dependency Theory

## **Agency Theory**

Agency theory defines the relationship between the principals (such as shareholders of company) and agents (such as directors of company). According to this theory, the principals of the company hire the agents to perform work. The principals delegate the work of running the business to the directors or managers, who are agents of shareholders. The shareholders expect the agents to act and make decisions in the best interest of principal. On the contrary, it is not necessary that agent make decisions in the best interests of the principals. The agent may be succumbed to self-interest, opportunistic behavior and fall short of expectations of the principal. The key feature of agency theory is separation of ownership and control. The theory prescribes that people or employees are held accountable in their tasks and responsibilities. Rewards and Punishments can be used to correct the priorities of agents.

## **Stewardship Theory**

The steward theory states that a steward protects and maximizes shareholders wealth through firm Performance. Stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. The stewards are satisfied and motivated when organizational success is attained. It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are

maximized. The employees take ownership of their jobs and work at them diligently.

## **Resource Dependency Theory**

The Resource Dependency Theory focuses on the role of board directors in providing access to resources needed by the firm. It states that directors play an important role in providing or securing essential resources to an organization through their linkages to the external environment. The provision of resources enhances organizational functioning, firm's performance and its survival. The directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Directors can be classified into four categories of insiders, business experts, support specialists and community influentials.

## **Models of Corporate Governance**

Corporate form of business is generally managed by the Board of Directors and the board members are elected by shareholders. The board in turn appoints the professional managers to manage the business. Different countries have different regulations and corporate governance models differ based on these differences. The Corporate governance models are broadly classified into following categories:

### **1. Anglo-American Model**

Under the Anglo-American Model of corporate governance, the shareholder rights are recognized and given importance. They have the right to elect all the members of the Board and the

Board directs the management of the company. Some of the features of this model are:

- This is shareholder oriented model. It is also called Anglo-Saxon approach to corporate governance being the basis of corporate governance in Britain, Canada, America, Australia and Common Wealth Countries including India
- Directors are rarely independent of management
- Companies are run by professional managers who have negligible ownership stake. There is clear separation of ownership and management.
- Institution investors like banks and mutual funds are portfolio investors. When they are not satisfied with the company's performance they simple sell their shares in market and quit.
- The disclosure norms are comprehensive and rules against the insider trading are tight
- The small investors are protected and large investors are discouraged to take active role in corporate governance.

## **2. German Model**

This is also called European Model. It is believed that workers are one of the key stakeholders in the company and they should have the right to participate in the management of the company. The corporate governance is carried out through two boards, therefore it is also known as two-tier board model. These two boards are:

1. **Supervisory Board:** The shareholders elect the members of Supervisory Board. Employees also elect their representative for Supervisory Board which are generally one-third or half of the Board.

2. **Board of Management or Management Board:** The Supervisory Board appoints and monitors the Management Board. The Supervisory Board has the right to dismiss the Management Board and re-constitute the same.

### **3. Japanese Model**

Japanese companies raise significant part of capital through banking and other financial institutions. Since the banks and other institutions stakes are very high in businesses, they also work closely with the management of the company. The shareholders and main banks together appoint the Board of Directors and the President. In this model, along with the shareholders, the interest of lenders is recognized.

### **4. Social Control Model**

Social Control Model of corporate governance argues for full-fledged stakeholder representation in the board. According to this model, creation of Stakeholders Board over and above the shareholders determined Board of Directors would improve the internal control systems of the corporate governance. The Stakeholders Board consists of representation from shareholders, employees, major consumers, major suppliers, lenders etc.

### **5. Indian Model**

In India there are mainly three types of companies' viz. private companies, public companies and public sector undertakings.

Each of these companies has distinct kind of shareholding pattern. Thus the corporate governance model in India is a mix of Anglo-American and German Models.

