

MODEL QUESTION PAPER ANSWERS

PE II

AUDITING

Answer question no. 1 and 2 which is compulsory and **four** from the remaining.

1. (a) As per section 209(4A) of the Companies Act, 1956 the books of account relating to a period of not less than eight years immediately preceding the current year are to be preserved in good order by every company. Here the company is clearly in default. The auditor should, therefore, suitably qualify his report. As per the requirement of section 227 of the companies act, 1956 the auditor is required to state in his report whether in his opinion proper books of account as required by law have been kept by the company.

(b) AAS 22 – Initial Engagements – Opening balances requires that for initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

- (i) The closing balances of the preceding period have been correctly brought forward to the current period.
- (ii) The opening balances do not contain misstatements that materially affect the financial statements for the current period and
- (iii) Appropriate accounting policies are consistently applied.

When the financial statements for the preceding period were audited by the auditor, the current may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the stock has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the stock lying as it might have deteriorated and the same need to be examined. The auditor is advised not to exclude from his audit programme the audit of closing stock.

(c) The auditor is required to obtain necessary information and explanation which he considers essential for performing his duties as an auditor. However, there may be instances when an auditor fails to obtain sufficient information to form an overall opinion on the matters contained in the financial statements. Such a situation may happen either due to limitation on the scope of duties of auditors imposed by the management or the auditor is not

able to verify books of account or evidence due to circumstances beyond one's control. Under the first instance, a situation may also arise when an auditor is not permitted to verify inventory at different locations, say out side the city in which the company's office is located. It would also amount to restriction on the scope of the duties of an auditor. The second category may involve a situation when the books of accounts of a company are seized by the Income tax authorities then the auditor would be unable to conduct an audit of the same. In view of these situations, the auditor would not be able to obtain sufficient information to reach at any conclusion. Under the circumstances, he would not be in a position to express any opinion on the financial statements. Therefore, the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient audit evidence to form an opinion.

(d) Section 226(3) of the Companies Act, 1956 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding one thousand rupees. This provision aims to ensure that the auditor is independent and under no financial obligation to the company.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees one thousand, he is disqualified for appointment as an auditor of the company. It will not make any difference if the company allows him the same period of credit as it allows to others customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

(e) The amount due from shareholders in respect of calls in arrears should be verified by reference to the share register. Part I of Schedule VI to the Companies Act, 1956 requires that the calls due from directors and by others should be shown separately in the Balance Sheet. The articles of company provided for charging interest on calls in arrears. Accordingly, interest due from Directors on account on Calls in Arrears need be provided for. Therefore, neither the disclosure requirements as specified in Schedule VI have been followed nor the interest has been properly charged as required by the Articles of Association.

2. (a) Under section 228(4) of the Companies Act, 1956 the Central Government has formulated Companies (Branch Audit Exemptions) Rules, 1961 to exempt any branch office of a company from being audited having regard to quantum of activity. These Rules require that, if during the said financial year, the average quantum of activity of the branch does not exceed Rs 2 lakhs or 2% of the average of total turnover and the earnings from other sources of the company as a whole, whichever is higher, the said branch is exempted.

In the present case, the turnover is below Rs 2 lakhs and other information has not been furnished. Accordingly, it may be presumed that, exemption may have been granted but still

it is necessary that the fact must be mentioned in the audit report. Since, reference to branch is called for in the auditor's report even if the same has been exempted by the Central Government, the auditor remains responsible. The auditor has, however no responsibility in respect of the audit of earlier period accounts.

(b) Section 224A of the Companies Act, 1956, provides that in case of a company in which not less than 25% of the subscribed share capital is held whether singly or in any combination, amongst others, by a public financial institution or government company or central or state government or nationalized bank or an insurance company carrying on general insurance business, the appointment or re-appointment of an auditor or auditors at each annual general meeting shall be made by special resolution only. In the given case, the nationalized bank held 30% of the subscribed share capital which more than the limit prescribed.

In view of the above provisions, the appointment of Krishna & Co, Chartered Accountants, as auditor of the company is not valid, since as per law, special resolution is required in such circumstances. In such cases, it shall be deemed that no auditor has been appointed and thereupon the Central Government's power to appoint the auditor pursuant to Section 224(3) will become operative.

(c) Section 224(6) of the Companies Act, 1956 deals with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g, death, disqualification, resignation, etc. In the instant case, Mr. X has been validly appointed and thereafter he had resigned. Thus a casual vacancy had been created on account of resignation. The law provides that in case a casual vacancy has been created by the resignation of the auditor, the Board cannot fill in that vacancy. The company in a general meeting can only fill the same. Thus, in this case, the company will have to call an extra-ordinary general meeting (EGM) and appoint another auditor. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting. The provisions of the Companies Act, 1956 applicable for the appointment of an auditor in place of a retiring auditor would equally applicable.

