Study on
Audit and Certification in
Situations of Missing Records

Research Committee

The Institute of
Chartered Accountants of India
New Delhi

Study on
Audit and Certification in
Situations of Missing Records

Contents > Foreword

Foreword

During the discharge of his professional responsibilities, an auditor might come across situations which are unique. One of such situations could be expression of opinion or certification where all or some of the books of account and other records are not available due to fire, flood, seizure of the records by statutory authorities, etc. In such situations, the responsibility of the auditor becomes more onerous as sufficient appropriate audit evidence is not available. Nevertheless, the clients and users of financial information look upon the professional expertise of the auditor to provide reasonable assurance on the financial information subject to audit/certification. So far, guidance on how an auditor should go about gathering audit evidence in such situations was not available. I am happy to note that realising this need, the Research Committee of the Institute has brought out the 'Study on Audit and Certification in Situations of Missing Records'. I hope that the publication would be immensely useful not only to the members in effective discharging of their professional duties but also to the others concerned.

New Delhi
January 2, 2001

G. Sitharaman
President

Previous	Contents	Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Preface

Preface

Obtaining sufficient appropriate audit evidence is one of the important and significant audit procedures in an audit or a certification assignment since the outcome of performance of this audit procedure materially affects the expression of opinion in audit report or certificate. In the situations of missing/incomplete records and/or supporting documents due to fire, flood, riot or seizure thereof by income-tax or such other statutory authorities, the auditor is severely constrained in obtaining sufficient appropriate audit evidence. However, in audit assignments in such situations or certification assignments for the purpose of insurance claim such as where stock and relevant records have been destroyed in fire, the auditor has to use his specialised skills and judgement to arrive at audit conclusions by performing certain alternative procedures. Keeping in view the need for guidance in such situations, it was decided by the Research Committee to bring out this publication entitled 'Study on Audit and Certification in Situations of Missing Records', which suggests certain procedures and techniques which may be applied gainfully for obtaining audit evidence as well as for collecting certain missing information in such circumstances. The Study also provides guidance for drafting the audit report/certificate in such circumstances. Further, it also covers some case studies based on real life situations illustrating the application of the procedures/techniques discussed in the study.

I place on record the deep appreciation of Research Committee of efforts put in by Shri Chetan Dalal, a member of our profession, for preparing the basic draft of this publication.

I am confident that this publication would be of immense use to the members of the Institute and others concerned.

Bhavna Doshi
Chairperson
Research Committee

New Delhi
January 3, 2001

Previous | Contents | Next

Study on
Audit and Certification in
Situations of Missing Records

Contents >

Contents

Previous	Contents	Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Introduction

1

Introduction

OBJECTIVE OF THE STUDY

REASONS FOR MISSING OR INCOMPLETE RECORDS

PURPOSES FOR AUDIT OR CERTIFICATION

APPROACH OF AN AUDITOR

1.1 In exceptional circumstances such as fire, riots, theft or seizure of books and records by authorities etc., books of account, supporting records, documents, and other source inputs containing data and information required for compilation of accounts may not be available or accessible. Since the day to day operations of the business can not be stopped, accounts would have to be prepared on 'best judgement basis'. The accounts so prepared may also have to be audited/certified by the auditors[1] depending on the purpose for which they are prepared.

1.2 While reporting/certifying accounts in respect of which sufficient appropriate evidence is not available, the auditor faces a situation which is unconventional and unique. In many cases, his opinion may be used for purposes such as release of money from banks, settlement of large receivables or payables, insurance claims, or even adoption of accounts by shareholders of the company of which he is the statutory auditor. Thus, when he audits or certifies such financial statements[2], he has big responsibility since the degree of risk of expressing a wrong opinion is several times greater in such cases than it would be in normal circumstances. While the auditor would normally have to either qualify his report or give a disclaimer of opinion in such circumstances, still the nature and extent of his qualification is very important. In some cases, he may have to give a negative opinion, if appropriate. The auditor has to be extremely careful in expressing any opinion in such situations.

OBJECTIVE OF THE STUDY

1.3 This study seeks to provide guidance about procedures and techniques that may be gainfully applied by an auditor, under the circumstances of missing or incomplete records, to arrive at a level of confidence in respect of the financial statements submitted to him so as to enable him to determine the nature and extent of his observations for drafting the audit report.

REASONS FOR MISSING OR INCOMPLETE RECORDS

1.4 There can be numerous reasons due to which records in an organisation may be missing, unavailable or incomplete. It would be difficult to list all such situations but some of the common ones where audit and certification of financial statements without adequate evidence may be required are listed below:

- Fire, floods, riots, earthquakes or other natural calamities.
- Burglary/theft of records or documents.
- Seizure of records by any authority such as income-tax, sales tax, excise, customs, and Central Bureau of Investigation.
- Files, vouchers, papers or other data are misplaced
- Partial availability of records where particular set of records have been damaged or affected by spilling of water, ink, colour, or chemicals.
- Links with a country may be broken and data regarding the accounts of overseas branches may not be accessible.

This Study does not deal with instances where records have been fraudulently or deliberately altered or destroyed. It also does not deal with the situations where proper records have not been maintained.

PURPOSES FOR AUDIT OR CERTIFICATION

1.5 It would be useful to list the purposes for which an auditor may be called upon to certify or audit the accounts based on incomplete or missing records. Some of the important ones are discussed hereunder:

Insurance claims

1.6 In the circumstances of missing or incomplete records, an auditor may be appointed by an insurance company or the claimant or the surveyor to audit and certify valuation of stock, machinery, property etc., or even the loss of profits. In this case, his audit report/certificate would be used as a basis for settlement of the claim.

Audit under statutes

1.7 An auditor may be required to give his opinion on/certify the accounts under the Companies Act, 1956, the Income-tax Act, 1961, or other laws.

Certification for various users of financial statements

1.8 The auditor may also be asked to certify specific reports for banks, financial institutions, liquidators, Income-tax or other authorities for specific purposes. For example, where a borrower is unable to repay a bank loan due to any of the reasons mentioned in para 1.4 above and wishes to reconstruct his business, he may be expecting to recover monies from various debtors, loanees, and creditors to whom advances have been given. In such a situation, the banker may insist on an auditor's certificate on the net recoverable amount so as to permit the borrower to have more time to repay the loan. Another instance of specific report from an auditor can be where a client is required to submit details for Income-tax hearings after the records are destroyed.

APPROACH OF AN AUDITOR

1.9 The auditor has to determine an approach which would enable him to formulate an appropriate audit plan and compile a supporting checklist within the constraints of information and evidence available. In contrast to audit under normal circumstances, audit under circumstances of missing or incomplete records provides little or no evidence to support the financial statements furnished for audit. The auditor is faced with an environment of uncertainty. He cannot, therefore, proceed in the normal manner. In such circumstances, the auditor has to design the audit approach keeping in view the needs and objectives of the assignment and the constraints of the situation, i.e., the extent of non-availability of the relevant records. His approach should be that since the accounts have been prepared on the basis of missing or incomplete records, the data available to him would have to be examined using all the skill and judgment he possesses. As in case of a jigsaw puzzle, unless one piece fits into two or three other pieces properly, the answer is not assumed to be correct. Similarly, in the circumstances of missing or incomplete information, unless the facts tie-in reasonably with the figures considered from various angles and viewpoints, the auditor cannot arrive at an opinion.

1.10 While the approach of the auditor will vary from case to case, broadly, he may consider the assignment with the following considerations in his mind:

- The specific objective of the audit/certification.
- The extent of non-availability of the relevant records.

On the above basis, the auditor may follow any of following three approaches discussed hereinafter.

The Direct Approach

1.11 This approach can be undertaken when the auditor has the possibility of verifying the constructed or reconstructed records on the basis of evidence, judgment and data available. This would be possible in situations where, although the books of account are not available, relevant details, statements, and computer data are available at other locations and it is possible to formulate audit plan and conduct reasonable checks. It may further be possible to review the system of internal controls in other locations, or have other evidence to satisfy himself as to the fairness of the financial information subject to audit/certification.

1.12 An example where such an approach could be used would be the situations where books of account have been seized by any authority such as Income-tax/Sales Tax Department or police and certified photocopies have been furnished to the auditor. In such instances, the auditor does have the information but not in its original form. The auditor may apply the direct approach in such a case.

The Indirect Approach

1.13 The indirect approach is useful to the auditor when he is faced with a situation where records are missing altogether or to such an extent that he has no direct method of confirmation, verification or examination. Statistical sampling and application of systems compliance tests may not be possible. As per this approach, the auditor uses '*The Process of Elimination*', *i.e.*, he attempts to find out what is not possible or cannot be and determines the possible ranges within which the figures in the financial statements are likely to fall by attempting to work out upper and lower limits. According to this approach, it would be essential for the auditor to collect all the data or the 'clues' available and fit them most appropriately under the circumstances.

1.14 This approach requires a search for indirect evidence, meticulous appraisal of data furnished, procedural review and evaluation of the level of internal controls in existence in the organisation on the strength of even verbal explanations and information. Any disparities or aberrations must be inquired into in-depth. The auditor has to be absolutely clear about the assumptions he makes and his report has to be carefully drafted to convey accurately the circumstances of audit, nature and extent of information available and his opinion.

The Mixed Approach

1.15 The auditor may apply a combination of the above two approaches, depending on the nature of the circumstances. As per this approach, to the extent he can satisfy himself about the correctness or reliability of certain pieces of information he applies a direct approach by compiling an appropriate checklist and test a sample. For the gaps or areas, where data or evidence is missing, he may apply the indirect approach as explained above.

1.16 In most of the cases of missing or incomplete records, the auditor would normally follow the Mixed Approach. In the next chapter, the procedures explained have been broadly based on this approach.

---

1 The term 'Auditor' has been used in this study irrespective of whether the engagement relates to audit or certification.

2 The term 'financial statements' has been used in this study to encompass 'other financial information' also.

Previous	Contents	Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Audit Procedures and Techniques

2

Audit Procedures and Techniques

AUDIT PROCEDURES

SPECIAL AUDIT PROCEDURES, TECHNIQUES AND CONSIDERATIONS WHICH MAY BE USED IN CIRCUMSTANCES OF MISSING OR INCOMPLETE RECORDS

EVALUATION OF ITEMS OF FINANCIAL STATEMENTS

2.1 The starting point of any audit assignment is formulation of the audit plan, which would depend upon the terms of the appointment. In any situation, the audit plan must primarily focus on the purpose for which the auditor has been appointed. A properly formulated audit plan provides the auditor with the right strategy, direction and thrust to approach the assignment. For example, if the auditor knows that his report will be used for settlement of an insurance claim or by a debtor for paying his debt, he may presume that his client will make all efforts to ensure that the value of the relevant assets is not understated. However, the client may not make all efforts to ensure that the value is not overstated. Therefore, misstatements or errors in terms of overvaluations will have to be guarded against more carefully. On the other hand, if a financial statement were to be used for filing tax return or for settlement with creditors, or for other payments to be made by the client, the client would try to ensure that the payables are not overstated. It does not mean that the client would be deliberately or fraudulently making a wrongful statement, but that all the relevant facts may not have been considered in the right perspective. Therefore, the auditor must ascertain the purpose of audit to decide upon the right strategy. *The auditor should also disclose in his report/certificate the purpose for which the audit has been carried out so as to enable other possible users of report/certificate to understand the limited or specific purpose of the audit.* For example, if an audit report has been issued for valuation of stock for an insurance claim, the report may not meet the parameters of the Income-tax department for stock valuation, or hypothecation of stock to a bank.

AUDIT PROCEDURES

2.2 The audit procedures recommended in cases of missing or incomplete records are discussed hereinafter.

Obtaining the documents from the client

2.3 The auditor may obtain the following documents from the client:

- Letter of Engagement clearly stating the terms of his appointment. In this regard, the auditor is advised to refer to the Guidance Note on Audit Engagement Letter, issued by the Institute of the Chartered Accountants of India.
- The financial statements to be certified/reported upon along with the supporting schedules/annexures.
- Reasons for non-availability of the records and information required for the audit.
- The procedure by which the financial statements have been prepared by the client.
- A list of all underlying assumptions made by the management in preparing the financial statements. The auditor would be able to draw a more comprehensive audit plan, if he knows the method of reconstruction of financial statements adopted by the management.
- A list of records in use before the date of their destruction or their non-availability for other reasons. Where the records are numbered, the list of the numbers of the last

records, if available.

- A brief note on the activities of the organisation highlighting all important functions such as purchases, sales, method of accounting, fixed assets in use, production process, consumption ratios, scrap, storage, methods of financing etc.
- A list of records, books of account, vouchers and other data available, if any, to support the financial statements. A certificate should be obtained from the management to the effect that barring whatever has been furnished, no other records are available. This certificate is of significant importance to the entire audit assignment.

Examining the information to be audited/certified for drafting an audit plan

2.4 Depending on the nature of the information required to be audited/certified, the auditor should draw his audit plan. He should prepare an internal control questionnaire in the same way as he would do in normal circumstances. In this exercise, it is not necessary that all negative answers to the questions in the Internal Control Questionnaire would result in a qualification. However, this exercise enables the auditor to assess exactly where he stands. He comes to know, on the basis of this questionnaire, about non-availability of the required information and this information should be compared with the certificate given by the management earlier. On this basis, he can determine his future course of action and draw his audit plan and detailed programme with a checklist. The plan should indicate what seems possible and what does not and the alternatives, if any

Normal audit procedures: Conducting the normal audit to the extent possible as per the audit plan

2.5 As regards the audit of items for which evidence is available, the audit procedures need no elaboration since the methods and techniques would be the same as in the normal circumstances. The auditor would summarize his observations to determine points for qualification, if any, based on the checks carried out. The auditor should carry out the audit of items for which evidence is available by applying the Direct Approach discussed in para 1.11. The working papers for the aforesaid must be made as comprehensive and detailed as possible.

Special audit procedures: Formulation of audit procedures and techniques in respect of items for which evidence is not available

2.6 On the basis of the management certificate and the responses to the internal control questionnaire, the auditor should summarise the evidence and information which is not available. It would be useful to categorise such evidence into the four categories as prescribed in para 12 of the Statement on Standard Auditing Practices (SAP) 5 on ‘Audit Evidence’, issued by the Institute of Chartered Accountants of India, as below:

> “Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal controls over their processing. Four major categories of documentary evidence, which provide different degrees of reliability to the auditor, are:
>
> - documentary evidence originating from and held by third parties;
> - documentary evidence originating from third parties and held by the entity;
> - documentary evidence originating from the entity and held by third parties; and
> - documentary evidence originating from and held by the entity.”

2.7 In all probability, in the situations of missing or incomplete records, evidence of only the first and third types would be accessible to the auditor. The auditor would be well advised to categorise the evidence and data available as well as that which is not available into these categories.

2.8 The normal audit programme should be cross-referenced to the evidence available while a 'Special Audit Programme' may be compiled for the evidence which is not available. This is the crucial area where an auditor has to depend a lot on his judgment and take decisions that could have far reaching implications. If he is unable to arrive at an opinion due to large gaps in information, he should use the Mixed Approach or if the situation is such where no information or evidence is available whatsoever, he has no option but to adopt the Indirect Approach. Special audit procedures and techniques in cases of missing and incomplete records are discussed in detail in a separate section later in this Chapter.

Drafting the assumptions

2.9 The auditor should carefully and exhaustively list all the assumptions made by him as well as by the management, separately. The auditor should ensure that all material and relevant assumptions by the management have been covered in the notes to accounts.

Summarization of final observations

2.10 This is the exercise of tying-up all audit findings into a single summarised note for final discussion with the management. The discussion with the management should be considered with an open mind. Since the situation of missing records does not necessarily arise out of fraudulent circumstances, it would be proper to help the management, to the extent possible. The final discussion should also involve technical personnel, wherever a technical issue is involved, and should be minuted and circulated before the audit report is finalised. This step would determine the nature of opinion that an auditor would express in his report.