## **BOARD COMMITTEES**

Board committees meet according to their task, and as specified in their terms of reference. This might be at a specific time of the year (eg coinciding with the financial reporting and audit cycle for the company's audit committee) or at certain intervals. It is important that prospective board members consider whether they have sufficient time to dedicate not only to the work of the board, but also to that of a committee or committees because board committees are usually made up of a sub-selection of board members.

### **1. Audit committee**

The primary task of the audit committee is to oversee the relationship with external auditors to ensure the quality of the company's financial statements. The audit committee's role includes making recommendations on the appointment and reappointment of the external auditors, their remuneration, and their terms of engagement.

### **2. Remuneration committee**

The members of remuneration committees must keep independence, transparency and potential conflicts of interest at the front of their minds when deciding on pay arrangements. The design of remuneration policies should be linked to the achievement of the company's long-term success, but there is no simple answer that works for every company.



### 3. Nomination committee

The nomination committee is responsible for leading the board appointment process, considering the requirements of the company and making recommendations to the board. This responsibility covers both executive and non-executive directors.

### **Insider Trading**

Insider trading refers to the practice of purchasing or selling a publicly-traded company's securities while in possession of material information that is not yet public information. Material information refers to any and all information that may result in a substantial impact on the decision of an investor regarding whether to buy or sell the security.

By non-public information, we mean that the information is not legally out in the public domain and that only a handful of people directly related to the information possess. An example of an insider may be a corporate executive or someone in government who has access to an economic report before it is publicly released.

### **Corporate governance rating**

Corporate Governance Rating (CGR) is an opinion on relative standing of an entity with regard to adoption of corporate governance practices. It provides information to stakeholders about the level of corporate governance practices of the entity. It enables corporate entities to obtain an independent and credible assessment of the quality and extent of their corporate governance. The rating process would also determine the relative standing of the entity vis-à-vis the best practices followed in the domestic as well as international arena.

Companies can also use these ratings as reference and set benchmarks for further improvements. Investors and other stakeholders get benefited as they are able to differentiate companies based on degree of corporate governance. Corporate Governance Rating (CGR) is an opinion on the relative position of an organization in respect of adoption of corporate governance practices. It indicates to the stakeholders about the level of corporate governance practices prevailing in the organization.

### **Green governance**

The concept of green governance can be applicable to different field. It may be in a community, state, country, company or non-governmental originations. In every context, the basic idea is sustainability without much pressure on the environment. Green governance is a systematic life cycle approach for ensuring the sustainability of the business. It necessitates the continuous improvement in strategy, risk management, compliance management, idea management, portfolio management project management, performance management and stakeholders.

### **Objectives of green governance**

1. To ensure sustainable development
2. To conserve non renewable natural resources
3. To control the human intervention
4. To permit the companies for online compliance

### **Features of green corporate governance**

1. Appoint of independent directors

2. Separate board committee
3. Distinct corporate governance code
4. Reporting of disclosure

## **CLAUSE 49 OF “LISTING AGREEMENT”**

**Clause 49** of “**Listing agreement**” deals with the complete guidelines for corporate governance. Following are the provisions, a company, must comply to implement effective corporate governance.

### **1. Board of directors**

Composition of Board

- Optimum Combination of Executive & Non Executive Directors,
- Not less than 50% of the board should comprise Non-Executive Directors,
- At Least one Women Director,
- Where chairman is non executive Director as least 1/3<sup>rd</sup> of the board should comprise Independent Director, and if
- Chairman is executive director then ½ of the board should comprise Independent Director.

### **2. Audit Committee:-**

The audit committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of independent auditor, receipt of audit results from

both internal & external auditors. The committee assists the board to fulfil its corporate governance and overseeing responsibilities in relation to an entity's financial reporting, internal control system.

- Minimum 3 directors shall be the members of Audit Committee,
- 2/3<sup>rd</sup> shall be the Independent Director
- All the members shall be financially literate & at least one member must have expertise in accounts & finance field.
- Chairman shall be Independent Director and must be present at annual general meeting.
- Company secretary shall act as secretary of committee.