(d) As per facts of the case, the company did not carry any manufacturing or trading activity except rising of share capital, purchase of land, acquisition of plant and machinery etc. Section 210(3) of the Companies Act, 1956 requires preparation of the profit and loss account from the period beginning with the incorporation of the company. Though the company did not carry any manufacturing or trading activity but the company has carried on certain activities like construction of factory shed, acquisition of plant and machinery etc. In such a case, it is necessary to provide for depreciation and other expenses. The mere fact that there was no manufacturing or trading activity cannot be the basis for not preparing the profit and loss account. Therefore, the contention of the Chief Accountant is not correct.

3. (a) Internal audit is a review of the operations and records, sometimes continuously undertaken, within a business by specially assigned staff. It is thorough examination of the accounting transactions as well that of the system according to which these have been recorded, with a view to reassuring the, management that the accounts are being properly maintained and the system contains adequate safeguards to check any leakage of revenue or misappropriation of property or asset and the operations have been carried out in conformity with the plans of the management. However, the routine processes by which an internal audit is carried out are broadly the same as those followed for a professional audit. But internal audit often differs in its scope and emphasis – it is more managerial than accounting, also it's varied, depending on the size of the organisation.

Basic principles of establishing internal auditing in a business concern:

(i) The internal audit department should have an independent status in the organisation. The internal auditor must have sufficiently high status in the organisation. At times, he may be required to report directly to the Board of Directors.

(ii) The scope of internal audit department must be specified in a comprehensive manner to extent practicable. In fact the department must have authority to investigate from financial angle every phase of organizational activity under any circumstances.

(iii) It must have an unambiguous and clear understanding of the objectives on each assignment given to it from time to time.

(iv) The internal audit department should not be involved in performance of executive actions.

(v) The management should take care in selecting the staff of the internal audit department. The size and qualification of staff of the internal audit department should be commensurate with the size of the business organisation. In any case, the cost of internal audit department should not exceed the benefits to be derived from it.

(vi) Programme of the internal audit should be time-bound with the provisions for periodic reporting.

(vii) The Programme of the Internal audit should be so passed as to give a sufficient scope for the follow up action on the various points raised in its report.

(viii) The copy of the report of the internal auditor should be made available to the statutory auditor.

(xi) There must be a specific procedure to follow up the report submitted by the internal audit department.

(b) The general principles involved in drafting an audit programme are as under:

(i) Nature, size and composition of business: The auditor needs to have a good knowledge of the clients business, its structure and the management pattern that will enable him to identify the events, transactions and practices that in his judgment may have a significant effect on the financial information.

(ii) Terms of engagement, scope of work and statutory responsibilities: The exact nature of audit steps required in a particular audit depends upon what precisely is required to be done and what type of opinion is required from the auditor.

- (iii) Dependability of internal control system: In preparing the audit programme, the auditor should review and evaluate the accounting system and related internal controls. Depending on the reliability of internal control system, the auditor may determine the nature, timing and extent of audit procedures to be performed. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants and the involvement of auditors or experts.
- (iv) Specifying appropriate evidence in respect of various items: The auditor must determine what kind of evidence can be obtained in the support of the quantifiable information under examination.
- (v) Identification of significant audit areas and setting materiality levels: Review of internal control system would also reveal crucial areas which must be tested. The level of materiality should also be set and the appropriate audit procedures to be applied.
- (vi) Coordination of the work to be performed
- (vii) Assignment of work to assistants with a clear cut set of instructions involved in the audit with the specified limits.
- (viii) Review of the audit programme as the audit progresses: The audit programme should be reconsidered as the audit progresses. Such consideration is based on the auditor's review of internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.
- (ix) In case of recurring audits, the audit programme should be reviewed periodically to ascertain changes in business structure, accounting policies, accounting system etc.

4. (a) In planning and performing his examination, the auditor should take into consideration the risk of material misstatements of the financial information caused by fraud or error. Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error are:

AAS – 4 on Fraud and Error lists the following events which may increase the risk of fraud or error:

- (i) Weaknesses in the design of internal control system and non-compliance with the laid down control procedures, e.g. a single person is responsible for the receipt of all and marking it to the relevant sections or two persons are responsible for receipt but the same is not followed in actual practice etc.
- (ii) Doubts about the integrity or competence of the management, e.g. domination by one person, high turnover rate of employees, and frequent change of legal counsels or auditors, significant and prolonged understaffing of the accounts department.
- (iii) Unusual pressures within the entity, for example, industry is doing well but the company is not performing all right, heavy dependence on a single line of product, inadequate working capital, entity needs rising share profit to support the market price in the wake of public offer etc.
- (iv) Unusual transactions such as transactions with related parties, excessive payment for certain services to lawyers, etc.