Preparation of the final audit report

2.11 The importance of the audit report cannot be over-emphasised since it may be used by various users for making important decisions. The report should, therefore, be clear and focussed. Qualifications, if any, should clearly indicate the extent of non-satisfaction and also state the impact of the qualification(s), wherever possible, on the focal point of the report such as the profit, or the tax liability, or the stock value, etc. In this regard, the Statement on Qualifications in the Auditors' Report issued by the Institute of Chartered Accountants of India, *inter alia*, states the following in paragraph 3.14 of Chapter 3 relating to Manner of Qualifying Reports:

> "The statement should be as precise as possible, bringing out clearly the items affected and their effect on the accounts. Although normally full information should be given in the report. Where full information is not available, it is desirable to give as much information as is available. This is because, in such cases even partial information may be more useful to the shareholders than no information at all. Similarly, where full information with regard to the monetary effect on the Profit and Loss Account and/or Balance Sheet of a qualification or a comment is not available, the auditors' report should either indicate the approximate monetary effect (taking care to state whether it is before or after tax) or state that it is not possible to ascertain the monetary effect, as the case may be."

2.12 The Expert Advisory Committee of the Institute of Chartered Accountants of India has given certain opinions which may be relevant for the audit/certification of the financial statements in the circumstances of incomplete/missing records. Some important opinions are given in **Appendix 'A'**.

SPECIAL AUDIT PROCEDURES, TECHNIQUES AND CONSIDERATIONS WHICH MAY BE USED IN CIRCUMSTANCES OF MISSING OR INCOMPLETE RECORDS

2.13 There can not be hard and fast rules for application of audit techniques, since circumstances under which the incomplete records exist are mostly unique. The auditor cannot just accept certificates from the management regarding non-availability of evidence or information and merely issue a disclaimer at all times. He should also use his professional skill and expertise in analysing, examining and verifying the available information to arrive at a considered judgment. Since users such as bankers, insurance companies, and others seek the opinion of the auditor keeping in view his professional skill and expertise, the disclaimer should be the last resort. There are certain techniques which can be applied gainfully by an auditor with appropriate modifications or fine-tuning to suit the requirements of a given situation for attaining useful or meaningful audit results.

2.14 In this connection, it would be useful to refer to an opinion, given by the Expert Advisory Committee of the Institute of Chartered Accountants of India (Volume I page 252), regarding the reconstruction of accounts following destruction/loss/damage of account books. An office was flooded with water and as a consequence stocks, machinery, account books, cash in hand, etc., were fully destroyed. The ruined machinery was the only asset available. Particulars of debtors and creditors were not available as all the books were destroyed. Creditors were pressing for their payments and customers were not expected to come forward and pay on their own accord. The Committee opined that if the records were destroyed, the following procedures might be followed in order to reconstruct the accounts:

> "The last available balance sheet may be obtained from an external source, as for example, the Registrar of Companies or the Income-tax Officer with whom it may have been filed. Duplicate copies of bank statements may also be obtained from the bankers. Suppliers may be asked to send statements showing the amounts due to them and a similar request may be sent to customers. From the data thus obtained, an attempt should be made to reconstruct the accounts based on the personal knowledge of proprietors, directors, and the staff dealing with such matters. The cheques issued on bank accounts may be obtained, if the required information is not available in the bank statements. It is difficult to make more than a general statement of the methods involved as the procedure would depend on the facts of each case and the extent to which the records have been destroyed."

2.15 Some of the audit procedures and techniques, which may be applied individually or collectively, as a part of the 'Special Audit Programme' referred to earlier, by an auditor, are discussed hereinafter.

Techniques and Considerations Related to Evidence Corroboration

Data and evidence assessment: "Analysis of clues that don't fit"

2.16 The auditor should devote some time to critically appraise the trivial or limited evidence, information and records placed before him. In such circumstances, his role assumes greater responsibility in view of the fact that his opinion is based on missing and incomplete information and there could be colossal implications of the smallest and most insignificant clues, which could be detected if the data and other evidence are assessed.

2.17 It must further be borne in mind that it is easy for any auditee to fend-off an audit query stating that records are not available even if his intentions are not *mala fide*. For instance, where a riot has taken place and records are strewn all over the premises, an auditee may truthfully state that he does not know whether the records are available or not. These could always be found at a later date. Therefore, the auditor should not readily accept the non-availability of any data or evidence unless he has fully satisfied himself about the non-availability of records. A few illustrations of instances where small clues or queries led to major discoveries, in circumstances of incomplete records, are given below:

- Very large purchases were made just before the date of theft of certain records, which were not even paid on the date of audit. Information from the middle level management showed that a lean season was expected and stock levels were adequate to meet existing orders. Therefore, the auditor requested the management to obtain certified confirmations from the suppliers with full details of challans, lorry receipt references, and payments for freight, sales tax and excise. The management reluctantly agreed to do so but found that two of the invoices were booked twice inadvertently and were later reversed.
- In a claim relating to stocks, certain stock verifications conducted by bankers of a company, indicated that balances of several items remained unchanged in a particular month. On cross checking the value of purchases during that month, it was found that despite purchases of large amount, the quantitative balances had remained unchanged. About this inconsistency, the auditee made inquiries and found that these purchases were returned to suppliers due to quality defects but the debit notes had been missed out.
- In a case of riot and looting in a supermarket, the cashier had informed the auditor that the all records were torn, damaged and destroyed, therefore, he produced scraps and pieces of records and documents of the original accounting records and evidence. The auditor calmly took them and piece by piece went through them. While doing so, he came across a voucher, with a date, which was after the date of looting. On being interrogated, the cashier confessed to having taken advantage of the riot and destroyed all records to cover up his own cash shortage.

2.18 It is, therefore, absolutely necessary that the auditor should have a keen eye and must develop the expertise to judge whether the information given to him is capable of being corroborated through other means. The following are some of the factors, which will significantly facilitate his assessment of evidence:

2.19 *Detection of accommodation bills or adjustment entries* Depending on the objective and motive of the auditee, such as repayment of a bank loan, or minimising tax liability, the possibilities of obtaining 'accommodation bills' can not be ruled out. Even though there may not be any reason to suspect the auditee, as a part of a comprehensive audit procedure, the auditor must keep an eye open for such bills which do not really represent value of materials or services supplied. Detection of such bills becomes extremely difficult in circumstances of missing records and, conversely, extremely easier for an auditee to insert such bills. The auditor would, therefore, be well advised to undertake detailed scrutiny of the suppliers' statements of account and he should examine in-depth the procedures related to major purchases. For instance, where payments have been made for purchases before the date of non-availability of records, the transaction is likely to be genuine and satisfactorily supported. Fax acknowledgments/copies of orders, terms of contracts dated prior to the date of non-availability of records, etc., are other sources of evidence for corroborating the genuineness of purchases.

2.20 *Serial numbering and dating of documents* The auditor should keep his eyes open for documents numbered after and before the date mentioned in the certificate submitted to him by the client. In particular, statements from clients, suppliers, and loanees, which are used as a basis of corroborative evidence, should be scanned for such numbers.

2.21 *Illogical events or transactions* Large sales in slack seasons, or vice versa, sudden drop or sharp increases in routine revenue expenses, and unusually large cash withdrawals, can be symptoms of irregularities in the accounts.

2.22 *Adjustments for events likely to affect the information to be certified* For example, during periods of riots, strikes, lockouts, etc., cash sales in supermarkets, shops and trading concerns should be logically less. Conversely, if demand for the product has suddenly increased for any reason, the auditor should verify whether the revenue has also increased accordingly.

2.23 *Compliance tests of current data, if possible* Wherever possible, compliance test of current data is undertaken to learn more about the operation of the internal controls. Wherever appropriate, the auditor may also draw flow charts to strengthen his working papers. Wherever the operations of the auditee are unimpaired, it is useful to pay a visit and understand the operations in detail, to the extent possible.

2.24 It is recommended that the auditor should ask for the following details:

- The list of parties with whom the client had dealings.
- The percentage of cash sales and credit sales in total sales, duly supported by historical data.
- Whether the client had any discounting facilities with the bank, and if so, whether a list of bills discounted with the bank could be certified by the bank.
- Whether any octroi payments were applicable, and if so, whether an octroi consultant had been appointed and whether details of octroi payments/refunds as well as the consultant's fees could be obtained.
- Whether sales tax was applicable, and if so, whether the returns were regularly filed. If a consultant was appointed, whether he would have copies of returns filed.
- What was the system of accounting for free replacements, sales returns, and consignments for goods supplied for demonstration purposes?
- Whether Excise Duty was applicable, and if so, whether it is possible to obtain certified copy of relevant records from the Excise Authorities.
- Whether stocks were dispatched to third parties such as subcontractors, external warehouses, C&F agents etc., and if so, whether any records such as challans could be retrieved from them.
- In respect of purchases, the auditor may call for details of the following type:
    - List of evidence available for materials and services received.
    - External weighment reports.
    - Insurance policies for capital purchases. For most capital purchases, such as machines, computers and cars, insurance policies are generally taken. Where bank finance is obtained, the bankers insist upon insurance. Insurance policies would offer reliable documentary evidence.
    - Where an auditee has contracts with transporters, lorry receipt copies for transport of materials can be obtained and cross-referenced to bills.
    - Hundis discounted with the bank for purchase bills.

Application of Certain Statistical Techniques

2.25 There are several methods of conducting compliance and substantive tests using statistical techniques, which an auditor can apply under normal circumstances for arriving at the required level of confidence. However, in circumstances of missing records, this may not be possible. If parts of the records are available, the most appropriate technique, which can be effectively applied, is '*Discovery Sampling*'. Discovery sampling is essentially a sampling technique for evaluating the '*sufficiency*' of audit evidence on the basis of error or exception in a sample of transactions.

2.26 Discovery sampling is undertaken with the help of a Discovery Sampling Table which indicates the levels of confidence that may be placed on a population depending upon various sample sizes, and percentage of errors noticed in the samples checked. The methods of using such a table are quite simple. For example, as per the table, if the error or exception occurrence rate was 2%, the probability of including at least one error in a sample of 200 is about 0.985. If no error was found, with 98.5% reliability the auditor can believe that the occurrence rate is 2 percent or less than 2 percent.

2.27 Probability Sampling is the other statistical technique which may be applied gainfully under the circumstances of missing or incomplete records. As per the theory of normal distribution, a normally distributed population has 68 percent of the items of the population within the range of standard deviation from the mean (i.e. mean $\pm$ standard deviation) and 95 percent of the items are within the range of 1.96 times of standard deviation from the mean (mean $\pm$ 1.96 x standard deviation). Further applying the test of hypothesis, results of a sample of data can be tested for deciding upon their acceptability as to the entire population. For example, in an audit assignment where some records are missing and receivables spread over 3,000 open accounts are to be audited and certified, the technique of Probability Sampling can be applied gainfully. For this purpose, a random sample of 35 accounts could be selected on the assumption that the population has a normal distribution which, if plotted, would have a 'bell' shaped curve. Supposing the sample, so selected, had the mean of Rs. 10,200 and standard deviation of Rs.1300. If the results of the sample are acceptable, the auditor, based on the characteristics of the normal distribution, can conclude that 68% of the accounts are within the range of Standard Deviation from the computed mean of the sample, i.e., between Rs. 8,900 and Rs. 11,500 (10,200 $\pm$ 1300). Since the desired level of confidence should normally be atleast 95% and not 68%, the standard deviation is multiplied by the factor of 1.96 to calculate a more realistic and acceptable range of Rs. 7,652 to Rs. 12,748 (10,200 $\pm$ 1.96 x 1300). Applying this range to the entire population of 3000 accounts, the range can be obtained as Rs. 2,29,56,000 to Rs. 3,82,44,000 and the auditor can be 95% certain that the value of receivables lies between this range. The remaining 5% possibility of the auditor being wrong is likely to be both ways i.e., 2.5% probability that the value is less than Rs. 2,29,56,000 and 2.5% probability that the value is greater than Rs. 3,82,44,000. The probability of the amount of Rs. 3,06,00,000, being the average of the aforesaid range, is the highest and the auditor would be inclined to believe this figure.

2.28 It should, however, be borne in mind that statistical techniques are not substitutes for the exercise of professional judgement. In fact, these techniques are little more than means of making explicit the role and influence of several judgmental factors in a decision about the true and fair presentation of financial statements. The primary responsibility remains with the management as regards the construction of the accounts and the auditor can only apply his judgement and experience in the sampling methods used in any situation. For instance, in the above example, if the auditor is of the opinion that the range of Rs. 7,652 to Rs. 12,748 cannot be relied upon, he can increase the sample size to say 300 from earlier size of thirty-five, if possible. Let us assume that after including the additional 265 accounts, the mean is recalculated to Rs. 9,900 and the standard deviation to Rs. 950. To calculate the range for desired level of confidence, i.e., 95%, the standard deviation is multiplied by the factor of 1.96. The Range, so calculated, comes out to be Rs. 8,038 to Rs. 11,762. Expressed for the entire population, the total correct value of the receivables is between Rs. 2,41,14,000 and Rs. 3,52,86,000 at 95% certainty of being correct. The best estimate is, the mean of the aforesaid, is Rs. 2,97,00,000.

Trend analysis and ratio analysis

2.29 An auditor can obtain a wealth of data and information by using trend and ratio analysis. The importance of trend and ratio analysis in circumstances of missing or incomplete records is immeasurable. These techniques are some of the few stepping stones available to the auditor for determining the acceptability of the truth and fairness of the financial statements. In an instance, an auditor, under circumstances of incomplete data due to loss by floods, queried the inconsistency and drop in the amount of electricity bills of a factory in a remote place. He was surprised to find that they had been lower for about two months in the year by 10-20%. On inquiry, he came to know that due to a major machine breakdown for almost 40 days, the factory had operated on a crippled basis during the period. The auditor deduced that costs of freight, purchases, and other operating costs and the actual production and sales should also have been proportionately lower. However, it was not so because the auditee had actually derived the figures of sales, purchases and other expenses on the basis of production plan available at the head office, limited data available in computer floppies, analysis of collections and payments from bank statements and a separate file of bills and challans received from telephone, electricity and tax authorities which was temporarily sent to their consultants' office and had, therefore, been saved. After making adjustments for the reduced level of production, the profit determined actually dropped by about 7%, which the auditee readily accepted. Thus, by a careful analysis of electricity bills, the entire financial statements underwent a change.

2.30 Under normal circumstances, trend and ratio analysis is normally applied at or near the end of audit for drawing conclusions as to whether the financial statements, as a whole, are consistent with the auditor's knowledge and only unusual fluctuations or relationships are enquired. However, in circumstances of missing records, the exercise of trend analysis and accounting ratios is far more crucial and not merely confirmatory. In fact, as shown by the illustration in the above paragraph, it may form the very basis of actual determination or revision of financial statements to be certified. In cases where all data has been lost and the auditor has nothing but some previous years' certified data to assist him, trend analysis and application of important ratios are the only methods available to the auditor for verification of financial statements. These techniques are used to identify the limits of each item of financial statements which would enable the auditor to query any figures outside these limits and ask for very strong and convincing reasons of deviations, if any.

2.31 Depending on the explanations received and his own expertise and judgment as regards the validity of the explanations received and the weight of other evidence available, the auditor can deduce the upper and lower limits, for various items of financial statements. In particular, figures of average stocks, daily cash sales, monthly purchases, most of the overhead expenses such as electricity, telephone, salaries, rent, postage, conveyance, and the like are deducible in this manner in the absence of other data or evidence. A suggested table of very useful combinations of accounting ratios for audit under the circumstances of missing and incomplete records is given below:

Area	**Ratio**	**Average for 5 to 10 Years**	**Highest Point**	**Lowest Point**	**Most Likely**
Sales	Gross Profit to sales	12%	15%	9%	11 to 12%
	Debtors Turnover	6.00	8.00	4.00	5.00
Inventory	Stock Turnover	5.00	7.00	4.00	5.00
Purchases	Creditors Turnover	3.00	6.00	2.50	3.50

Working Capital	Acid Test Ratio	1.10	1.60	0.75	1.00
Operating Expenses	Operating Expenses to Sales	79%	88%	64%	79%
Capital Gearing	Debt Equity Ratio	0.75	2.00	0.50	0.75

2.32 The 'Most Likely' ratios have been calculated on the basis of facts and circumstances of each case and the judgment of the auditor. Though some degree of subjectivity may creep in here but that would be unavoidable.