### **3. Subsidiary Company:-**

At least one independent director must be the director of Material Non Listed Subsidiary Company. Audit Committee shall review the financial performance of subsidiary in order to have a good control or view of subsidiary company. Board of Holding must review all significant transactions and arrangements between holding & subsidiary, all material subsidiaries shall be disclose to stock exchange.

### **4. Disclosure:-**

For good corporate governance company should make all necessary disclosures. It is also a responsibility on management to make disclosures of all material matters which all stakeholders are suppose to know. Stakeholders like creditors

and customers can not attend meetings so the disclosure is only way through which they can get information.

#### **5. CEO/CFO Certification-:**

Any managing director, CFO or whole time finance director, who is in discharging of finance function, must certify to the board that the financial statements have been reviewed by him and present the true & fair view and do not contain any material untrue statement or misstatement.

#### **6. Report on corporate governance-:**

A company must give a separate section on Corporate Governance in annual report, where all the disclosures regarding compliance & non compliance with mandatory requirement and the extent to which non mandatory requirements have been adopted.

#### **7. Compliance**

Company shall obtain **Annual Activity Certificate** from auditor or practicing company secretary, about the compliance of the clause 49 of Listing Agreement.

## **Shareholders activism**

Shareholder activism is a way that shareholders can influence a corporation's behavior by exercising their rights as partial owners. Classes of shares allow for distinct voting privileges, in addition to dividend entitlements. While minority shareholders don't run day to day operations, several ways exist for them to influence a company's board of directors and executive management actions. These methods can range from dialogue

with managers to formal proposals, which are voted on by all shareholders at a company's annual meeting.

### **Reason for shareholders activism**

#### **1. The interest of shareholders are not protected**

The bulk shareholders always take the decision based on their interest and choice. In most of the cases the importance or value of the shareholders are ignored by the directors and management of the company. Especially, this may ultimately shatter the hopes and interest of the minority shareholders.

#### **2. Self dealing**

The management or top executive engages in self dealing are one of the reason for shareholders activism. Self dealing is nothing but engage in a transactions by the top authorities or executives of the company for their personal benefit rather than the common interest of the company or trust.

#### **3. Fragile management**

The weak enforcement of law and poor display of business functions are also results shareholders activism. In some of the cases the management may conceal the relevant transactions and do not provide all relevant information to shareholders.

#### **4. Lack of transparency**

Transparency and fairness is essential for the smooth functioning of the organization. It should be noted that in most of the cases management is interested to cover their transaction. This may results shareholders activism.

## **Objectives of shareholders activism**

1. To act as monitor of management
2. To protect the interest of the shareholders
3. To ensure accountability

## **Aspects of shareholders activism/forms of shareholders activism**

1. Proxy voting
2. Dialogue
3. Resolution
4. Divestment

## **Module V**

# **MAJOR CORPORATE GOVERNANCE FAILURE**

One of the prime reason for the emergence corporate governance is the increased rate of corporate scams and scandals. Despite the various rules and regulations, the rate of accounting and financial frauds in the corporate sector was alarming. Corporate failure means when the company fails to meet the expectation of customers, investors and creditors. By meeting the needs of the customers, the companies can generate adequate cash flows and repay the creditors. Negative returns, technical insolvency and bankruptcy are the major visible symptoms of corporate failures. Following are the major corporate governance scandals which have shattered the hope of investors and regulators.

### **Bank of Credit and Commerce International (UK) 1991**

Bank of Credit and Commerce international (BCCi) was a major international bank founded in 1972 by agha Hassan abedi, a pakistani financier. The BCCi was incorporated in luxembourg with head offices in Karachi and London. The bank primarily focused on serving Muslim and third-world clients. the quadrupling of oil prices in 1973-74 led to huge deposits by arab oil producers. as a result BCCi expanded rapidly in the 1970s. BCCi also acquired parallel banks through acquisitions. BCCi entered the African markets in 1979, and Asia in the early 1980s. BCCi was among the first foreign banks awarded a



license to operate in the Chinese special economic Zone of shenzhen. By 1980, BCCi was reported to have assets of over \$4 billion with over 150 branches in 46 countries. BCCi expanded rapidly and by 1991 it had 420 offices around the world and a presence in 70 countries.