(v) Problems in obtaining sufficient and appropriate audit evidence, e.g. inadequate documentation, significant difference between the figures as per the accounting records and confirmation received from third parties etc.

(b) The duties of auditors are not limited to the verification of the arithmetical accuracy of the books of accounts kept by the client. Simply because, the verification of arithmetical accuracy would amount to certification of accounts only which would not serve much purpose since the auditor is required to report on the manner of selection of accounting policies and to assess the judgement made by the enterprise on arriving at certain accounting estimates or how the final accounts have been ultimately prepared to portray the financial statements. The auditor must satisfy himself by performing substantive audit procedures to verify and substantiate the entries in the books of account. Accordingly, he must examine all vouchers, invoices, minutes of meetings, correspondence and other documentary evidence that is available to establish the nature and authenticity of the transactions. Furthermore, he must verify that there exists a proper authority in respect of each transaction and that they are properly recorded. An important aspect would involve valuation of different assets and liabilities shown in the balance sheet. Finally, the auditor must verify that the form in which the final accounts have been drawn up is the one prescribed by law and as per professional pronouncements and exhibit a true and fair view. In case of companies, Section 227(2) of the companies act, 1956, requires auditors to make a report to members of the companies on the accounts examined by him. Thus, the duty of the auditor is just not restricted to mere checking arithmetically accuracy of accounts but to report on the same.

5. (a) Goods sent out on sale or Return basis:

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (ii) See that price of such goods is unloaded from the sales account and the debtor's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account has been credited correspondingly.
- (iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.
- (iv) Confirm that the stock of goods sent out on approval, period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing stock.

(b) This type of revenue expenditure, whose benefit extends to more than one accounting year during which it has actually incurred. Accountancy principles require that only that part of the expenditure which is pertaining to the accounting period should be debited to the profit and loss account of the year. Remaining amount should be carried forward in the balance

sheet and it should be written off against the future income, depending upon the number of years during which the benefit of expenditure is likely to be enjoyed. This type of expenditure is known as deferred revenue expenditure. Part of such revenue expenditure is to be treated as assets for the purpose of disclosure in the balance sheet for the time till the benefit of such expenditure is fully exhausted.

(c) Wasting Assets: Wasting Assets generally refer to assets like mines, quarries oil wells, etc. Those assets, normally do not suffer the usual wear and tear. But since there is only a limited quantity of the minerals available for extraction, by working upon these assets, such assets gradually gets consumed. But no specific provision to reduce the value of wasting assets exists in the companies act, 1956. It cannot, however be contended that the value of wasting assets exists remain unaltered despite their exploitation year after year. In terms of the clarification issued by the Company law board, it seems that even wasting assets need to be depreciated for the purpose of Section 205 of the Companies Act, 1956. Section 205(2)(d) of the companies act, covers cases in respect of which rate of depreciation is not provided by the companies act. On the very same consideration, if a mine has been acquired on a lease, the total amount paid for the lease should preferably be amortized over the period of the lease, the proportion to the output in each year. This may sometimes appear impracticable, under such a situation, amortization on a time basis may be considered.

(d) Live-Stock:

- (i) Examine live stock register and note various particulars like breed, year of purchase, purchase price, depreciation etc, for various categories of animals.
- (ii) See that the animals have been identified by assigning identification number. Yield and employment record may also be examined to ensure that same are in existence.
- (iii) Verify the basis of valuation. In case of animals purchased at the age of maturity, see that purchase price plus freight has been considered as its cost. Where an animal is reared from its conception and then brought to maturity, the cost has been calculated on the basis of cost of calving, cost of fodder etc, consumed till maturity and suitable share of overheads comprising cost of water, maintenance of sheds, medicines, less sale proceeds etc.
- (iv) Verify that cost accumulated upto the maturity stage of animal has been written off once the earning capacity of the animal starts declining over the remaining life of the animal by straight line method.
- (v) See that disposal value at the end of the life has been adjusted properly. Normally this value may be taken at nil because the carcass does not fetch anything substantially.