2.33 The greater is the period for which trend analysis and comparison of ratios is conducted the better will be the results.

2.34 The auditor must, however, make appropriate adjustments for specific disturbances in trends which can be brought about by reasons such as:

- change in statutory regulations;
- evident changes in market conditions with substantiation from trade journals or business periodicals; and
- the auditees' own actions such as purchase of new machinery, staff expansion, and technological refinements.

The reasons for each specific disturbance in trend should be recorded in writing by the auditor and preserved in the working papers file.

2.35 In addition to the accounting ratios, in circumstances of incomplete records, non-financial ratios and trends can be immensely significant and useful in decision making as also to corroborate the information to be certified. For instance, in an assignment of stock valuation, where valuation of work-in-progress is required to be certified, the consumption norms provided may be verified with the trend of such norms in previous years. For example, in a certain chemical plant, the finished product 'Resist Salt' is made from raw materials such as nitrobenzene, hydrate lime and other consumables. There is loss of materials at every stage of manufacture, percentages of which are certified by the management. While the auditor need not go into the correctness of such percentages under normal circumstances, in situations of incomplete records these percentages are areas where errors or 'adjustments' can creep in stealthily and materially affect the stock valuation. In such instances, where production records are not available, valuations for the previous few years and consumption, yield and production loss ratios and trends for the previous years would prove invaluable.

2.36 A Case Study on reconstruction of records using 'Ratio and Trend Analysis' is given at **Appendix 'B'**.

Application of dimensional limits wherever logically possible

2.37 Dimensional limits in respect of storage of assets could be the most important consideration in asset quantification. It is logical for an auditor to presume that the inventory cannot be more than:

(a) *The physical limits of space available.*

(b) *The permissible storage facility* The storage facility might not be affected by mere dimensions only but also by other factors such as safety norms, etc. For instance, a godown having stock of pressure cookers may have a height of 15 feet, but storage may not be permitted over 10 cooker cartons vertically since the cookers may not be able to withstand the weight of more than 9 cartons on top.

(c) *Legal/Technical constraints* Similarly, certain items of plant and machinery may, technically, require certain open space or clear area surrounding it or on top, thereby again restricting the physical dimension of the asset or the number of such assets in a given area.

2.38 The auditor is advised to obtain technical guidance on the storage and custody of the assets as per the plan and layout furnished by the auditee. This would give the auditor the upper limit of the asset quantification with suitable modifications and adjustments for stock lying with third parties and third party stock lying with the auditee. The importance of this can be explained by the following example:

An auditor was appointed to certify, for insurance purposes, the value of stock destroyed by fire in a godown. He applied checks relating to inward receipts and issues, and reconstructed stock records using purchase and sales bills and challans retrieved from the suppliers and other parties. He further checked debtors' and creditors' statements to cross-verify the extent of reliability of sales and purchases. He also applied financial tests through ratio analysis and found no serious discrepancy or reason to doubt the correctness of the value of the stock destroyed as per the auditee's statement. However, when he checked the dimensions of the godown, he learnt that the maximum stock, which could be stored in the godown, was only 70% of the stock claimed. The error was then confirmed by the fact that certain stocks were returned by certain parties much later. It was learnt that on rare occasions, stocks were sent out for demonstration. It so happened that a few months before the fire some stocks had been sent out on demonstration to upcountry dealers on the basis of challans for which no invoice was issued. Had the auditor not verified the godown layout and the physical dimensions, he would not have realized that the capacity was far less than the stock declared as destroyed by fire and the insurance claim would have been approved for an inflated inventory.

Production capacities

2.39 The auditor must get a technical evaluation of the production capacity in quantitative and value based terms. The production statements submitted to him must be within the installed capacity.

Techniques related to computers and electronic data processing

Electronic Mail and Internet Communication Facilities

2.40 Rapid progress in the field of computer assisted communication, Electronic Mail (E-Mail) and Internet have offered the auditor an access to data, information and facilities unimaginable hitherto. E-mail is now being used by a large number of organisations for data exchange, internal reporting and communication. The auditor will soon have to adjust his audit procedures to suit reporting through E-mail. For example, in a large organisation, having 13 factories all over India, E-mail was introduced to obtain, the following reports on daily basis:

- Branch/Factory final accounts
- Branch/Factory cash flows
- Branch sales, budgets, variances, and gross margins

2.41 In addition to the availability of above reports on daily basis, the branch books of account were available to the Head Office on monthly basis through E-mail. Also, the set of accounts, duly audited by the internal auditors, was also available on quarterly basis. The operation was so convenient that the entire data files could be sent through E-mail. If the records of a particular location in the organisation are destroyed or are not available for any reason, data transmitted through E-mail may be relied upon because this data comes through an external networking channel (like the post office in case of ordinary mail), provided the auditor is in a position to satisfy himself that the data furnished is obtained through E-mail facility. The auditor can ascertain this by examining the procedure of file transmission through E-mail and the internal controls in force by undertaking a walkthrough test in operation for any other location at random. If the procedure is satisfactory and the auditor is reasonably satisfied regarding the internal controls, he can rely on the financial information submitted to him. The management must be asked to certify that the information furnished is as received through the network and a hard copy of the output is taken out before the data destruction, with E-mail references of the run date, file name, and log-in and log-out time.

2.42 It is felt that more research is necessary on this subject and as the number of users grows, possibly new and better audit techniques will be introduced. The auditor will have to make extensive use of this medium in future.

Disaster Testing Methodology

2.43 With growing reliance on computers, related risks have also increased. Viruses and data corruption can be disastrous and may lead to considerable amount of data being lost. Even back-ups may be affected thereby making retrieval of information impossible. As a result, many organisations have adopted techniques to identify potential weaknesses in systems and procedures on a continuous basis and appropriate disaster combating procedures are developed simultaneously. Thus, in short, the management recognises the risk of loss of information at any time and takes steps to provide for such contingencies. The auditors of the organisation may carry out their own checks through integrated computer programs or other computer audit techniques. Accordingly, if an auditor is faced with a situation where he has been asked to certify information in respect of which the basic data in terms of records, books, etc., is not available, the question arises whether he can rely on the data retrieved by the management through disaster combating procedures. In such a case, it is upto the auditor to define and assess the relative strengths of different types of audit evidence. In this context, it would be relevant to mention the introduction of section 610A in the Companies Act, 1956, through the Companies (Amendment) Bill, 1996, according to which, microfilms, facsimile copies of documents, computer printouts, and documents on computer media such as floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media shall be deemed to be documents for the purposes of the Act and shall be admissible in any proceedings thereunder, without proof or production of the original, as evidence of any contents of the original, or of any fact stated therein of which any direct evidence is admissible. The auditor can apply the spirit of this section in his audit/certification within reasonable limits. Therefore, he can place strong reliance on data and evidence available from computer media which may have been preserved at other locations of the auditee, or filed with the Registrar of Companies, or transferred through E-mail to other entities. Even facsimile documents may be relied upon.

2.44 If the auditor is required to certify or audit any financial statements in an environment which has internal checks and controls, he can place greater reliance on the financial information submitted, provided he is in a position to satisfy himself that the disaster testing procedures were implemented regularly and satisfactorily. For this purpose, he must

- have a note in his working papers file, duly supplemented by flow charts, to describe the system of disaster testing procedures;

- identify the key-control areas in the system; and
- obtain the opinion of software experts and others in the field of computers to have a greater insight into the financial information submitted.

2.45 This technique is not very much in vogue in India as yet, but will certainly form an important method for collection of information in times to come.

Other audit considerations

Using work done by experts

2.46 It is suggested that wherever required, the auditor should include in his working papers/file, the certificates from professionally or technically qualified experts to ensure greater credibility of the data which he has to certify. Statement on Standard Auditing Practices (SAP) 9, "Using the Work of an Expert", in the paragraph relating to determining the need to use the work of an expert, states that the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert. It further states that while determining whether to use the work of an expert or not, the auditor should consider matters such as the nature and complexity of the item including the risk of error therein and the other audit evidence available with respect to the item. Therefore, in the circumstances of missing or incomplete records, the auditor is advised to seek assistance from technically competent consultants such as engineers, architects, chemical analysts, and such other professionals, in the following areas, wherever he deems fit:

- Quantification and valuation of fixed assets, such as plant, machinery, tools, buildings, furniture and stocks.
- Determination of statutory liabilities.
- Production capacity.
- Computation of gratuity and other statistical calculations.
- Company law requirements such as certification of reconstructed minutes, statutory records, share certificates, etc.
- Cost sheets, production processes, consumption, yield, rejection rates, etc.
- Provisions for liabilities in respect of dues and claims against the auditee where litigation is in progress.

2.47 The auditor's responsibility in relation to, and the procedures the auditor should follow while using the work of an expert, have also been prescribed in SAP 9, which may be referred to by the auditor.

Using work done by other auditors

2.48 In the circumstances of missing or incomplete records, the auditor may virtually be groping in the dark and work done by other auditors such as internal and/or statutory auditors in the recent or even in distant past may be invaluable. He can place reliance on the work done by these auditors and their certificates, but cannot escape his own responsibility. He has to undertake his own method of verification and examination, as required by the assignment, and use the reports and data furnished by other professionals as reliable evidence. In this regard, reference may be made to Statement on Standard Auditing Practices (SAP) 10, 'Using the Work of Another Auditor', issued by the Institute of Chartered Accountants of India.

2.49 The relevance of reports and certificates of other auditors in circumstances of missing records is immense since, very often, the issuer of these reports/certificates would be the only external entity who had seen and examined the books or physically verified the assets. For example, for constructing a balance sheet in circumstances where records have been lost or stolen, the previous year's audited statements would give the starting point for the audit trail of the financial statements to be subjected to audit. In case of assets, such as stocks, fixed assets, investments, cash etc., lost in fire, the previous audited physical verification statement would be invaluable to compute the quantitative balance as at a particular date. However, the reliance on the work done by others must be considered in the light of the considerations discussed in the following paragraphs.

2.50 *The objective of the report or certificate given by the other auditor* If, for example, a certificate is given by the internal auditor to the external auditor specifically for the assignment in question, the reliance on the certificate can be of a very high degree. On the other hand, an internal audit report, in general, may not be depended upon in entirety because its scope and extent of check may have been limited. Attention is also invited to Statement on Standard Auditing Practices (SAP) 7, "Relying upon the Work of an Internal Auditor" issued by the Institute of Chartered Accountants of India. In general, SAP 7 requires consideration of the organisational status of the internal auditor, scope of his audit, the technical competence and due professional care taken by him, in determining the extent to which the external auditor can place reliance on the internal auditor. In evaluating specific internal audit work, SAP 7 states that the external auditor must take into account several factors such as the scope of work and the adequacy of the related audit programmes, planning of work and supervision and documentation of the work of assistants, appropriateness of the conclusions reached and consistency of reports prepared, and disclosures of any exceptional matters and internal audit procedures applied to resolve such matters. However, the most relevant factor to be evaluated is whether sufficient appropriate evidence was obtained to afford a reasonable basis for the conclusions reached. This factor would have a considerable impact on the conclusions to be drawn by the external auditor, particularly, in circumstances of incomplete records.

2.51 *The date on which the work of the other auditor was carried out*, as it is possible that the situation could have changed since then. For example, if physical verification of plant and machinery, furniture and fixtures, computers and office appliances was last done by the auditor five years ago in a phased schedule of verification of fixed assets, the audited statement may be relied but with other checks to be applied to ensure that the situation had not changed except as informed.

2.52 *His assessment of the quality of the work done.*

Obtain other reliable audit evidence

2.53 The audit evidence is required to be checked with regard to its reliability and relevance. The situation of incomplete and missing records is unique and unconventional, therefore, the auditor is required to use his professional knowledge and expertise for deciding upon the reliability and relevance of evidence. The reliability and relevance of audit evidence depends upon a number of factors such as its source, nature, etc. Ian Gray and Stuart Manson, in "The Audit Process"(First Edition, 1989) have furnished some useful guidelines for assessing evidence reliability, which are as follows:

TYPE OF EVIDENCE	GRADE OF AUDIT EVIDENCE
Existence of physical objects confirmed by the auditor	Good Evidence.

Analysis carried out by the auditor	Good Evidence.
Evidence from independent third parties	Good Evidence.
Evidence from third parties in the hands of the management	Cannot be accepted at face value and must be corroborated. For example, an auditor always seeks confirmations from the bankers for the balance shown in the bank statements. Similarly, the auditor seeks confirmations from debtors and creditors even though their acknowledged challans and other documents are available.
Evidence created specially for the auditor	Evidence created in normal course of business is better than evidence created specially for the auditor. For example, if the management has preserved regular research reports, order books for assessment of stock value during the course of the year, such information is far more reliable than special quotations called for year-end realizable value for stocks.
Evidence furnished and certified by the management	Cannot be accepted at face value and must be corroborated.
Written evidence as against oral evidence	Good Evidence.
Strength of internal controls is an important factor in determining reliability of the evidence	Tested and established controls in the past would enhance the reliability of the evidence generated.

2.54 SAP 5 "Audit Evidence", issued by the Institute of Chartered Accountants of India, provides in paragraph 7, the following guidelines on reliability of audit evidence:

> "The reliability of audit evidence depends on its source - internal or external, and on its nature - visual, documentary or oral. While the reliability of audit evidence is dependent on circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:
>
> - External evidence (e.g., confirmation received from a third party) is usually more reliable than internal evidence.
> - Internal evidence is more reliable when related internal control is satisfactory.
> - Evidence in the form of documents and written representations is usually more reliable than oral representations.
> - Evidence obtained by the auditor himself is more reliable than that obtained through the entity."

2.55 Considering the above guidelines, the auditor could make gainful use of the following:

- Bank statements supported by balance confirmation certificates from the bank

- List of cancelled cheques from the bank
- Separate statements in writing from cashiers, storekeepers, technical managers, and the chief executive. Sometimes, even affidavits may be taken, depending on the extremity of the case.
- Confirmations from suppliers and depositors.
- Confirmations from customers and loanees.
- Certified copies of returns, and financial statements filed with statutory authorities such as Excise, Sales Tax, Income-tax and Customs.

EVALUATION OF ITEMS OF FINANCIAL STATEMENTS

2.56 The application of the above techniques/procedures for auditing the individual items of profit and loss account and balance sheet in circumstances of missing and incomplete records has been dealt with hereinafter.

Evaluation of Assets

2.57 The auditor may consider application of the above techniques/procedures in respect of the following assets, namely:

- Fixed assets and stocks
- Investments and cash on hand
- Other current assets (such as debtors, loans and advances etc.)

Fixed Assets and Stocks

2.58 In respect of each item of fixed assets such as plant and machinery, furniture etc., and current assets such as stocks, and tools, the procedures to be followed by the auditor are discussed in the following paragraphs.

2.59 *If the actual assets are physically in existence as on the date of audit* The first check that the auditor should apply in relation to assets is the physical verification, wherever possible. All assets, including fixed assets, stocks, etc., should be physically verified in-depth to, the extent possible within the constraints of time and cost. This would provide a basis for working out the quantity for valuation as at the date of the financial statements. Since the auditor may not have the technical expertise in verifying the assets, it is suggested that, wherever necessary, he should seek the help of experts and technically qualified consultants for this purpose, particularly if the Fixed Assets Register is not available to support his verification procedure.