### **Forced Closure of the Bank**

Although BCCi's published results showed ever-rising profits, by the late 1970s the bank was suffering an alarming level of bad debts due to reckless lending. BCCi came under the scrutiny of numerous financial regulators and intelligence agencies in the 1980s due to concerns that it was poorly regulated. Reality was not reflected in BCCi's accounts because the losses were concealed in a Cayman Islands subsidiary, a bank within a bank known internally as 'the dustbin', safe from regulatory scrutiny. As the losses mounted Abedi resorted to more and more desperate ways of keeping the bank afloat. He tried 'proprietary trading', but the results were further huge losses. The bank only kept going by fraudulent accounting and massive misappropriations of depositors' funds. Desperately in need of new sources of deposits and revenue, from the early 1980s BCCI's Panama branch acted as money-launderer for Latin America's drug barons. Subsequent investigations and the inquiry report in June 1991 for BCCI by Price Waterhouse at the behest of Bank of England code named 'Sandstorm Report' revealed that BCCI was involved in massive money laundering and other financial crimes, and illegally gained controlling interest in a major American bank. The report indicated massive manipulation of non-performing loans, fictitious transactions and charges, unrecorded deposit liabilities, fictitious profits and concealment of losses.

## Maxwell Communications

Maxwell Communications Corporation was a leading British media company. It was listed on the London Stock Exchange and was a constituent of the FTSE 100 Index. The company was established in 1964 as the British Printing Corporation. In 1967 it acquired a majority stake in Haymarket Group. In July 1981 Robert Maxwell launched a dawn raid on the company acquiring a stake of 29 per cent. In 1982 he secured full control over the company and changed the name of the Company to British Printing & Communications Corporation and to Maxwell Communications Corporation in October 1987. The company acquired Macmillan Publishers, a large US publisher, in 1988 and Science Research Associates and the Official Airline Guide later that year. By the end of the 1980s the Maxwell Empire, comprising more than 400 companies was loosely organized into three clusters. The two publicly listed companies: *the Mirror Group*, which published the Daily Record, the Sunday Mail and Racing Times, as well as the Mirror newspapers; *Maxwell Communication*, the flagship company which controlled such concerns as Macmillan books, the Official Airline Guides and P.F. Collier encyclopedias; and the *Robert Maxwell Group* which was privately held and owned 100 per cent by the family whose operations included the Oxford United Football Club and publications like the European, as well as stakes in newspapers in Israel, Hungary and Kenya. All the three holding companies were also directly and indirectly linked to dozens of other family-controlled enterprises.

## Enron USA

The Enron scandal, which broke out in October 2001, eventually led to the bankruptcy of the Enron Corporation, an American

energy company based in Houston, Texas. It was the largest bankruptcy reorganization in American history at that time.

The primary reason for the failure of Enron was attributed to an audit failure. The problem faced by Enron was despite having structures and mechanisms in place for good corporate governance. Nobody flaunted and flouted these rules and regulations! The board of directors turned a blind eye to open violation of the code. Particularly, when it allowed the CFO to serve in special purpose entities(SPEs). The auditors failed to prevent suspect and questionable accounting. The auditors did not even examine the SPE transactions.

Enron shareholders filed a \$40 billion lawsuit after the company's stock price fell. It achieved a high of US\$90.75 per share in mid-2000, plummeted to less than \$1 by the end of November 2001. On December 2, 2001, Enron filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code. As a result of the scandal, the US government introduced new regulations and legislation to expand the accuracy of financial reporting for public companies. The Sarbanes-Oxley Act was introduced as a result of the Enron scandal. It increased penalties for destroying, altering, or fabricating records in federal investigations or for attempting to defraud shareholders. It also increased the accountability of audit firms to remain unbiased and independent of their clients.