6. The special steps involved in the audit of an educational institution are the following:

- (i) Examine the Trust deed or regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act or legislature and the regulations framed thereunder.

- (ii) Read through the minutes of the meetings of the managing committee or governing body, noting resolutions affecting accounts to see that these have been duly compiled with, specially the decisions as regards the operations of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students fee register for each month or term with the respective class registers, showing names of students on rolls and test amount of fees charged and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (v) Total up the various columns of the fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free students concessions have been granted by a person authorized to do so having regard to the prescribed rules.
- (viii) Confirm that fines for late payment or absence have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xiv) See that the investments representing endowments funds for prizes are kept separate and any income in excess of the prize has been accumulated and invested along with the corpus.
- (xv) Verify that the provident fund money of the staff has been invested in appropriate securities.
- (xvi) Vouch donations, if any with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilized for the purpose.
- (xvii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the committee as contained in the minutes book.
- (xviii) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

- (xix) See that increase in the salaries of the staff have been sanctioned and recorded by the committee.
- (xx) See that the increase in the salary of the staff has been sanctioned by the committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provisions and all equipment etc. These should be checked by reference to stock register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investments has been claimed and recovered since the institutions are generally exempted from the payment of income tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of accounts have been prepared as regards Poor boys fund, Games fund, Hostel and Provident fund of staff etc.

7. (a) Approaches to EDP auditing:

Computerization of accounts does not affect the basic objective of auditing. However, the auditor would need to modify his audit procedures, approach and technical capabilities so as to be able to form an opinion on the accounts processed in a computerized environment. The auditor must plan whether or not to use the computer. The two approaches are commonly called “auditing around the computer” and “auditing through the computer”

“Auditing around the computer”: Initially the general approach was to examine the controls that existed around the computer. The concept was to compare the input with the output. The trail was picked up from the input-output. Auditors traced transactions to the black box and picked the trail on the other side by examining printouts. The auditor by following this approach is ‘auditing around the computer’. In literal sense, the auditor did not care about the transformation of data which took place inside the computer.

With further use of computer and complete loss of visible audit trail, the concept of using the computer as a tool for aiding the examination by the auditor emerged.

- (i) Issuance of confirmation requests.
- (ii) Analysis and process of data and
- (iii) Examination of the computer programme for determining the reliability and accuracy of the data being processed.

“Auditing through the computer”: Audit through the computer wherein there is complete loss of audit trail and thus the auditor has to test the system itself. Auditing through the computer requires that the auditor submits data to the computer for processing. The results are then analysed for the processing reliability and accuracy of the computer program.

The auditor can use the computer to test:

- (a) the logic and controls existing within the system and
- (b) the records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. Technical and other developments that necessitated this approach include the emergence of on-line data entry. While auditing through the computer it is common to use computer-assisted audit techniques. The primary advantage of this approach is that the auditor has increased power to effectively test a computer system. The range and capability of tests that can be performed increases and the auditor acquires greater confidence that data processing is correct. By examining the system's processing, the auditor also can assess the system's ability to cope with environment change.

The primary disadvantage of the approach includes costs involved and the need for extensive technical expertise when systems are complex. However, these disadvantages are really spurious if auditing through the computer is the only viable method of carrying out the audit.

(b) The internal controls in an EDP Environment:

The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedures designed into computer programmes. Such manual and computer controls affect the EDP environment (general EDP controls) and the specific controls over the accounting applications (EDP application controls).

General EDP controls: The purpose of general EDP controls is to establish a framework of overall control over the EDP activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include:

- a. Organisation and management controls are designed to establish an organizational framework over EDP activities, including
 - (i) Policies and procedures relating to control functions
 - (ii) Appropriate segregation of incompatible functions
- b. Application systems development and maintenance controls are designed to establish control over:
 - (i) Testing, conversion, implementation and documentation of new or revised systems.
 - (ii) Changes to application systems.
 - (iii) Access to systems documentation
 - (iv) Acquisition of application systems from third parties.
- c. Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that:
 - (i) The systems are used for authorized purposes only.
 - (ii) Access to computer operations is restricted to authorized personnel.
 - (iii) Only authorized programs are used.
 - (iv) Processing errors are detected and corrected.
- d. Systems software controls include:
 - (i) Authorization, approval, testing, implementation and documentation of new systems software and systems software modifications.

- (ii) Restriction of access to systems software and documentation to authorized personnel.
- e. Data entry and program controls are designed to provide reasonable assurance that:
 - (i) An authorization structure is established over transactions being entered into the system.
 - (ii) Access to data and programs is restricted to authorized personnel.
 - (iii) Offsite back up of data and computer programmes.
 - (iv) Recovery procedures for use in the event of theft, loss or intentional or accidental destruction.
 - (v) Provision of offsite processing in the event of disaster.