2.60 *If the assets are not available due to damage or destruction by fire, floods, etc.* In such situations, in order to satisfy himself that fixed assets or stocks or any other assets as claimed were in existence, the auditor may consider the following:

- *Evidence in the form of photographs, films taken at functions, etc.* These should be certified as to the date, place, and the description of the photograph.
- *Verification of the damaged asset at the site* Wherever possible, the auditor should physically verify the damaged, broken or destroyed asset. Otherwise, he may place reliance on verification reports issued by insurance surveyors or the management. The physical verification, to the extent possible, should be supplemented by photographs and video film specially for inventories of higher value, which will form a part of the

evidence for the auditor's working papers file.

- *Sample tests using laboratory test reports* (on the remains of the asset, wherever possible) This would furnish further evidence to the auditor regarding the authenticity of the asset. In certain instances, depending on the damage caused, the auditor may be able to assess the original condition of the asset using technical help from laboratories. For example, a laboratory may be able to certify the condition or age of certain items such as cloth, chemicals, yarn, metal, paper, adhesive etc., from the available remains of the asset. Such reports may be a useful evidence for determining the condition of the asset before the date of the mishap which would be useful for valuation.
- *Using the work of experts* It is suggested that, wherever required, the auditor should include in his working papers file certificates from professionally or technically qualified people to have greater credibility of the data required to be certified.
- *External evidence in the form of reports from fire brigade/insurance companies/police* If the auditee has been affected by any mishap such as fire, flood or earthquake, reports may be available from external entities such as the insurance companies, the fire department and even the police panchnama may also be available in some cases. These reports are invaluable to the auditor because they invariably give first hand reports on the state of affairs on the date of mishap.
- *External evidence of physical verification conducted by the auditee's bankers, internal auditors, or surveyors,* if any, prior to the date of destruction or non-availability of records. The verification so conducted will enable the auditor to
  - ensure that internal checks were carried out; and
  - ensure existence of the assets such as stocks, machinery etc., before the date of destruction/non-availability.
- *The dimensional limits of storage* As explained earlier, the auditor should ensure that the physical limits of space, legal regulations and storage and stacking norms have been considered while quantifying the assets.
- *Financial returns and statements from external authorities such as excise and sales tax authorities* The auditor can reconstruct almost the entire stock record on the basis of the relevant statements submitted to the Excise authorities. All excisable items of manufacture require submission of the following information on a monthly basis:
  - Raw materials received
  - Raw materials used and finished products yield and balance raw material in stock.
  - CENVAT claimed
  - Finished products dispatched and balance in stock. Details of the amount of sale are also available in Excise Records.
- A certified set of records from the Excise authorities would constitute reliable 'audit' evidence emanating from the auditee but held by a 'third party'. This would enable the auditor to vouch the following:
  - Inventory - both in quantity and value.
  - Purchases of raw materials.
  - Dispatches of finished stocks for sales evaluation.
- Cross-referencing these records with certified Sales Tax returns would give greater reliability to the auditor.

2.61 A Case Study on audit plan and procedures for the certification of stock in a situation where stock records were substantially destroyed is given in **Appendix 'E'**.

Investments and cash on hand

2.62 If cash/investments were physically verified by the auditor on a date subsequent to the date of financial statements, calculating cash/investments as on date of financial statements by working backward would not be a problem for the auditor. However, if cash/investments were destroyed in fire or the audit is carried out long after the date of financial statements, physical verification of cash/investments of date near to the date of financial statements would not be possible. In such a case, the auditor should apply the method of cross verification discussed hereinafter to test the correctness of cash and investments stated in the financial statements.

2.63 For deducing cash balance, the auditor should obtain a list of all the sources of cash inflow and outflow. The sources of cash inflow are likely to be the following:

- Cash sales
- Cash collected from debtors
- Cash withdrawals from the banks
- Cash receipts
- Miscellaneous income received in cash.
- Return of advances in cash, if any.

The sources of cash outflow are likely to be the following:

- Cash expenses/purchases.
- Cash paid to creditors
- Cash advances
- Cash deposits

2.64 It would be useful for the auditor to prepare Cash Determination Audit Worksheet as follows:

Cash on hand as at the beginning of the period (From previous year's certified data)		Rs. xxxxx
Cash withdrawals (as per bank the statement)	Rs. xxxxx	
Cash sales (as per Working Note 1)	Rs. xxxxx	
Cash collected from debtors (as per statement received from debtors)	Rs. xxxxx	
Cash receipts (as per Working Note 2)	Rs. xxxxx	
Miscellaneous income (as per Management certificate)	Rs. xxxxx	Rs. xxxxx
Maximum possible cash balance		Rs. xxxxx

Less:	Cash expenses/purchases (as per Working Note 3)	Rs. yyyyy	
	Cash paid to creditors (as per statement received from creditors)	Rs. yyyyy	
	Cash advances (as per statement of employees' confirmations)	Rs. yyyyy	
	Cash deposits as per bank statement	<u>Rs. yyyyy</u>	<u>Rs. yyyyy</u>
Best estimate of closing cash balance			<u>Rs. zzzzz</u>

2.65 The following statements and certificates should be taken from the management:

i) Certificate of cash on hand as on the date of financial statements.

ii) Statement of cash flow from the date of the certificate to the date of audit.

iii) Statement of cash on hand as on the date of audit with denominations and quantities of notes and coins on hand that should be physically verified by the auditor.

Working Notes

1. *Determination of cash sales* Most companies having reasonably good control systems, insist on depositing entire cash sales in the bank on a daily or weekly basis. The cashiers are not permitted to use the cash so received and, in fact, have separate cash for expenses. In such instances, the bank statement would enable the auditor to identify such cash deposits and classify them as cash sales of the auditee. If the system of depositing cash sales has been satisfactorily implemented in the past, the auditor may reasonably finalise cash sales on the basis of cash sales deposit entries in the bank statements. In other cases, where such satisfactory systems do not exist, the auditor has the extremely tough task of determining cash sales that he may attempt on the basis of:

- Average cash sales in the past 5-10 years.
- Explanations and confirmations from the sales manager and the management.
- Applying statistical methods such as measures of central tendency, e.g., the mean or an average sale value per receipt printed and used.
- Sales Tax returns

The last of the above would be the best estimate for cash sales on a conservative basis.

2. *Determination of cash receipts* These may be easier to determine on the basis of credits reflected in statements submitted by the parties. Wherever cash receipts from parties are on record, they form reliable audit evidence and such cash receipts need not be disputed. However, where confirmations are not so available, a separate list should be prepared and if the amount is material, a qualification in the audit report would be essential.

3. *Determination of cash expenses* As in the case of cash sales, these should be worked out on the basis of the following, except that, in this case, the auditor, on a conservative basis, must take the maximum of these figures:

- Average cash expenses in the past 5-10 years.

- Explanations and confirmations from the concerned management personnel.
- Cashier's statement.
- Expenses as per Income-tax assessments or returns and if assessments are not available, preferably certified copies.
- Statistical methods, such as discovery sampling/probability sampling, if part of the records are available.

2.66 For deducing investments, wherever investments are physically available, the auditor would be in a position to determine the following:

- the quantity of scrips and the description;
- the date of transfer; and
- the income due or accrued.

2.67 The auditor would, however, not be able to easily access the book value and whether any provision for loss due to fall in value of investments would have to be made. Here again, where previous years' certified data from balance sheets have been obtained from external sources such as the bankers, tax authorities or the auditor's own records, reliance can be placed on such records. In case purchases or sales of investments have been made in the current year, it would create an uncertainty. In most of the cases, the auditee's brokers' or agents' statement of account may provide an exhaustive list of details to fill-in the missing gaps. In short, as far as investments are concerned, wherever physically available, the audit trail can be reconstructed in most cases.

2.68 The problem arises where the investments have been physically lost. In such cases, purchases and sales of investments for the current year will be most uncertain. As regards sales, if time permits, the auditor may independently obtain confirmations from the individual companies, regarding the status of the holding of the investments by the auditee. The usual broker of the client may be asked to furnish a list of purchases/sales made on behalf of the auditee. The auditor may further analyse the bankbook and the bank statement to list payments to or receipts from any major share broker, financial service agent, or any new company to confirm and corroborate this fact.

2.69 In respect of investments, the auditor is required to exercise extra care where high amounts are involved and there is time constraint to perform audit procedures.

2.70 The best and most reliable evidence in case of any investment would be the latest dividend or interest warrant, if any, received from the investee after the date of destruction or non-availability of records. These would provide evidence of the holding as on the date on which the records were destroyed or became otherwise non-available. The auditor must keep copies of such warrants in his working papers' file. In addition, the auditor may consider the following:

- Wherever duplicate certificates or confirmations are received from companies/institutions/government agencies for the value of investments held in the previous year, investments should continued to be shown at the same value as in the previous year.
- Wherever data is awaited or not available, and the bank summary does not indicate any material deposit or payment relating to investments, he may rely on the investment figure of the previous year with a note to that effect in the notes to account.
- In other cases, a qualification, appropriately quantified explaining the situation as clearly as possible, may be given in the auditor's report.

Other current assets

2.71 In respect of current assets which cannot be physically verified such as debtors' balances, the auditor needs to obtain statements from the parties concerned. Previous years' certified data, if available, will form the auditor's basis for his scrutiny. The auditor will also be able to use invoice number references given by the customers for corroborating documentary data furnished by clients and to ensure proper cut-off procedures. The auditee's customers may be further requested to furnish copies of challans, packing slips and invoices for improving the audit trail, again within the constraints of time and costs. The extent of reliance that the auditor can place on the data furnished by the customer will vary depending upon the judgment of the auditor based on the circumstances of individual case. The following suggestions may be considered in this regard:

- Audited statements of account of the customer would form important audit evidence which may be relied upon by the auditor.
- Statements received from reputable companies, such as listed companies, would be more reliable than those received from unknown companies, firms or small traders.
- Statements backed by documents and full details would be relatively more reliable.
- The amount received and paid should be cross-verified with the bank statement of the auditee for cheques received and deposited. Any mismatch should give enough reason to reduce the reliance on the statement.
- Payments made by debtors in cash for sales or for clearing an outstanding should be supported by cash receipt or at least receipts references from the auditee.
- The debtors should also be requested to furnish a list of disputed sales invoices, goods returned, and sales orders executed and pending, to give the auditor data regarding sales returns, and a basis for provision for doubtful debts.

2.72 If the dealings are voluminous and the materiality of the receivables and sales so warrant, the auditor, with the consent of the client and the debtor, would be better equipped if he visits the office of the debtor and gets all the data and information necessary to determine the correctness of figures of sales, sales returns, credits for discounts and rate differences, and cheques paid as well as the outstanding amount. In respect of interest payable on delayed payments, a worksheet for the calculations should be requested.

2.73 In case of loans and advances, the techniques would be the same as in the case of debtors except that generally the number of entries in this regard would be lower and may be easily verified with the previous years' certified data and current year's bank statements. The auditor may rely on the balance (at least as far as the principal amount is concerned) indicated in the certified data of the previous years and the bank statements. Interest receivable, if any, should be supported by a worksheet.

2.74 The bank balances may be accepted as certified by the bank. Detailed analysis of the bank statements might have been done for reconstruction of other evidence such as payments to creditors, collections from debtors, items of income received and payments made for expenses. However, the major weakness in this procedure would be the inability to detect any errors on the part of the bank. The auditor would be well advised to examine the explanatory note on possibilities of errors on the part of the bankers and the uncertainty of their impact on the financial statements.

Other assets/debit balances

2.75 In respect of prepaid expenses, the previous year's schedule would provide to the auditor a basis for the current year's figures. In respect of the items repeated from the previous years such as insurance premium, rent etc., a confirmation or receipt from the recipient might provide sufficient evidence which should be matched with entries in the bank statement.

2.76 In respect of debit/credit balances of profit and loss account, deferred expenses etc., the auditor would require the previous years' certified data. The closing balance would depend on his observations after performing various other procedures.

Determination of Liabilities

2.77 The verification of the correctness and genuineness of any liability is relatively an easier proposition from the auditor's point of view since the creditor may be asked to prove, with documentary evidence, the truth of his claim. If adequate documentary evidence is not available and the matter is under dispute, depending on the probability of the liability to crystallise, the auditor should insist on a provision or inclusion of this liability under 'Contingent Liabilities' keeping in view the requirements of Accounting Standard (AS) 4, 'Contingencies and Events Occurring After Balance Sheet Date', issued by the Institute of Chartered Accountants of India. In brief, the audit procedures discussed in the following paragraphs may be performed for various types of liabilities.

Sundry Creditors and Outstanding Expenses

2.78 The auditor would require full details of all invoices, purchase orders, challans for supplies, evidence of goods/services received and a statement of account indicating the balance as at the date of the financial statements with full references of payments made by the auditee from time to time in the previous year for verification. The basis of verification will be provided by the previous years' certified data. All cheque issued as per bank statements must be matched with payments shown in the statements received from suppliers. The suppliers may also be requested to furnish details of cash purchases by the auditee, if possible, to enable the auditor to determine the quantum of cash purchases. Verification of outstanding expenses should not be a problem because copies of bills for all unpaid expenses would be available. The auditor should obtain management representation as to the authenticity of the goods/services received. It would also be desirable to obtain a representation from the management in respect of large bills. The auditor should scan the list of creditors and outstanding expenses for any unusually large purchases and record the explanations given to him.

2.79 The audit procedures relating to possibilities of suppliers' accommodation/adjustment bills, which are relevant here, have been discussed earlier. The auditor may visit the offices of a few suppliers with the consent of the auditee to satisfy himself about the reliability of the transactions between the auditee and the suppliers concerned.

Loans or Advances Received

2.80 In addition to the statements and confirmation of balances as stated above, the agreement or purpose for which the advance was taken may be specified. If the advance is against a purchase order, a copy of the order may be obtained. If the loan is a secured term loan, full details of loan should be available from the lender including the nature of the security. The details furnished by the lenders may be considered reliable evidence of loans and advances due as well as the interest paid and payable.

Recognition of Revenue Earned and Expenses Incurred

2.81 The auditor should ensure that the cash and bank book has been reconstructed with the help of bank statements obtained from all the bankers of the auditee. From the cash and bank books, so prepared, a summarised cash flow statement should be prepared to segregate receipts into transactions relating to realisation of assets such as receivables, loans, tax refunds or sale of fixed assets and transactions relating to sale of trading assets, and other revenues. A suggested Bank Transactions Review Sheet, which can be gainfully used in these circumstances, is given below:

Bank Transactions Review Sheet
(Preferably separate for each bank)

Bank Balance (as per the previous year's certified data)			Rs. xxxxx
Add:	Cash Sales (As explained earlier)	Rs. xxxx	
	Lease Rentals (As per the agreement and monthly rent deposit)	Rs. xxxx	
	Interest on Loans (As per the agreement and loan confirmation)	Rs. xxxx	
	Loans Repaid/Received (As per the agreement and confirmation)	Rs. xxxx	
	Debtors Recoveries (As per the bank/debtors statement and confirmation)	Rs. xxxx	
	Unidentified Receipts (Balancing figure)	Rs. xxxx	
	Cash Deposits (As per the bank statement)	Rs. xxxx	Rs. xxxxx
	Total:		Rs. xxxxx
Less:	Cash withdrawal (As per the bank statement)	Rs.yyyy	
	Estimated Expenses (Explained below)	Rs. yyyy	
	Loans and Advances (As per the confirmations received)	Rs. yyyy	
	Cheques returned by the bank	Rs. yyyy	Rs. yyyyy
Balance as confirmed by the bank			Rs. zzzzz

2.82 The unidentified receipts may include items of sales as well as other recoveries. The auditor should apply his skill of compiling accounts on single entry basis to determine a realistic or acceptable amount of recoveries made from trade debtors and from others. The figure so deduced, can be reduced from unidentified recoveries to determine the revenue receipts out of the unidentified receipts. As regards transactions relating to realisation of assets such as return of loans or recoveries from debtors, the auditor should cross-verify the correctness with confirmations or statements from the concerned loanees or debtors. In respect of those recoveries for which no corroborating evidence is available, the auditor will have to make a disclaimer in his report to the effect that certain receipts are yet to be identified.