## **Sathyam Computers Services Ltd**

Satyam began facing problems from December the 16th, 2008. Its chairman Mr Ramalinga Raju, in a surprise move announced a \$1.6 billion bid for two Maytas companies. He wanted to deploy the cash available for the benefit of investors. Raju's family promoted and controlled the two companies.

The share prices plunged 55% voicing concern towards Satyam's poor corporate governance. They overturned the decision in 12 hours. This resulted in the resignation of several independent directors of the firm. Thus, this resulted in a further fall in the share prices of Satyam.

On 7th January 2009 B Ramalinga Raju, the founder of Satyam Computer Services, confessed to a Rs 7,000- crore balance sheet fraud . He had hidden it from the IT company's board, employees and auditors for several years. He revealed in his confession that his attempt to buy Maytas companies was his last attempt to "fill fictitious assets with real ones". The government reacted to the fraud by overhauling the regulatory framework. It introduced the new Companies Act 2013, which fixed liabilities of auditor and independent directors, among other changes. In 2014, market regulator SEBI amended Clause 49 of listing guidelines to improve corporate governance.

## **Tata finance**

Tata finance is one of the companies operated and owned by Tata group, Indian's largest and most socially responsible business group. The company was incorporated as a private limited company in 1984 and later converted into a public ltd company. Transport and constructed sector are the major thrust areas of the company. It was basically engaged in the hire purchase business of commercial vehicles, plant and machinery, consumer durables and two wheelers. Further the company also undertakes leasing of plant and machinery for selected corporate client. During 1990s company diversified its operation by setting up a trade finance department. The trade finance department is basically liking after the commercial bill discounting and other money market operations of the company.

During 1<sup>st</sup> January 1992 the company merged with Tata Industrial financial corporation Ltd (TIFCO). During 1994, Tata Finance Security Ltd was established as a subsidiary. During 1997 Tata Finance became the RBI compliant non banking financing company engaged in the working of hire purchase, leasing and accept deposit from public under various schemes, it has become the finance service wing of Tata group and become the first NBFC to deal with the BADLA transactions by 2000. Moreover, Tata Finance agreed to float Nishkalp investment and trading company as its fully owned investment subsidiary. A total 500 crores of funds has lost between Tata Sons and Nishkalp. The chairman of Nishkalp was committed insider trading of company shares.

Poor investment policies by the management, Insider trading by the company executives, concealment of material facts and back dated sales are major reasons of Tata Finance fiasco.

### **Kingfisher airlines**

Kingfisher Airlines was a privately owned airline company has head office at Mumbai and registered office at UB City Bengaluru, India. The fifty percent of the share of the Kingfisher Airlines was with United Breweries UB group based in Bangalore under the leadership of liquor baron, Vijay Mallya. The company has played significant role in the Indian aviation industry until 2011. It was the second largest company in Indian Airlines industry. Even though the company is established in 2003 but started domestic commercial operation in 2005 from Mumbai-Delhi route. However the company started its international operation during the 2008.

Kingfisher Airlines have offered three classes of passenger services such as Kingfisher First, Kingfisher Class and Kingfisher

red. King fisher first is meant for high class or luxurious expectation people. It offers a luxurious service to the passenger. Kingfisher class luxurious economy experience to the passengers. Moreover, king fisher red offers a low cost travel experience through kingfisher airlines.

Kingfisher airlines had provided luxurious service in flight travel. However Indian passenger treated the flight journey also a mode of travel. Competition from other airlines such as indigo, spice jet and Go air who operated in the same domestic segment are also result a heavy loss to the company. Further, hike in oil price also is one of the reasons of serious setback to the company. By acquiring air deccan kingfisher has entered in the domestic air travel business. The company expected that the air deccan is already in the budgeted airlines segment and they can bring more revenue to the organization. However, the rebranding from a more luxurious air travel business to budgeted air travel business failed miserably. As result of the problems and issues in the management the kingfisher airlines stopped their operation during 2012. Civil aviation ministry has cancelled their licence on the same date.