Application EDP controls: The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorized and recorded, and are processed completely, accurately and on a timely basis. These include:

- a. Controls over input are designed to provide reasonable assurance that:
 - (i) Transactions are properly authorized before being processed by the computer.
 - (ii) Transactions are accurately converted into machine readable form and recorded in the computer data files.
 - (iii) Transactions are not lost, added, duplicated or improperly changed.
 - (iv) Incorrect transactions are rejected, corrected and if necessary, resubmitted on a timely basis.
- b. Controls over processing and computer data files are designed to provide reasonable assurance that:
 - (i) Transactions, including system generated transactions, are properly processed by the computer.
 - (ii) Transactions are not lost, added duplicated or improperly changed.
 - (iii) Processing errors are identified and corrected on a timely basis.
- c. Controls over output are designed to provide reasonable assurance that:
 - (i) Results of processing are accurate.
 - (ii) Access to output is restricted to authorized personnel.
 - (iii) Output is provided to appropriate authorized personnel on a timely basis.

8. (a) Stratified Sampling: Stratified Sampling is one of the methods of Random sampling. This method involves dividing the whole population to be tested into a few groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and proportionate items are selected from each of the stratum. The groups into which the whole population is divided is determined by the auditor on the basis of his judgment, e.g. entire expense vouchers may be divided into:

- (i) Vouchers above Rs. 1,00,000

(ii) Vouchers between Rs 25,000 and Rs. 1,00,000

(iii) Vouchers below Rs. 25,000

The auditor can then decide to check all vouchers above Rs 1,00,000, 50% between Rs 25,000 and Rs 1,00,000 and 25% of those below Rs. 25,000

The reasoning behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each stratum. It can be seen that the stratified sampling is simply an extension of simple random sampling.

(b) Control Risk: AAS 6, Risk Assessment and Internal control defines the control risk as follows: Control risk is the risk that a misstatement, that could occur in an account balance or class or transaction and that could be material, either individually or when aggregated with misstatements in other balances or classes, will not be prevented or detected and corrected on a timely basis by the accounting and internal control systems.

(c) Accounting Estimates: According to AAS 18 “Audit of Accounting Estimates” accounting estimate means an approximation of the amount of an item in the absence of a precise means of measurement. Some examples are:

- (i) Allowances to reduce inventory and accounts receivable to their estimated realizable value.
- (ii) Provisions to allocate the cost of fixed assets over their estimated useful lives.
- (iii) Accrued revenue.
- (iv) Provision for taxation.
- (v) Insurer’s liability for outstanding claims.
- (vi) Provision for loss from a lawsuit.
- (vii) Losses on construction contract in progress.
- (viii) Amortizations of certain items like goodwill and deferred revenue expenditure.
- (ix) Provision to meet warranty claims.
- (x) Provisions for retirement benefits in the financial statements of employers.

(d) Propriety Audit: It is concerned with scrutiny of executive decisions bearing on the financial and the profit and loss situation of the company with special regard to public interest and commonly accepted customs and standards of conduct. While performing a propriety audit, the auditor would judge whether the standards of propriety have been maintained in making payments, incurring expenditure or entering into transactions. According to Propriety audit the auditors try to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. It is hard to frame any precise rules for regulating the course of audit against propriety. Such an objective of audit depends for its acceptance for its acceptance on its appeal to the common sense and straight logic of the auditors and of those whose financial transactions are subjected to propriety audit. However, some general principles have been laid down in the Audit code, which have for long been recognized as

standards of financial propriety. Audit against propriety, seeks to ensure that expenditure conforms to these principles which have been stated as follows

1. The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
2. No authority should exercise its power of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
3. Public moneys should not be utilized for the benefit of a particular person or section of the community unless:
 - (i) The amount of expenditure involved is significant or
 - (ii) A claim for the amount could be enforced in a court of law or
 - (iii) The expenditure is in pursuance of a recognised policy or custom and
 - (iv) The amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type, should be regulated that the allowances are not, on the whole, sources of profit to the recipients.

It may be stated that it is the responsibility of the executive departments to enforce economy in public expenditure. The function of audit is to bring to the notice of the proper authorities of wastefulness in public administration and cases of improper, avoidable and infructuous expenditure.

Section 227(1A) and CARO 2004 issued under Section 227 (4A) of the companies act, 1956 also contain certain clauses dealing with examination of transaction from the view point of propriety.