2.83 In respect of credit sales, pending full confirmation from debtors, in circumstances of missing/incomplete records, the audit trail is incomplete as the auditor may not be in a position to obtain evidence of dispatches and consequently unable to prove the claim of the amount receivable from the debtors. Unless reconciliations are completed, the auditor may not be in a position to arrive at a reasonable conclusion and may have to make a disclaimer in this regard.

2.84 In case of certain other items of income, where the actual receipt books are not available, the auditor may consider the following while verifying the same:

- Lease rental receipts are usually of a fixed amount and are received on fixed dates.
- Cash sales (on the basis explained earlier).
- Interest/Royalties
    - Agreements for interest/royalties
    - Past interest/royalty payments
    - Confirmation certificate from the Income-tax office.
- Dividends
    - As per the dividend warrant
    - As per the dividend declaration made by the company in the Annual General Meeting.

2.85 As regards payments, the auditor may get a list of cheques cleared from the bank. The cheques would indicate clearly the payees' names, which would be extremely useful in determining the nature of the payment. In this case also, revenue payments may be considered, where vouchers are not available in respect of certain expenses, as follows:

- Lease rent payments of fixed amounts and on fixed dates as per the agreement(s).
- Payments to Telephone Company, such as MTNL, can reasonably be considered as the telephone expenses.
- Payments to the Electricity Board/Company can reasonably be considered as electricity expenses.
- Payments to Municipal authorities can reasonably be considered as rates and taxes.
- Payments to auditors and consultants can reasonably be considered as legal and professional charges.
- Payments to excise, sales tax and Income-tax authorities can be considered as the concerned expenses.
- Monthly salary payments can also be reasonably identified.
- Payments for Provident Fund and Professional Tax can also be reasonably identified.

2.86 The auditor should try and narrow down the areas where receipts and payments are not reasonably identifiable so that the qualification/disclaimer areas could be reduced. As in the case of receipts explained earlier, the auditor may be able to segregate the non-revenue payments using, if possible, single entry accounts compilation procedures from the total payments.

2.87 In respect of other payments and expenses, various types of procedures as explained above, to the extent possible, with appropriate modifications, keeping in view the facts and circumstances of each case, may be used. In such cases, the skill, judgment and professional experience of the auditor becomes important.

Previous | Contents | Next

Study on Audit and Certification in Situations of Missing Records

Contents > Auditors Liability

3

Auditor's Liability

IMPORTANCE OF WORKING PAPERS

3.1 The role of the auditor is more important in the circumstances of missing or incomplete records since his certificate/report may not only be a statutory requirement but also a basis of important financial decisions. It is the uncertainties surrounding the financial statements in these circumstances which makes expression of his opinion much more onerous and important.

3.2 The extent of the liability of an auditor in the circumstances of missing or incomplete records would be determined by taking into consideration the constraints within which he had to work. The most important factors to determine his liability would be his presumptions, identification of the key control issues in determining the validity of various statements and the procedures adopted in the light of the information and evidence, if any, available.

3.3 One of the most important court judgments, in this context, is that of Motiff. J in a famous Australian case, 'Pacific Acceptance Corporation v/s Forsythe and Ors. (1970) WN (NSW) 29', (referred to in 'Professional Negligence' by E. F. Mannix and J. E. Mannix, Third Edition) which covered approximately 359 pages and is not only a detailed treatise on the facts of the case but also about the limits of the role of an auditor. His Honour recognised the problems of the profession when he said: "One matter which emerges clearly is that it is not possible in most situations to make an absolute pronouncement as to what an auditor should do in an auditing situation generally. There is always an exception or in some cases an extreme that provides a reason for a different approach in some special cases." He further stated that "It is beyond question that when an auditor, professing as he does to possess the requisite professional skills, enters into a contract to perform certain tasks as an auditor, he promises to perform such tasks using that degree of skill and care as is reasonable in the circumstances as they then exist. That is the limit of his promise."

3.4 An auditor's liability, in the circumstances of missing and incomplete records, would depend on:

- the appropriateness of the audit procedures;
- the presumptions; and
- the report.

3.5 In all probability, the auditor may not be able to express an unqualified opinion on the true and fair view of the financial information by using deductive methods for estimating financial information. At best, he can express an opinion based on the reasonableness of the information, which, in turn, would be based on assumptions made, facts available and the evidence relied upon. Wherever possible, the auditor may disclose the likely margin of error, as it would assist the user.

IMPORTANCE OF WORKING PAPERS

3.6 The importance of working papers in the assignments involving audit/certification of missing/incomplete records is tremendous. Under normal circumstances, the auditor would have in his working papers file parallel set of data, evidence and records, etc., which are deemed necessary by him. However, in assignments involving incomplete or missing records, the auditor may have some data, information, evidence or records, etc., which are obtained directly from third parties, experts etc., and it would be almost impossible to create or obtain these again, if required at a later date, and, therefore, the proper maintenance of working papers is very important in cases of missing/incomplete records.

Previous	Contents	Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Reporting

4

Reporting

4.1 In the case of incomplete or missing records and supporting audit evidence, the audit report assumes added importance. The auditor, therefore, will have to be extremely careful in preparing his audit report in these situations. While drafting the audit report, he should keep in mind the following with regard to the manner of expressing a disclaimer/qualification/disclosure or an adverse opinion in the Audit Report:

i) In making a disclaimer/qualification/disclosure or an adverse opinion in the audit report, the auditor must consider the materiality of the relevant item.

ii) The auditor should follow the requirements of the 'Statement on Qualification in Auditor's Report'.

iii) A disclosure, which is not a subject matter of audit qualification, should be made in a manner that it is clear to the user of the report that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

4.2 In the circumstances of incomplete/missing records and supporting audit evidence, primarily the auditor's opinion is affected in respect of (a) maintenance of proper books of account, and (b) the true and fair view of the state of affairs and the operating results of the enterprise. The following paragraphs deal with the aforesaid aspects of the auditor's opinion.

Auditor's opinion on maintenance of proper books of account

4.3 The auditor in various audit assignments has to express an opinion as to whether proper books of account have been maintained by the entity insofar as it appears from the examination of the books. In the situations of missing or incomplete records, it may be difficult for an auditor to give an unqualified opinion on this aspect. His opinion may be qualified where he is of the opinion that proper books of account have been maintained subject to certain exceptions. For example, a qualified opinion may be expressed where proper books of account have been maintained by the entity with the exception of fixed assets register, which does not contain a complete record of certain fixed assets. The opinion in this regard may appear as follows:

> "In our view, proper books of account have been maintained by the enterprise with the exception of the records related to fixed assets, which were destroyed in a fire."

4.4 The auditor may express an adverse opinion stating that proper books of account have not been maintained. For example, an adverse opinion may be required in a situation where cash book has not been maintained properly thereby affecting various ledger accounts. The adverse opinion in such a situation may be expressed in the following manner:

> "In our view, the company has not maintained proper books of account since its cash book for the year has not been maintained properly as it does not contain complete record of cash transactions. As a consequence of this, the ledger accounts are also incomplete."

4.5 In certain situations, the auditor may have to express a disclaimer of opinion. Such situations may arise, for instance, where Income-tax authorities have seized the books of account. The disclaimer of opinion in such a case may appear as below:

> "The books of account of the company have been seized by Income-tax authorities and are still in their custody. We are, therefore, unable to express an opinion whether proper books of account have been maintained by the company."

4.6 Another example where the auditor may have to express a disclaimer of opinion could be where the books of account and statutory records were seized by the Income-tax authorities, and the authenticated photocopies of the cash book and the ledger are made available but the copies of supporting vouchers and other books of account are not available. The disclaimer in such a situation may appear as below:

> "The books of account and supporting documents of the company have been seized by the Income-tax authorities in a search and seizure operation under section 132 of the Income-tax Act, 1961. The management of the company has been able to obtain the authenticated photocopies of the cash book and ledger but not of other records including supporting vouchers and documents. Accordingly, we are unable to form an opinion as to whether proper books of account as required by law have been kept by the company."

4.7 The auditor may, however, express an unqualified opinion where copies of all the books of account and the supporting vouchers authenticated by an appropriate third party, say, the Income-tax authorities, are available. He should, however, make a disclosure of the fact that audit has been completed on the basis of the copies of the books of account authenticated by the Income-tax authorities. The disclosure in such a situation may appear as follows:

> "The books of account and supporting documents of the company have been seized by the Income-tax authorities in a search and seizure operation under section 132 of the Income-tax Act, 1961. However, the management of the company has been able to obtain photocopies of the books of account and supporting documents duly certified by the authorities. Accordingly, audit had been carried on the basis of certified copies".

Auditor's opinion on true and fair view

4.8 The auditor's opinion as to whether the financial statements reflect a true and fair view of the state of affairs and the operating results of the enterprise may also be affected due to incompleteness or absence of records. The auditor may have to express disclaimer of opinion or a qualified or an adverse opinion although in a few cases, the auditor may be able to express an unqualified opinion despite the incompleteness or absence of records.

4.9 In the situation of incomplete or missing records, the auditor is unlikely to be able to obtain sufficient appropriate audit evidence. In situations where the evidence obtained by the auditor is so insufficient that he cannot form any opinion about the true and fair view of the financial statements under audit, he should express a disclaimer of opinion. An example of such an opinion would be where certain authorities have seized the books of account and supporting vouchers. In such a situation, the disclaimer may be worded as below:

> "The books of account and the supporting vouchers of the company have been seized by the Income-tax authorities. As such, we have not been able to examine the same.
>
> In view of the above, we are unable to express an opinion as to whether the balance sheet gives a true and fair view of the state of affairs of the company as at .... and whether the profit and loss account gives a true and fair view of the profit of the enterprise for the year ending as on that date."
>
> A sample of the audit report, giving a disclaimer when books of account have been seized by a statutory authority, has been given in **Appendix 'C'**.

4.10 In situations where the effect of missing or incomplete records and/or supporting audit evidence is not so material and pervasive as to require a disclaimer or an adverse opinion, the auditor may express a qualified opinion. An example of such a situation would be where old records of a company have been destroyed in a fire during the year, to which the original cost and total depreciation written off in respect of each item of fixed asset cannot be calculated. In such a situation, the report may be qualified as follows:

> "Owing to destruction of the company's old records in a fire during the year, it has not been possible to ascertain the original cost and the total depreciation written off from the fixed assets. An analysis of the original cost of the fixed assets is also not available. It is not possible, therefore, to give the particulars of the fixed assets as required by the Companies Act, 1956.
>
> Subject to the above, we report that ...."

A sample of qualified audit report, when certain supporting documents and records have been destroyed in fire at the company's premises, is given at **Appendix 'D'**.

4.11 The auditor may express an adverse opinion in a situation where, although the evidence is available, but it does not support the position as shown by the financial statements and the effect is so material as to affect the true and fair view of the state of affairs and the operating results of the enterprise.

4.12 While expressing a qualified or an adverse opinion or a disclaimer of opinion, the auditor should clearly state the reasons for the same.

4.13 In a situation where the auditor is able to obtain sufficient appropriate audit evidence, he would be able to express an unqualified opinion. This situation may arise where the auditor has been able to obtain sufficient appropriate evidence by performing alternative procedures. However, such a situation is likely only in those situations where the extent of incompleteness of records is not significant. An unqualified opinion may also be possible in those situations where the duplicate set of books of account and ledger as well as the supporting vouchers duly authenticated are available and the auditor is satisfied about their correctness.

4.14 In many cases, the auditor is also required to report on various other assertions in his report. For example:

i) Whether the auditor has obtained the information and explanations which to the best of his knowledge and belief are necessary for the purpose of his audit,

ii) Whether the accounts give the information required by the relevant statute and in the manner so required.

4.15 In the situations of incomplete/missing records, the auditor will have to make appropriate modifications in his opinion while reporting on the above-mentioned assertions, i.e., he may have to disclaim or qualify or express an adverse opinion with regard to the above assertions also.

Reporting requirements under sections 227(1A) and 227(4A) of the Companies Act, 1956

4.16 The auditor is required to report on various aspects covered in sections 227(1A) and 227 (4A) of the Companies Act, 1956. In the situation of missing or incomplete records, the auditor has to use his professional judgement and expertise in considering the matters included in the aforesaid sections. The auditor may have to issue disclaimers in respect of various assertions required to be made in the said sections. For example, the following disclaimers may appear in respect of reporting requirements under section 227(4A) of the Companies Act, 1956:

Fixed Assets: The company has been maintaining records showing quantitative details and location of its fixed assets. We are informed that since the Income-tax authorities have seized the records, the management has not been able to implement its programme of verification of these assets and consequently, material discrepancies, if any, would not be noticed until such verification takes place.

Closing stocks of finished goods, raw materials, spares etc. The stocks of finished goods, raw materials and spares have been physically verified at reasonable intervals during the year. However, the discrepancies, if any, can be detected only on comparison with book records, which, as informed to us, are lying with the Income-tax authorities.

Loans to parties: Due to loss of all the relevant records in fire, we are unable to ascertain whether, in respect of all the loans given by the company to the parties, repayments of principal amount and interest are being recovered as stipulated.

Internal control procedures: In the absence of complete evidence in respect of purchases and sale of goods, materials and services, we are unable to comment upon the adequacy and commensurateness of internal control procedures.

Fixed Deposits: In the absence of records relating to fixed deposits accepted, which have been lost in fire, we have relied on the certificate, as regards compliance of the directives of the Reserve Bank of India and the provisions of section 58A, furnished to us by the Fixed Deposit Consultants of the company, with whom the company has a contract in respect of maintenance of records, calculations of interest, disbursements of interest and principal on maturity.

Reporting on certain Disclosure Requirements as per Schedule VI to the Companies Act, 1956

4.17 The auditor in his main audit report as prescribed under section 227(4) of the Companies Act, 1956, *inter alia*, reports on the true and fair view of the profit or loss and the state of affairs of the company for the relevant period. The Companies Act, 1956, also requires certain disclosures such as those pertaining to licensed capacity, installed capacity, actual production. expenditure in foreign currency, royalty, know-how, etc., as per Schedule VI to the said Act. The additional information required to be disclosed is an integral part of the profit and loss account and the balance sheet. The Statement on the Amendments to Schedule VI to the Companies Act, 1956, issued by the Institute of Chartered Accountants of India, *inter alia*, provides the following with regard to the auditor's duties and functions in relation to the above:

> "Since the additional information in terms of the new requirements of Schedule VI, Part II and Part I, would be the integral parts of the Profit or Loss Account and the Balance Sheet, it would be covered by the normal statutory affirmations in the auditor's report rather than by any separate certification of such information by the auditor. Consequently, the auditor's responsibility would be derived from the statutory affirmations and as such, it would be his duty to perform such audit tests as he may deem necessary in order to arrive at an opinion as to whether or not the additional information is fairly stated and is in accordance with legal requirements. In expressing such an opinion, the auditor does not guarantee or certify the absolute accuracy of the information. The test of his responsibility with reference to additional information is precisely the same as test of his responsibility with reference to the company's accounts taken as a whole."

4.18 The Statement also states that the primary responsibility for the accuracy of the information presented pursuant to the above requirements rests with the management. The auditor's duty, important as it is, is essentially of a secondary nature, since his function is merely to test the information presented by the management rather than to ensure the accuracy of the information itself.

4.19 In the circumstances of incomplete records, the information pertaining to the aforesaid aspects may not be available. The auditor should ensure that appropriate disclosures in this regard have been made in the notes to the accounts. If such disclosures have been made, he may not refer to these aspects in his report. However, if appropriate disclosures in this regard are not made in the notes to the accounts, he may have to consider making a qualification or a disclaimer or a disclosure in audit report, as appropriate.