### **Common governance problems noticed in various corporate failures**

1. Regulators mistake
2. Supremacy of the CEO
3. Lack of vigilance by the auditors
4. Individual/ concentrated ownership
5. Incompetent board

6. Misleading accounting policies
7. Insider trading
8. Poor investment policies
9. Exorbitant rate of borrowings

## **Code and standards on corporate governance**

In the modern the day corporate governance scenario, every countries government and regulatory agencies have established corporate governance guidelines for ensuring transparency and fair dealings. The phrase “corporate governance” was not so popular until 1970-80. The misconducts and ethical issues in the corporate sector have created dissatisfaction among investors. This has opened up the eyes of the regulators and ministries. As result committees were appointed by various governments to set up corporate governance code. UK was the first country that has set up sir Adrian cadbury committee to formulate corporate governance code for UK. The committee has finalized and submitted the report during 1992.

### **Cadbury report (1992)**

The major recommendation and thrust areas of Cadbury committee reports are as follows:

1. Appointment of independent non-executive directors.
2. The board has to form an audit committee with minimum of three non executive directors: majority of them should be independent.
3. Division of responsibilities between the chairman of the board and chief executive. However, if the chairman and the

board are one and same the board should have strong independent elements.

4. A remuneration committee should be established to monitor the executive rewards.
5. A nomination committee with sufficient independent directors should be established to nominate new board members.
6. Comply the code of best practices.

### **Greenbury Report(1995)**

It focused on the issue of directors remunerations. The committee has recommended the following.

1. The remuneration committee should solely consist of independent non executive directors.
2. Head/ chairman of the remuneration committee should answer all the questions raised by the shareholders at annual general meeting.\
3. Annual report should mention the remuneration paid to each director.
4. Directors contact should not run for more than a year.
5. Stock option scheme for directors should be linked to long term corporate performances.

### **Hampel Report (1998)**

Proposed suggestion on the Cadbury reports by the directors of major public companies and professional advisors.



1. Corporate governance should be based on board principles rather than rules.
2. Separation of responsibility of board chairman and chief executive should be company specific.
3. The board is accountable to company shareholders. Redefining or directors responsibility to other stakeholders group is not required.
4. Self regulation is required than further company legislation.
5. Unitary board is widely accepted in UK. Hence two tier boards are not required in UK.

### **UK Combined Code (1998)**

During 1998 UK combined code was established and included in the listing criteria of London stock exchanges. It is the combinations of Cadbury, greenbury and hampel recommendation on various matters of corporate governance. The combined code had set up clear guidelines for board composition, directors remuneration, audit and accountability to shareholders. All the companies who are listed in the London stock exchange have to follow the corporate governance code and mention the same in manual report of the companies. Apply the code or explain why not the major philosophical underpinning of the corporate governance code has. However, the code has no legislative basis but the companies have to follow to avoid delisting from the stock exchange. In USA, Sarbanes – Oxley Act(2002) recommended that the companies have to follow the corporate governance mandate otherwise they have to face severe penalties and imprisonment.

There are various reports have published on various aspects of corporate governance. Turnbull report (1999) the trunbull report has focused on the internal control mechanism of the companies. The report has specifically asserts financial, operational, compliance and risk management. Further, the committee has identified that enterprise risk analysis and risk management is key and vital area of internal control and thereby corporate governance. Higgs report (2003) the report was basically the re examination of corporate governance practices of UK companies after the Cadbury reports. Smith report (2003) concentrated on the audit committee of an organization. The main focus of the committee was to strengthen the role of audit committee to ensure fair dealings in an organization. Tyson (2003) has focused on the recruitment and development of directors. The committee recommends that there should be more professionalism and fairness in the selection of directors and directors should be given training.

### **Codes from international Agencies**

Organization for economic development and corporation (OECD), international corporate governance network (ICGN) and commonwealth association for corporate governance are three agencies proposed various recommendations on corporate governance. The important recommendations are b organization for economic development Corporation.

Following are the principles of corporate governance proposed by the OECD.

1. Effective and efficient governance framework
2. Protect the shareholders interest.

3. Equitable treatment of all kinds of shareholders.
4. Role of all stakeholders should be recognized.
5. Disclosure and transparency.

## **Corporate governance code in India**

Following are the various committees constituted in india on corporate governance

- a. CII code 1998
- b. Kumar managalam Birla Committee 1999
- c. Naresh Chandra Committee 2002.
- d. Narayan moorthy Commmitte 2003
- e. Jj irani Committee 2005
- f. Udy kotak Committee

### **CII Code 1998**

The federation of Indian industries has appointed a special task force for submitting report on corporate governance in india. The task force has submitted the report titled “ desirable corporate Governance : A code “ which include voluntary recommendation for corporate governance practices for listed companies. It is basically for the promotion of corporate governance and thereby development of Indian corporate sector.

- i. Board should consist of professionally qualified non executive directors

- ii. The board should meet six times in year preferably an interval of two months.
- iii. A listed company with more than one billion turnover should constitute a board with 30% non executive director, if the chairman of the board is a non executive director. If the managing director and chairman s the same person then the board should consist of 50% of the independent non executive directors.
- iv. No single person should hold directorship in more than ten listed companies
- v. To provide a better effort from a non executive directors the company should provide.
- vi. Commission over and above their sitting fees for their professional efforts.
- vii. Stock option scheme as a reward for long term performance of the firm.
- viii. Attendance register must be checked before reappointing a director. If the director has attended less than fifty percent of the meeting the decision to reappoint the directors should placed for voting.
- ix. All the key information and reports should be to the board.

### **Kumar Mangalam birla Committee 1999**

In early 1999, Securities and Exchange Board of India (SEBI) had set up a committee under Shri Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of good corporate governance. The report submitted by the committee is

the first formal and comprehensive attempt to evolve a 'Code of Corporate Governance', in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.

The Committee's terms of the reference were to:

- suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;
- draft a code of corporate best practices; and
- suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

The primary objective of the committee was to view corporate governance from the perspective of the investors and shareholders and to prepare a 'Code' to suit the Indian corporate environment.

The recommendation made by the committee has divided into two parts:

Mandatory recommendation

Non mandatory recommendations.

### **Mandatory and non-mandatory recommendations**

The committee divided the recommendations into two categories, namely, mandatory and non- mandatory. The

recommendations which are absolutely essential for corporate governance can be defined with precision and which can be enforced through the amendment of the listing agreement could be classified as mandatory. Others, which are either desirable or which may require change of laws, may, for the time being, be classified as non-mandatory.

### **Mandatory Recommendations:**

- Applies To Listed Companies With Paid Up Capital Of Rs. 3 Crore And Above
- Composition Of Board Of Directors – Optimum Combination Of Executive & Non-Executive Directors
- Audit Committee – With 3 Independent Directors With One Having Financial And Accounting Knowledge.
- Remuneration Committee
- Board Procedures – Atleast 4 Meetings Of The Board In A Year With Maximum Gap Of 4 Months Between 2 Meetings. To Review Operational Plans, Capital Budgets, Quarterly Results, Minutes Of Committee's Meeting. Director Shall Not Be A Member Of More Than 10 Committee And Shall Not Act As Chairman Of More Than 5 Committees Across All Companies
- Management Discussion And Analysis Report Covering Industry Structure, Opportunities, Threats, Risks, Outlook, Internal Control System
- Information Sharing With Shareholders

### **Non-Mandatory Recommendations:**

- Role Of Chairman
- Remuneration Committee Of Board
- Shareholders' Right For Receiving Half Yearly Financial Performance Postal Ballot Covering Critical Matters Like Alteration In Memorandum Etc
- Sale Of Whole Or Substantial Part Of The Undertaking
- Corporate Restructuring
- Further Issue Of Capital
- Venturing Into New Businesses

### **Naresh Chandra committee 2002**

Committee was constituted by ministry of corporate affairs in the light of various corporate scandals and scams. The prime objective of Naresh chnadra committee was to suggest various amendments on auditor client relationship and the role of independent directors.