Compliance with the Statements and Standards issued by the Institute of Chartered Accountants of India

4.20 In circumstances of missing/incomplete records, the auditor would have to carefully consider the various provisions of the mandatory statements and standards, both on accounting and auditing, issued by the Institute of Chartered Accountants of India, to determine whether a disclaimer, qualification or a disclosure in the audit report is necessary. For this purpose, the auditor should prepare a checklist of the applicable requirements of the statements and standards and ensure that the provisions are complied with or else, he may qualify his report. For example, if the auditor is of the opinion that due to a calamity such as fire, flood or riot, the auditee finds it difficult to revive the operation at least in the foreseeable future so that the going concern assumption is in question and the financial statements are prepared by the auditee on going concern basis, the auditor should disclaim or express his opinion keeping in view the requirements of the Statement of Standards Auditing Practices (SAP) l6, 'Going Concern', issued by the Institute of Chartered Accountants of India.

4.21 A situation which illustrates the consideration of an accounting standard could be where the books of account and other records of a large organisation, having large number of receivables, were destroyed in a fire. The company was able to ascertain only the gross amount of receivables by performing various procedures. Amount due from individual debtors was unsettled and there was a possibility that some debtors may remain undetected who would not come forward to make payment on their own. In such a case, it should be considered whether a provision for loss of debtors should be made keeping in view the requirements of Accounting Standard (AS) 4, "Contingencies and Events Occurring after the Balance Sheet Date", issued by the Institute of Chartered Accountants of India, i.e., the loss should be provided, if it is probable that future events will confirm the loss and a reasonable estimate of loss can be made, otherwise the existence of loss should be disclosed by way of a note.

Previous	Contents	Next

Appendix A

OPINIONS OF THE EXPERT ADVISORY COMMITTEE

Audit of Accounts Based on Duplicate Set of Books

Conduct of audit on the basis of Xerox copies of records when the records are seized by the Income-tax Department

Query: **Audit of Accounts Based on Duplicate Set of Books (Volume I, Page 81)**

1. Books of a private limited company for the year 1972-73 have been taken away by the CBI authorities for an inquiry on a complaint by the labourers. The company had submitted annual returns under section 259 of the Companies Act, 1956 without audited statements. The Income-tax returns were also filed and assessment completed.

2. The cash book and ledger were copied from the books lying with the investigating authorities from which statements for the year 1972-73 were prepared.

3. Whether audit for 1972-73 can be completed, with remarks in the Auditor's report, from the copies of the duplicate set of books, or only audit for 1973-74 onwards can be completed with remarks in the Auditor's report.

Opinion: Date: January 16, 1978.

1. In the opinion of the Committee, it should be open for the auditor to complete the audit of accounts based on such duplicate books. What an auditor is expected to state is whether the relevant Balance Sheet and the Profit & Loss Account as certified by him are in accordance with the books of accounts examined by him. The books of accounts examined by him in this case would be the duplicate set of cash books. If, therefore, the auditor audits such set of books duly supported by the original vouchers and other documents in respect of entries appearing therein and he is satisfied with the correctness thereof, there should not be any objection on his part in certifying the correctness of the accounts. The auditor should bring out the facts in his report to members with regard to limitation on his audit.

Query**: Conduct of audit on the basis of Xerox copies of records when the records are seized by the Income-tax Department (Volume IX, Page 32)**

1. A group of companies was subject to a search operation under section 132 of the Income-tax Act, 1961, by the Income-tax Department during September, 1988, which was concluded in December, 1988. Almost all the accounting records, such as the books of account, stock books/Kardox, voucher files etc. pertaining to the earlier years as well as the current year upto September, 1988, were seized. The accounting year of most of the companies was June ending, which has been extended by three months upto September, 1988.

2. The companies would be obtaining Xerox copies of all the records (books, vouchers etc.) seized by the Income-tax Department. Some books are available on the computer and the company will have these books reprinted. The accounts for the year ending September, 1988 would be finalised/audited on the basis of Xerox copies of such books/vouchers. For the purpose of finalising the accounts and the audit thereof, the querist had sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether accounts finalised/audited on the basis of Xerox copies of books and vouchers can be called "true and fair"?

Specifically, should the auditor:

(a) Merely give an explanatory note to the accounts stating that the accounts have been made up on the basis of Xerox copies of books and vouchers or,

(b) Qualify the audit report stating that "subject to the audit being made on the basis of Xerox copies of books/vouchers seized by the Income-tax Department under section 132 of the Income-tax Act, 1961, the accounts show a true and fair view" or

(c) Refrain from expressing an opinion by stating that "I am unable to express an opinion whether the accounts show a true and fair view of........since the original books/vouchers have been seized by the Income-tax Department under section 132 of the Income-tax Act, 1961, and the accounts annexed thereto have been made upon the basis of Xerox copies of such books/vouchers seized."

(ii) Since it would not be possible to ascertain the liability for the Income-tax on account of the matters that will come to light on account of the search operation, should the auditor:

(a) Give an explanatory note, or

(b) Qualify the report, or

(c) Refrain from expressing an opinion.

(iii) What would, in general, be the professional responsibility of the auditor under such circumstances while performing the audit of current year?

Opinion: Date: September 13, 1989.

1. The Committee notes that in the conduct of an audit, obtaining evidence through examination of records and documents is of crucial importance. The auditor, therefore, strives to obtain such evidence which is appropriate in terms of its relevance and reliability. In this regard, the Committee notes that para 12 of the Statement on Standard Auditing Practices (SAP) 5, Audit Evidence, issued by the Institute of Chartered Accountants of India, states as below:

"Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature and source and the effectiveness of internal controls over their processing. Four major categories of documentary evidence, which provide different degrees of reliability to the auditor, are:

- documentary evidence originating from and held by third parties;
- documentary evidence originating from third parties and held by the entity;
- documentary evidence originating from the entity and held by third parties; and
- documentary evidence originating from and held by the entity."

2. The Committee notes that in the present case only Xerox copies of all types of the above documentary evidence are available to the auditor. The degree of reliance, which can be placed by the auditor on such audit evidence, will be considerably increased if the Xerox copies of account books and vouchers are certified to be true copies by the Income-tax Department. If the tax authorities refuse to certify the Xerox copies to be true copies, the auditor should get the certificate, to this effect, from the management of the company. However, in this case, the degree of reliance, which can be placed by the auditor, would be considerably less. The auditor should use procedures like confirmation of balances from third parties, inspection of tangible assets, observation of various processes or procedures being performed by the client's personnel, e.g.,

counting of inventory items, analytical review procedures, making inquiries from the personnel within the entity and outside it, compliance procedures with regard to internal controls, etc., and gather evidence which corroborates or refutes the documentary evidence available. The Committee is of the opinion that it should be open to the auditor to complete the audit of the accounts on the basis of such Xerox copies of books and vouchers. The auditor should, however, qualify his report clearly stating that audit has been conducted on the basis of Xerox copies of books of accounts and vouchers seized by the Income-tax Department and the Xerox copies have been authenticated by the Income-tax Department/management of the company.

3. The Committee noted that the Accounting Standard (AS) 4 "Contingencies and Events Occurring After the Balance Sheet Date" issued by the Institute of Chartered Accountants of India defines Contingency as:

> "A Contingency is a condition of situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of on or more uncertain future events".
>
> Further paragraphs 10 and 11 of Accounting Standard (AS) 4 state as follows:
>
> "10. The amount of contingent loss should be provided for by a charge in the statement of profit and loss account if:
>
> a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and
>
> b) a reasonable estimate of the amount of the resulting loss can be made.
>
> 11. The existence of a contingent loss should be disclosed in the financial statement if either of the conditions in paragraph 10 is not met, unless the possibility of a loss is remote."

4. The committee is of the opinion that in the present case, no tax demands have been raised and no tax evasion has been detected so far. Since the ultimate outcome will be known and determined on completion of the investigation in this regard, the liability which may arise, therefore, is a contingent liability. Since a reasonable estimate of the amount of the liability cannot be made, disclosure in this regard should be made, unless the possibility of loss is remote, as required in paragraph 11 of AS 4. If this is done then the auditor should not qualify his report.

5. The Committee is of the opinion that the auditor should, as a part of his professional responsibility, exercise reasonable skill and diligence to comment on the authenticity of the financial statements. He should use procedures which have been discussed in para 2 to gather evidence which corroborates or refutes the documentary evidence available.

Previous	Contents	Next

Study on Audit and Certification in Situations of Missing Records

Contents > Appendix B

Appendix B

CASE STUDY ON RECONSTRUCTION OF RECORDS USING 'RATIO AND TREND ANALYSIS'

1. PQR Dental Traders lost all their records, stocks, papers and files in a devastating fire. There was very little data to enable reconstruction of records, except the following, which was obtained with considerable difficulty:

- Previous years' accounts from the auditor's file.
- Stock statement submitted to the bank for obtaining overdraft.
- Bank statements obtained from the bankers.
- Details of sales and sales tax paid, from the sales tax consultant's file for the first nine months of the year.
- Confirmations and statements of account of the suppliers.
- Loan statements from all loanees with interest paid.

2. The accounts had been compiled for tax audit purposes and for filing of the return of income. The auditor performed the procedures explained in the text.

3. The auditor had to satisfy himself about the reasonableness of figures relating to sales, stocks, purchases and expenses. Using the available records for last ten years in the audit file, he analysed the trend of all the revenue accounts as shown in the table below. The gross profit margin was also carefully examined. The maximum and minimum peaks were considered. The following table provides an indication of the method applied by the auditor:

M/s PQR Dental Traders

Trend Analysis (in Rupees):

Year	Sales	Purchases	Opening Stock	Closing Stock	Gross Profit	GP % to Sales
1	4321540	3522123	1987654	1687543	499306	11.55
2	4765432	4290876	1687543	1803234	590247	12.39
3	5976543	5154321	1803234	2187654	1206642	20.19
4	6475678	5890867	2187654	2695432	1092589	16.87
5	8224876	7790765	2695432	3593450	1332129	16.20
6	8924876	7840765	3593450	3823450	1314111	14.72
7	9100297	7940999	3823450	3963561	1299409	14.28
8	10010327	8835099	3963561	4359917	1571584	15.70
9	11211359	9718609	4359917	4745909	1878742	16.76
10	14850540	11565144	4745909	4057795	2597282	17.49

4. Statement showing analysis of the percentage increases over the previous year was prepared which is as follows:

Year	Sales	Purchases	Gross Margin

1			
2	10.27	21.83	18.21
3	25.41	20.12	104.43
4	8.35	14.29	-9.45
5	27.01	32.25	21.92
6	8.51	0.64	-1.35
7	1.97	1.28	-1.12
8	10.00	11.26	20.95
9	12.00	10.00	19.54
10	32.46	19.00	38.25

5. Year 3 was exceptionally good because there was a huge export order. Therefore, the sale and cost of the export was omitted from sales and purchases to get a realistic trend. The revised table was as below:

Year	Sales	Purchases	Opening Stock	Closing Stock	Gross Profit	GP % to Sales
1	4321540	3522123	1987654	1687543	499306	11.55
2	4765432	4290876	1687543	1803234	590247	12.39
3	5301543	4884321	1803234	2187654	801642	15.12
4	6475678	5890867	2187654	2695432	1092589	16.87
5	8224876	7790765	2695432	3593450	1332129	16.20
6	8924876	7840765	3593450	3823450	1314111	14.72
7	9100297	7940999	3823450	3963561	1299409	14.28
8	10010327	8835099	3963561	4359917	1571584	15.70
9	11211359	9718609	4359917	4525909	1658742	14.80
10	14850540	11565144	4525909	3534795	2294282	15.45

6. The trend of percentage increases was more realistically analysed as under:

Year	Sales	Purchases
1		
2	10.27	21.83
3	11.25	13.83
4	22.15	20.61
5	27.01	32.25
6	8.51	0.64
7	1.97	1.28
8	10.00	11.26
9	12.00	10.00
10	32.46	19.00

7. Maximum and minimum increase limits were estimated for further corroboration with other facts, evidence, explanations, etc. These limits were fixed on the basis of minimum and maximum increase during the period, which were as follows:

Lower Limits

Year	Sales	Purchases
7	1.97	

6		0.64

Upper Limits

Year	Sales	Purchases
5		32.25
10	32.46	

Average rate of Gross Margin was considered at 14.71%

8. On the basis of these limits, the following sales and purchases figures were deduced for the Year 11:

	Maximum	Minimum	Best Estimate
Sales	19671025	15143095	17407060
Purchases	15294902	11639160	13467031

9. The figures, so obtained, were the point of commencement for the auditor to assess other available evidence and accordingly to either corroborate or refute it.

10. The figures furnished by M/s PQR Traders were:

Year	Sales	Purchases	Opening Stock	Closing Stock	Gross Profit	GP % to Sales
11	18538850	15967294	4057795	3189123	1702884	9.19

The auditor inquired into the reasons for increase in purchases beyond the maximum increase of 32.25%. Since the Gross Margin had dropped below 12%, the sales figure was also questioned. As a result of inquiry, it was found that purchases had been booked twice to the extent of Rs. 1050000.

11. After above correction, the auditor came to the realistic conclusion of the figures as follows:

Year	Sales	Purchases	Opening Stock	Closing Stock	Gross Profit	GP % to Sales
11	18538850	14917294	4057795	3189123	2752884	14.85

12. As per above, percentage increases in Year 11 over the year 10 were as follows:

Year	Sales	Purchases
11	24.84	28.98

Previous | Contents | Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Appendix C

Appendix C

SAMPLE AUDIT REPORT GIVING A DISCLAIMER WHEN BOOKS OF ACCOUNT OF AN ENTERPRISE WERE SEIZED BY A STATUTORY AUTHORITY

AUDITORS' REPORT

To the shareholders of ABC Limited:

We have examined the attached balance sheet as of 31 March, 1999 and the profit and loss account for the year ended on that date of ABC Limited. These financial statements have been prepared by the company using extracts from books of account, since the books of account and supporting documents have been seized and are in custody of Excise Authorities as stated in note number … of Schedule … to the accounts and report that:

1. As required by the Manufacturing and Other Companies (Auditor's Report) Order, 1988 and on the basis of such checks of the extracts of books and vouchers made available as we considered appropriate and also the information and explanations given to us, during the course of our audit, we give in the Annexure a Statement on the matters specified in paragraphs 4 and 5 of the said Order.

2. In addition to our comments in the Annexure referred to in paragraph 1 above, we report as below:

a) In absence of the complete books of account and records, we have not been able to satisfy ourselves about the completeness and accuracy of all *items* included in the said financial statements. Note … in Schedule … refers to the non-availability of these books of account and records and reliance upon certified statements furnished from the bank.

b) Attention is invited to Note … in Schedule … regarding seizure of all the books of account and supporting documents of the company by the Excise Authorities. However, extracts from the books of account in custody with the Excise Authorities have been furnished to us.

c) Attention is invited to the following matters stated in Schedule … which we cannot comment upon due to non-availability of information:

- Note…regarding receivables of Rs._______lacs.
- Note…regarding the claims of suppliers amounting Rs.___________lacs.
- Note…regarding various incomes and expenses stated in the said financial statements.
- Note…regarding inability to conduct physical verification of cash.
- Note….regarding unexplained receipts of Rs._____lacs and unsupported expenses Rs.______lacs.

3. The scope of our audit has been restricted to audit of extracts of books of account received from the Excise Authorities. As stated in paragraph 2 (a) above, due to the non-availability of complete books of account and supporting documents, we were unable to obtain all the necessary information and explanations required for the purposes of our audit, and consequently we have

not been able to satisfy ourselves that all books of account as required by law have been kept by the company and also whether the accounts are in agreement with the books of account.

4. Consequent to the uncertainties arising from the matters stated in paragraphs 2 and 3 above, we are unable to form an opinion as to whether the accounts give all the information required by the Companies Act, 1956 in the manner so required and whether they give a true and fair view:

- in case of Balance Sheet, of the state of affairs of the Company as at 31 March 1999; and
- in the case of the Profit and Loss Account, of the profit of the Company for the year ended on that date.

For MD & A,
Chartered Accountants

DATED:____________.
PLACE:____________.