### **Narayana Murthy Committee 2003**

Narayana murthy was constituted by SEBI review corporate governance mechanism among Indian corporate sector. The committee also entrusted to review clause 49 of the listing agreement and suggest provisions of corporate governance. The committee has made certain recommendation and classified as mandatory and non mandatory.

### **The key mandatory recommendations focused on:**

- Strengthening the responsibilities of audit committees;
- Improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings;
- Requiring corporate executive boards to assess and disclose business risks in the annual reports of companies;
- Introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and
- Stock holder approval and improved disclosures relating to compensation paid to non-executive directors.

### **Non-mandatory recommendations included:**

- Moving to a regime where corporate financial statements are not qualified;
- Instituting a system of training of board members; and
- Evaluation of performance of board members.

## **JJ Irani Committee 2005**

Committee constituted by central government to analyses various provision of company law and thereby simplify various procedures as required by the corporate sector. There are various provisions suggested by the committee for efficient corporate functioning and classified into seven parts. Following recommendations are made by the committee with regards to corporate governance and investor protection.



- a. One third of the directors should be independent directors.
- b. Maximum directorship for a director should be limited to 15.
- c. A clear remuneration policy of directors should be implemented and it has to be clearly explained to the shareholders and investors.
- d. Three essential board committees to be formed in an organization;
  - i. Audit committee
  - ii. Stakeholders relationship committee and
  - iii. Remuneration committee.
- e. Certain basic duties of directors are clearly mentioned and the list of duties are not exhaustive.
- f. Related party transaction should be disclosed and subject to the board / shareholders approval.
- g. To protect the interest of investor and encourage shareholders democracy.
- h. Compensation to the paid to the shareholders in case of established fraud.
- i. Every company must credit a regular amount to the investor education and protection fund.
- j. Proper frame work for self regulation

- k. No relaxation in corporate governance requirement should be given to financial institutions.
- l. Electronic filing and submission of all the mandatory documents by the companies at the registration time itself to check the vanishing companies.
- m. Regulators/authorities should check the system of name change.
- n. Inter agency coordination system should be implemented to identify and book the person behind the corporate crime/fraud.
- o. Constitution of stakeholder relationship committee.
- p. Duties of directors are prescribed, annual general meeting of the company should be held at a place where company's registered office is located. The company can opt another place where 10% of the shareholders reside

## **Uday kotak Committee 2017**

Uday kotak committee is a committee on corporate governs constituted by SEBI during 2017. The committee includes 21 members and submitted their reports within four months. Following are the major recommendation of Uday kotak committee.

- a. Listed arms with more than 40% public shareholders should separate the role of chairman and managing director and chairman should be a non executive director.
- b. Minimum size of the board should be increased from 5 to 6 and one women whould be in the board as independent director.

- c. All listed firm should hold five board meetings in a year.
- d. Succession planning and risk management should be discussed by the board at least once in a year.
- e. All listed companies should have at least half of the board members as independent directors and all the board members must attend half of the board meetings.
- f. All listed firms must prepare a cash flow statement in every six months.
- g. All the listed from must disclose consolidated earnings at every quarter.
- h. Webcasting of shareholders meeting is allowed for top 100 firms.
- i. A minimum of Rs. 500000 should be given to an independent director as remuneration and sitting fee of Rs. 20000-50000 for each sitting or board meeting.
- j. If the annual remuneration of the executive directors from promoters exceeds rs. 5 crores or 2.5 % of the net profit of firm, the firm must obtain shareholders approval.