Previous | Contents | Next

Study on
Audit and Certification in
Situations of Missing Records

Contents > Appendix D

Appendix D

SAMPLE OF A QUALIFIED AUDIT REPORT WHEN CERTAIN SUPPORTING DOCUMENTS HAVE BEEN DESTROYED IN FIRE AT A COMPANY'S PREMISES

AUDITORS' REPORT

To the shareholders of ABC Limited:

We have examined the attached balance sheet as of 31 March, 1999 and the profit and loss account for the year ended on that date of ABC Limited. These financial statements have been prepared by the company using the books of account, records and supporting documents salvaged after the fire in the company's premises as stated in note number … of Schedule … to the accounts and report that:

1. As required by the Manufacturing and Other Companies (Auditor's Report) Order, 1988 and on the basis of such checks of the books and vouchers made available, as were possible and considered appropriate, and also the information and explanations given to us, during the course of our audit, we give in the Annexure a Statement on the matters specified in paragraphs 4 and 5 of the said Order.

2. In addition to our comments in the Annexure referred to in paragraph 1 above, we report as below:

a) In absence of certain supporting documents destroyed by fire, we have not been able to satisfy ourselves about the completeness and accuracy of all items included in the financial statements. Note … in Schedule … refers to the non-availability of these supporting documents and records and reliance placed upon certified statements received from third parties. The impact of the above, if any, on the profit for the year is not ascertainable.

b) Attention is invited the following matters stated in respective notes in Schedule…which we cannot comment upon due to non-availability of information

- Note…regarding receivables of Rs.__________lacs.
- Note…regarding the claims of suppliers amounting to Rs.____________lacs.

3. The scope of our audit has been restricted to audit of the available books of account records and supporting documents. As stated in paragraph 2 (a) above, due to the non-availability of some supporting documents, we were unable to obtain all the necessary information and explanations required for the purposes of our audit, and consequently we have not been able to satisfy ourselves that all books of account as required by law had been kept by the company during the year prior to the date of the fire.

4. Subject to the above stated in paragraphs 2 and 3, the account reads together with the notes given in Schedule … give a true and fair view of the state of affairs of the Company as at 31 March, 1999 and its profit for the year ended on that date and give all information required by the Companies Act, 1956 in the manner so required.

For MD & A,
Chartered Accountants

DATED:____________.
PLACE:____________.

Previous | Contents | Next

**Study on
Audit and Certification in
Situations of Missing Records**

Contents > Appendix E

Appendix E

AUDIT PLAN FOR AUDIT AND CERTIFICATION OF STOCK IN A SITUATION WHERE STOCK RECORDS WERE SUBSTANTIALLY DESTROYED

EXHIBIT A : LETTER OF ENGAGEMENT

EXHIBIT B : STATEMENT OF STOCKS AS ON DATE OF FIRE AT THANE

: LIST OF RECORDS AND DOCUMENTS IN USE BEFORE THE DATE OF

EXHIBIT CFIRE

EXHIBIT D : INTERNAL CONTROL QUESTIONNAIRE

EXHIBIT E : STOCK MOVEMENT FLOW CHART

EXHIBIT F : AUDIT PLAN AND ITS IMPLEMENTATION

EXHIBIT G : SPECIAL AUDIT PROGRAMME

EXHIBIT H : SUMMARY OF AUDIT OBSERVATIONS

CASE STUDY

AUDIT PLAN FOR AUDIT AND CERTIFICATION OF STOCK IN A SITUATION WHERE STOCK RECORDS WERE SUBSTANTIALLY DESTROYED

Circumstances surrounding the assignment

A firm was having a textile training unit and the warehouse at Thane. The firm used to purchase gray cloth from outside, get it processed from outside process houses and stored all its stock in the warehouse. The unit at Thane was entirely a training unit and all the processing was got done from the outside process houses. The entire records relating to the stock and books of account of Thane unit ware kept at Thane. In a devastating fire that broke out in Thane unit, all the stock records, books of account and the stock, barring salvage of rags and burnt material, ware destroyed. The firm filed claim for loss of stock with its insurance company and the insurance company suggested that the firm should get value of stock as on date of fire certified from M/s MD& A, Chartered Accountants. Accordingly, M/s MD&A, Chartered Accountants, were appointed to certify the value of stock in Thane unit as on the date of fire.

Procedure followed by the auditor

Step 1

The auditor received the following documents from the auditee:

- Appointment letter, setting out the scope of the assignment which was to certify the value of stock as on the date of the fire in the warehouse of the auditee. (Exhibit A)
- Statement of stock in the warehouse as on the date of fire which was lost in fire and was to be certified. (Exhibit B)
- List of records and documents in use before the date of fire, duly certified by the management. (Exhibit C)
- A brief note on the stock accounting and movement procedures.

Step 2

The auditor reviewed the information collected in Step 1 above and prepared the following:

- An internal control questionnaire as he considered appropriate and recorded the responses from the client (Exhibit D)

- A stock movement flow-chart for an overview of the stock movement, accounting and control procedures. (Exhibit E)
- Overall Audit plan encompassing a Routine Audit Programme (Exhibit F) and a Special Audit Programme. (Exhibit G)

Step 3

The auditor implemented the routine audit programme as well as special audit programme to cross-check the extent of reliability and correctness of the stock statement by applying such techniques and methods which he considered useful under the constraints to corroborate or refute the information in the stock statement.

Step 4

The auditor maintained separate working paper files for the routine audit programme and special audit programme and summarized the audit observations. (Exhibit H)

Step 5

The auditor listed out the crucial assumptions made in assessment of the value of stock.

Step 6

The auditor discussed his major audit observations as well as findings with the management wherein the auditor considered the management's view with an open mind and brought the irregularities to the notice of management. As a result of discussion, audit findings and exercise of professional judgement and knowledge by the auditor, the maximum possible value of stock as on date of fire was arrived at Rs. 60,33,750.

Step 7

The final certificate was prepared and submitted to the auditee .

EXHIBIT A

LETTER OF ENGAGEMENT

January 24, 1994

M/s MD & A,
Chartered Accountants
Mumbai.

Dear Sirs

Re: Certification of value of stock lost by our firm on December 22, 1993.

We had a devastating fire on the 22nd December, 1993 at our unit at Plot C, 11 GIDC area, Thane, wherein all stocks, the relevant stock records and books of account, maintained at Thane had been destroyed. We, however, have an office at Kalbadevi, Mumbai, where some of the details and records are available.

We have been advised by M/s …….. Ltd. to appoint you for the certification of stock as on the date of fire for the purpose of insurance claim. We shall furnish all the details and records which are available or can be made available. We have not disturbed the stock salvages at the warehouse and would appreciate if you physically verify the same. Please find enclosed the following:

- Statement of stocks at the warehouse as at December 22, 1993 prior to the fire.
- Brief note on the stock accounting and movement procedures.
- List of records and documents in use before the date of fire.

Please also let us know the fees payable to you. You will appreciate that time is of essence and a certificate at an early date will be sincerely appreciated.

Thanking you,

Yours faithfully,

BSD Enterprises

EXHIBIT B

STATEMENT OF STOCKS AS ON DATE OF FIRE AT THANE

Quality	Metres	Rate Per Metre (Rs.)	Total(Rs.)
NAGINE	192134	12	2305608
H.T.SPECIAL	257196	10	2571960
MISC. 2*1	117284	15	1759260
040/86*80	115728	11	1273008
BOSKY	327148	20	6542960
TOTAL	1009490		14452796

Notes

1. Lot-wise details of each quality are available at Kalbadevi office.

2. Stock as on the date of fire was arrived at by including all lots received till that date, though might not be referenced to in any invoice.

3. Processed Lots received back were referenced through bills. Lots sent for processing; which are still lying with processing houses are not included in above and we have obtained the confirmation certificates for above.

We certify that, barring the stocks stated above, no other stocks were lying at the factory as on December 22, 1993.

For BSD Enterprises

Dated: January l4, 1994.
Place: Mumbai.

EXHIBIT C

LIST OF RECORDS AND DOCUMENTS IN USE BEFORE THE DATE OF FIRE (FY 1993-1994 from 1.4.93 to 22.12.93)

M/s MD & A,
Chartered Accountants,

List of records and documents in use before the date of fire indicating the relevant stock movements in the current financial year 1993-94 is as below:

Document/Record maintained	First Serial Number	Last Serial Number	Date of Last Document	Place of Maintenance
LOT Receiving Slips	LOT No.1001	LOT No 3299	20.12.93	Thane
Receipt Challans	1	319	22.12.93	Thane
Gray Receiving Registers	1001	3299	21.12.93	Kalbadevi, Thane
Gray Checking Reports	1001	3260	20.12.93	Kalbadevi, Thane
Bale Numbers	1	5402	22.12.93	Kalbadevi, Thane
Packing Slip Register for Material sent to Processing House	1001		22.12.93	Kalbadevi, Thane
Gray Rejection Challans	1	5	18.12.93	Kalbadevi, Thane
Process Delivery Challans For Group Concerns	1	379	12.12.93	Thane
Packing Slips for Processed Material	?	?	?	Thane
External Delivery Challans	1	2417	21.12.93	Kalbadevi, Thane
Invoices	2248	3615	22.12.93	Kalbadevi, Thane

Out of the above records and documents, all the documents maintained at Thane were destroyed in the fire and are not available where as documents maintained at Kalbadevi Office are available. We hereby certify that no other documents or records are available other than those stated above.

For BSD ENTERPRISES

Dated: January 21, 1994.
Place: Mumbai.

EXHIBIT D

INTERNAL CONTROL QUESTIONNAIRE

(For quantification and valuation of stock on the basis of Exhibit C given earlier)

Client: BSD ENTERPRISES

QUESTION	RESPONSE	REMARKS
A. Dimensional Check		
Is there a layout of the warehouse in the factory for storage?	Yes	
Are the dimensions of length, breadth and height available?	Yes	
Is there a limit on the number of lumps/rolls which can be stored in one place?	No	
Furnish the actual dimensions in terms of thickness and length of each type of lump stored in the warehouse.		As per statement attached.
B. Evaluation of scope and work done by other auditors/external entities		
Did the auditee have a system of carrying out regular physical verifications? If so, when was the last verification carried out?	Yes	By bank – monthly; and by auditors annually. Last verification was carried out on June 30, 1993 by the auditors.
Whether certified statements are available from auditors/bankers etc.?	Yes	
Was the Stock (Gray) Register updated regularly?	Yes	Gray register is available at Kalbadevi.
Was there a system of determining damaged, unserviceable or rejected stock? If so, are any reports available?	Yes No	Records at Thane were destroyed.
C. Evaluation of Internal Control		
Are the unused documents such as challans, lot slips, packing slips, invoices available?	No	Lost in fire at Thane.
Is there a system of accepting sales returns?	No	Possibility of sale return is remote.
Is there a possibility of lot slip being received and not accounted for in the lot register?	No	Remote possibility may be there.
D. Evidence from Third Parties		
Are suppliers' challans available to support lots received?	No	Lost in fire at Thane.
Are the customers' acknowledged delivery challans available?	No	Lost in fire at Thane. However, copies attached with invoice available at Kalbadevi.
E. Evidence of physical state of stocks		
Please state whether any defective/old/ slow moving or damaged stock was on hand on the date of fire?	No	Information lost in the fire.
Were any stocks sent out on demonstration/approval or at any processing house?	Yes	As per Statement enclosed.
Are there any other locations other than the factory warehouse where stocks could have been lying?	No	Barring those with process houses.
Is there any photograph or videocassette of the damaged stock?	Yes	
Is there any saved stock?	Yes	As per Statement enclosed.
F. Trends and Historical Data		
What would be the average stock holding?		Rs. 40-60 Lacs
Please give a brief note on seasonal fluctuations		Note attached
Are historical figures available for sales, stocks, and purchases for the last five to ten years?	Yes	Details given
G. Certification from any statutory authority		
Is Octroi applicable on lots received or dispatched? If so, are details available in respect thereof?	Yes No	Details lost in fire at Thane.
Are stocks excisable? If so, are records/certified	No	Not applicable

copies available?		
H. Other data collection measures		
Are Statements of account available from Suppliers duly supported by challans acknowledged by BSD?	Yes	Exception list attached.
Are Statements of account available from debtors?	Yes	As above
Are all suppliers' bills paid in respect of stocks on hand as at December 22, 1993? If not, list out those unpaid.	No	List enclosed.

EXHIBIT E

STOCK MOVEMENT FLOW CHART

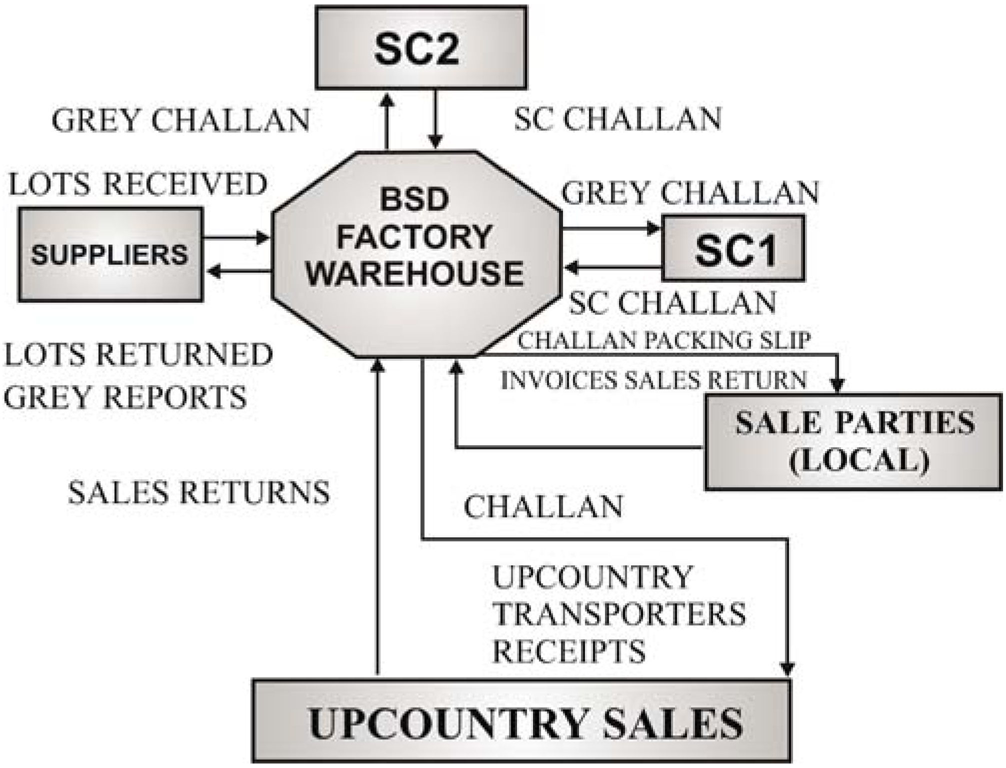

EXHIBIT F

AUDIT PLAN AND ITS IMPLEMENTATION

Client: BSD Enterprises

1. The overall audit plan for certification of stock at the factory warehouse as on the date of fire involved the following:

A. **Quantification of Stock**

- Review of Movement Inwards

- Review of Movement Outwards

B. **Valuation of Stocks**

- Method of valuation
- Application of rates

2. The auditor noticed that the availability of evidence for various areas of quantification of stock was as under:

AREA	POSITION OF EVIDENCE
Review of Movement Inwards	
Lots received	Not available
Gray receiving reports	Not available
Dispatches from group concerns	Available
Statement of account from suppliers	Partially available
Other receipts	Not Available
Receipt back of processed material	Not available
Review of Movement Outwards	
Sales Invoices	Available
Delivery Challans	Copies Available
Outward movement for processing	Not Available
Return of Gray for rejections	Not Available

ROUTINE AUDIT PROGRAMME

The auditor took the following steps for audit and certification of stock as a part of Routine Audit Programme:

Quantification of stock

Movement inwards

1. In respect of regular lots of gray cloth received, since the actual Lot Slips and gray receiving reports were not available, the other closest documentary evidence available was the Lots Register at Kalbadevi Office. From the limited number of suppliers' statements available, stocks received were checked into the Lots Register. In respect of other lots received, a random sample of 20% of the total lots was selected for scrutiny in terms of suppliers' bills, payments made and wherever called for, acknowledged challans from the auditee held by the suppliers were obtained.

2. In respect of processed gray received back from the processors, tracing into the Gray Register was done from their bills and challans available at Kalbadevi. This tracing was done for 100% gray received back during the last 6 months prior to the date of fire, i.e., using the other auditor's physical verification as reliable evidence of existence of stock as at June 30, 1993.

3. In respect of sales returns and rejections, 100% postings from credit notes were checked from the beginning of the year.

4. In respect of materials received from group concerns, 100% check using all inward

documents such as bills, challans, packing slips, etc. was done.

Movements outwards

5. Since almost all records were available the following audit procedures were carried out:

- Dispatches through sales invoices: 20% for each month.
- Dispatches for processing through process bills: 20% for each month.
- Returns to suppliers through debit notes: 100%.

Valuation of stock

Review of the method of valuation of stock

6. The stock of unprocessed gray cloth was valued at weighted average cost whereas the stock-in-process was valued at weighted average cost of material plus 20% for processing and other costs.

7. The cost sheet for quality-wise valuation of stocks was obtained and checked in-depth. Auditor's certificate for the consistency and correctness in the method of valuation of stocks in the previous years was also obtained.

8. The rates were compared with the latest available realisable rates in the market through orders and invoices with the auditee. It was confirmed that the rates as per the cost sheets were lower.

The Audit Team included a partner and two qualified assistants.

EXHIBIT G

SPECIAL AUDIT PROGRAMME

OBJECTIVE

1. The thrust of the audit was to ensure that the auditee had not overstated the stock in existence as on the date of fire at the warehouse. Of course, the auditor was also keen to ensure that it was not understated, but that was less likely since the auditee would not like to reduce his insurance claim.

ISSUES NOT COVERED BY ROUTINE AUDIT PROGRAMME

2. It was evident that certain issues were not covered by the sample checks performed in the conventional manner due to non-availability of records. The auditor noted that the following aspects were not covered by the routine audit programme.

Inward receipt of material

3. The Gray Lot register was not supported by actual Lot Slips or the Gray Receiving Reports or Suppliers' Challans due to their being destroyed.

4. Receipts for returns of gray after being processed were also not available.

5. Receipts of sales returns were computed on the basis of credit notes only, the basic documents such as goods/materials inward documents were not available.

6. Detailed statements from suppliers were not available in all cases. These were available from small sized proprietary concerns, where accounting standards might not have been applied with great degree of certainty.

In view of the above, it was difficult for the auditor to arrive at an opinion on correctness of the gray lots received at the warehouse merely on the basis of the Gray Lot Register. There was considerable risk that errors or misstatements in the Gray Lot Register might go undetected.

Outward movement of material:

7. Challans for sales dispatches actually made, evidenced by acknowledgements, were not available.

8. Challans for gray dispatched for processing were also not available.

9. Returns of rejections for gray were also not available except for debit notes available at Kalbadevi.

In view of the above, there was a fair amount of uncertainty as regards outward movement.

SPECIAL AUDIT PROGRAMME

As the quantification of stock was a major aspect and the auditor had great difficulty in ensuring and satisfying himself that:

(a) All receipts were genuine and that the quality accepted was good, and that sales returns were not material.

(b) All dispatches were accounted for before compiling the stock figure as at December 22, 1993.

The auditor, therefore, employed the following checks and audit techniques for cross verification and corroboration:

1. *Physical verification of damaged stocks*: The auditors sketched the layout of the warehouse and viewed the damaged stock, got it photographed and witnessed by insurance surveyors. The weight of the charred remains as well as the salvaged stock was noted.

OBJECTIVE: To satisfy himself about the physical existence of stocks by personally verifying the remains as it was the best alternative to actual physical verification. The auditor also wanted to understand the storage and stacking patterns, the extent of damage and possibilities of salvage to gain as much audit evidence as possible.

2. *Laboratory Reports*: The auditor obtained reports of the laboratory tests carried out on the remains in warehouse.

OBJECTIVE: To ensure that the stock of gray and processed cloth were destroyed and not rags, fents or unserviceable material.

3. *Expert Opinion*: Textile technical consultants' opinions were obtained based on samples and laboratory reports. The reports were negative except for the salvaged material.

OBJECTIVE: To verify for the valuation of stocks that if any of the stocks were of inferior or rejected quality or were reused or recycled material, since reduction in value would be required for material.

4. *Reasons for Fire*: Copies of fire brigade and police report were examined and kept in the working papers' file.

OBJECTIVE: To ensure that fire was accidental and not deliberate. If the fire was deliberate, circumstances of fraud would loom large and the approach of the auditor would be that of an investigator.

5. *Physical dimensions of the warehouses*: Physical dimensions of the warehouse were taken and also the stacking pattern. A detailed dimensional measurement was undertaken to ascertain the maximum stock which could be stored to compare with the quantity to be certified.

OBJECTIVE: To ensure that the stock claimed to have been in existence on December 22, 1993, could be stored physically within the storage capacity available.

6. *Obtaining the physical verification statements*: The auditor obtained stock statement furnished to the bankers duly certified by them in respect of mortgaged stock. He studied the quantity and value stated in them for each month for comparison with the quantity to be certified. He also obtained the Stock Verification Statement of the physical verification carried out by the auditors on June 30, 1993.

OBJECTIVE:

(i) To corroborate the stocking policy of the auditee certified by an external source.

(ii) To have reliable documentary evidence of stocks held at the nearest date to the date of fire.

7. *Review of material receiving procedure*: The auditor visited a local supplier with the consent of the auditee to verify the system of supply of gray lots and acknowledgments of materials received by the auditee.

OBJECTIVE: To learn more about and confirm to the receiving procedure for materials and to assess the degree of reliability of the supplier's statement of account. While the auditor may have expected any fraudulent motives of the auditee, it is nevertheless essential to satisfy himself that 'accommodation bills' were not provided by suppliers.

8. *Trend Analysis:* The auditor conducted a trend analysis to determine past percentages of:

- Gross Margin
- Sales
- Processing charges
- Purchases
- Stocks

OBJECTIVE: To examine historical data and to see whether it fitted into the pattern of trading activity and general information and explanations given by the client.

9. *Examination of pending orders:* The auditor also requested the auditee to furnish the details unexecuted sales orders.

OBJECTIVE: To verify the need of the auditee to stock the quantity as stated.

10. *Examination of Process House Statements:* The auditor visited the process houses to understand the procedure of accounting and storage of gray received from the auditee.

OBJECTIVE: To ensure that all dispatches to process houses, not returned after due process till date of fire, had not been included in the stock statement.

11. *Verification of rates:* The auditor undertook the following steps to verify the rates used for valuation of stock in the routine audit programme:

- Comparison of rates for the last five years
- Comparison with rates declared in stock statements filed with Income-tax returns.
- Examining rates from invoices checked during his visit to the supplier.
- Verifying realisable rates from rates quoted for salvaged stocks, subsequent to the date of fire.

EXHIBIT H

SUMMARY OF AUDIT OBSERVATIONS

Based on Routine Audit Programme

Lot Register

1. Casting errors noticed in quantities of lots received as follows:

Lot Number	Quantity (in Metres) as per Suppliers' Challans	Quantity (in Metres) as per Lots Register
204	506	606
608	435	1435
1030	1090	1009
1123	870	799
1450	1300	1008

2. Entries of the following lot number were found missing in the register.

224, 455, 1009, 2090, 2333, 3100

3. Loose material was received entered in the Gray Register without lot number on following dates:

Date of Receipt	Quantity Received
20.04.93	211
27.05.93	32
13.07.93	123

19.07.93	25
22.08.93	100
27.09.93	54
13.10.93	129
19.11.93	543
02.12.93	112

Unexplained receipts

4. Lot number 3240 received on 17.12.93 from MG Enterprises was not so shown as dispatched in the statement received from the suppliers. Further, they have not billed the auditee for the quantity of 985 metres entered in the Lots Register.

Double inclusion of certain stock quantities

5. The auditee had the practice of transferring certain quantity of goods from Lots of Inferior Grade (LIG) and larger quantity from Lots of Good Grades (LGG) for consolidated processing. However, certain goods transferred from Lots of Inferior Grade (LIG), remaining undispatched at the warehouse, were included in LIG Lots as well as LGG Lots. The detail of such lots is as follows:

LIG-Lot No. (Transferred)	**Quantity (in Metres)**	**Lot merged into (LGG No.)**	**Quantity Metres**	**Total Metres included**	
				LGG Lot	**LIG Lot**
121	2,230	129	20,110	22,340	2,230
343	210	399	10,020	10,230	210
1002	1,340	1,075	7,650	8,990	1,340
1981	2,340	1,991	5,430	7,770	2,340
1982	1,980	2,001	19,210	21,190	1,980

The stock statement as at December 22, 1993 included the quantities of both the last two columns.

Sales Review

6. Certain challans for invoices relating to M/s XYZ were missing. The reason was that file was taken to the warehouse for some reconciliation purposes and destroyed there.

7. Other missing challans carried the following numbers:

140, 141, 210, 996, 1900-1923, 2100

8. Last invoice certified by the auditee carried the number 3615. However, as per the statement received from M/s XYZ & Co., there were invoices numbered 3622, 3623. No satisfactory explanation was received from the client in this connection, therefore, the quantities of these invoices must be reduced from stock.

9. Bale numbers given in the invoices could not be verified because the Packing Slip Register was not updated

Based on Special Audit Programme

Dimensional Limits for Storage of Physical Stocks

10. As per the layout given and the dimensions of the gray/processed cloth lots in metres, the maximum stock that could be stored in the warehouse was ascertained. The total height of the

warehouse was 10 feet. About 21 lots could be stored in 4 square feet and one foot in height. For providing about 1 foot open space on top, in a height of 9 feet about 189 (9*21) lots could be stored. Taking net area of 200 square feet available for stocking of lots, out of total 250 square feet as agreed to by the auditee, 50 segments of 21 lots each could be stored at one foot of height i.e. 1050 lots. If the total height of 9 feet is considered, at the maximum, 9450 lots could be stored. Therefore, by taking a lot of 100 metres not more than 9,45,000 metres could be stored, which would be maximum quantity since on the left wall at the height of 8.5 feet there was a small cabinet of (3ft*1ft) used for keeping old files and documents. Therefore, a total of 10,09,490 metres, as per the statement to be certified, was not possible considering the above dimensions of the warehouse. Moreover, from the photographs taken after the fire it was observed that on the right wall where the damage was not serious and some partially damages lots had been saved, the stock did not extend to the full height. Therefore, it appeared to be unlikely that the entire storage capacity of the warehouse was utilized.

Laboratory tests reports and experts' opinion

11. Laboratory test reports and experts' opinions were satisfactory and did not indicate anything extraordinary. Fire brigade and police reports made it clear that the reason of mishap was short circuit leading to fire.

Analysis of stock statements submitted to bank

12. As per the Lots Register, no lots were received during the month of August. However, there was an increase in stock as per statement submitted to the bank in the month of August as compared to the previous month from 6,43,221 meters to 7,23,432 metres. There were no material sales returns in August. Therefore, it appeared that either the stock register might be unreliable or the bank statements could be inflated.

Review of last physical verification statement of physical verification conducted by the auditee's auditors.

13. The statement showed that total quantity of stock on the date of physical verification was 6,02,000 meters. No explanation or information was available as to the fate of that stock.

Scrutiny of suppliers' records

14. The scrutiny of M/s DEF's statement of account revealed the following anomalies:

- Though the business was steady and purchases in August were nil and sales increased at steady rate in the current financial year as compared to the previous years, there was a sudden spurt of purchases several lacs of Rupees in the last week of November and early December.
- The general practice was to have purchases against an advance of 50 %. Several purchases in November and December were made without advance payment and were paid well after the date of fire. Explanation given was that there was a sudden rush of orders due to a special festival to be held in the city and the auditee was not financially prepared. Due to excellent business relations with the supplier, he agreed to supply the goods at slightly higher than normal rates to tide over the situation. **However, no evidence for such arrangements was available by way of prior dated correspondence or even faxes.**
- Challans relating to November/December were not acknowledged in the usual manner with the stamp of the security guard, inward time and lot references.

- Sales were increasing during the year. However, the increase was more due to increase in rates whereas sales in terms of quantity have not increased much. Further, it was also doubtful that increasing trend would continue due to increase in competition. There was stock on hand of 6,12,902 metres as on 31st October 1993. There was apparently no need to make further purchases in November with limited sales in November and December. Explanation offered, for such purchases, was that stock prices were expected to increase in January and as per the prudent business considerations in expectation of better sales in the last quarter, stock-holding policy was revised.

Review of pending orders

15. The auditor also obtained a list of pending orders from the auditee on the date of fire. Orders worth Rs. 40,27,000 were furnished inclusive of those from group concerns. Advances were received barely in case of 3 parties of Rs. 1,25,000. It was explained that advances were not customarily received in this business which was confirmed by the other auditors also.

Realisable rates

16. Comparison of rates for the last four years period showed that they had gone up considerably in the last two years. However, the rates applied on individual cost sheets were certainly lower than those agreed to by customers in the pending orders evidenced earlier. There was no reason to dispute the rates for valuation since the cost sheets were satisfactory and also certified by the auditors of the auditee

Trend Analysis

17. As per the data available from the certified Income-tax returns and Sales Tax Returns for the previous four years, the following trends (in percentages) using Financial Year 1988-89 as the base year, were deduced (Gross Margin Rate has been determined as a percentage of sales) as given in the table overleaf. The increase in each individual item over the previous year was worked out and the maximum increase was identified. These figures were applied to the figures for FY 1992-93 and stock was deduced accordingly.

TREND ANALYSIS STATEMENT

Particulars	FY 1989-90	FY 1990-91	FY 1991-92	FY 1992-93
Gross Margin to Sales Rate	14.00	13.00	14.00	12.00
Sales	100.00	121.00	133.00	119.00
Purchases	100.00	119.00	142.00	129.00
Stocks	100.00	113.00	125.00	142.00
Processing Costs	100.00	105.00	122.00	132.00

STATEMENT SHOWING CHANGES OVER PREVIOUS YEAR

Particulars	FY 1990-91	FY 1991-92	FY 1992-93
Sales	21.00	9.92	-10.00
Purchases	19.00	19.33	-9.15
Stocks	13.00	10.62	13.60
Processing Costs	5.00	16.19	8.20

STATEMENT SHOWING MAXIMUM LIMITS (in %)

Particulars	Max. Limit (%)
Gross Margin to Sales Rate	14.00
Increase in Sales	21.00
Increase in Purchases	19.33
Increase in Stock	13.60
Increasing in Processing Cost	16.19

Considering the above limits, the Trading Account was reconstructed as follows:

TRADING ACCOUNT

Particulars	FY 1992-93	% Change	1.4.93 to 22.12.93
Sales **(A)**	59334240.00	21.00	52321421.00
Opening Stock	6374028.00		6165519.00
Purchases	36212345.00	19.33	31491624.00
Processing Costs	15793277.00	16.19	13373029.00
Gross Margin	7120109.00		7324999.00
Total (B):	65499759.00		58355171.00
Closing Stock **(B-A)**	6165519.00		6033750.00

The auditor discussed these figures with the other auditors of the auditee. It was agreed that maximum possible stock on the date of fire was Rs. 60,33,750.

Previous | Contents | Next

Study on Audit and Certification in Situations of Missing Records

Contents > Bibliography

BIBLIOGRAPHY

1. ‘The Audit Process’ by Ian Grey and Stuart Manson first edition, 1989 in Chapter 3: paragraph 3.5 on other evidence collecting procedures.

2. ‘Professional Negligence’ by E F Mannix and J E Mannix, Third Edition, in Chapter 4: Auditor’s Liability.

Previous | Contents