SEM - VI

Paper: <u>Auditing</u> and <u>Corporate Governance</u>

Q.9: What is Audit Program? How it is prepared? Explain its important characteristics.

Ans: Having fixed up the scope of audit and gained knowledge over the business, accounting and internal control system, the auditor need to draw up a plan of action. This plan of action is called Audit Programme. It is a detailed plan of work, prepared by the auditor, for carrying out an audit. It is comprised of a set of techniques and procedures which the auditor plans to apply to the given audit for forming an opinion about the client's statements of account. It is also a written scheme prepared by the auditor to distribute the work to be followed during the audit. It not only constitute the plan of work but also provide a basis for the supervision and control of the audit work. The nature and extent of an audit programme depend on the system of internal check or control in existence in the organisation and the books of accounts maintained.

Thus, just as civil engineer prepares a plan for the construction of a Dam and then all work is done according to that plan in a systematic manner to get success, similarly an auditor also prepares an outline for audit work and on this basis distributes the work among his staff in order to complete the audit work in a systematic and satisfactory manner. This is called "Audit Programme".

The various definition offered by some famous writers have been stated below:

"An audit programme is a list generally in detail of steps to be followed in the course of an examination. It control the nature and extent of examination, aids in arranging, timing and distributing the work, guards against possible ommission and duplication, and provide part of evidence of work done". — Montgomery.

"Audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required". — Prof. Meigs.

"The audit programme is an outline of all procedures to be followed in order to arrive at an opinion concerning a client's financial statements". — Howard stettler.

Thus, An audit programme is a written plan of action designed by the auditor, to see that all the books of accounts have been audited properly, the work is over in time, and there is uniformity in the audit work. Every person entrusted with the part of the audit work has to put his signatures of the part of the work completed by him".

IMPORTANT CHARACTERISTICS OF AUDIT PROGRAMME:

1. WRITTEN : Audit programme is a written scheme of auditor's work. It helps in maintaining harmonious relationship between the client and the auditor. In case of oral audit programme, the auditor cannot hold his employees responsible for their carelessness.

2. CLEAR-CUT : Each and every item of an audit programme must be clear-cut. An auditor must give all those information to his

staff members which can be utilised in the audit work. Information provided must be in such a way that the employees can easily understand what is to be done by them in the course of audit and they do not feel asking from the auditor about their assigned work. Clarity saves both, time and energy of the auditor & staff.

3: **FLEXIBLE:** As we know, nothing is static in the present age and therefore, an audit programme should be flexible and not rigid so that necessary changes or modifications may be introduced as per the requirements.

4: **DISTRIBUTION OF WORK:** Distribution of work among employees must be clarified in the audit programme. Usually work is distributed on the basis of departments, such as cash department, purchase department, sales department, wages department etc. to know that which work is to be performed by whom.

5: **FIXATION OF AUDIT STAFF'S RESPONSIBILITIES:** Fixation of audit staff's responsibilities will serve as a moral check over them and they shall do their work properly and effectively. In case of careless-ness they can be held responsible.

6: **OVERALL CHECKING:** An audit programme must be prepared in such a manner that each account book is audited from the beginning to the end and nothing is left out. Such a device shall help in easy detection of errors and frauds.

7: EXAMINATION WITH ORIGINAL VOUCHERS: Transactions must be verified with original vouchers to reduce the chances of occurrence of errors and frauds.

8: BASED ON ACCOUNTING SYSTEM: In the preparation of the audit programme, accounting system prevalent in the business must be considered by the auditor. It facilitates the audit work.

9: KEEP IN MIND THE WEAK AND STRONG POINTS: Audit programme should be prepared after fully ascertaining the reliability of the internal check system practised by the organisation under audit. The weakness of the system, must be known as well as strong points.

10: SIGNATURE, DATE AND COLUMN: An audit programme consists of separate columns for signatures of various officials, date, work.

CONSTRUCTION OF AUDIT PROGRAMME:

An audit programme is a written scheme prepared by the auditor to distribute the work to be followed during audit. The preparation of such programme involves only three things, they are:

(i) How much work is to be done?
(ii) who is going to do a particular portion of the work?
(iii) what's the duration of time by which the work is to be finished?

The audit programme ensures a complete grip of the auditor over his staff, for it not only specifies the work to be done by each of them within allotted time, but also records the actual performance i.e. the work actually done and the time taken to do the work.

SPECIMEN OF AUDIT PROGRAMME:

1. Name of the client : ______
2. Name of the client's representative : ______
3. Accounting year under audit: ______
4. Language in which A/cs. are maintained: ______
5. Audit work done by : ______

Particulars of Work.	Date	Checked by
I. CASH BOOK:		
(i) Receipts vouched.		
(ii) Payments vouched.		
(iii) Total checked.		
(iv) Posting to Ledger checked.		
(v) Carry forwards of bal. checked.		
(vi) Cash in hand counted.		
(vii) Scrutiny for unticked items.		
II. PETTY CASH BOOK:		
(i) Payment vouched		
(ii) Receipts compared with cash book.		
(iii) Totals checked		
(iv) Posting to ledger of cash book		

III. BANK A/c:

(i) Bank Passbook / Statements checked.
(ii) Reconciliation statements prepared and compared with Bank Passbook.
(iii) Certificates of confirmation from bank
(iv) Bank Passbook / statement scrutinised.

IV. SALES BOOK:

(i) Invoices / counterfoils checked with entries in the sales book.
(ii) Totals checked.
(iii) Position to ledger checked.
(iv) Scrutiny of discounts, commissions etc.
(v) Scrutiny of unticked items.

V. PURCHASE BOOK:

(i) Purchases Bills and Invoices checked.
(ii) Whether purchases have been authorised.
(iii) To compare purchases with contracts
(iv) Totals of Purchases books checked
(v) Posting checked with ledger.
(vi) Scrutiny for unticked items.

VI. MAIN JOURNAL:

(i) Entries vouched with relevant vouchers
(ii) Posting checked with ledger.
(iii) Scrutiny for unticked items.

Name of client: ______________________

Year : ______________________

LIST OF BOOKS AND OTHER RECORDS PRODUCED FOR AUDIT:

Book and records	No. of books or files	Initials
1. Cash book		
2. Sales book		
3. Purchases book.		
4. Petty cash book		
5. Rent Registers		
6. Journal		
7. Ledger:		
(i) General		
(ii) Debtors		
(iii) Creditors		
8. Stock Book		
9. Bank Passbook.		
10. salary and wages book.		

DURATION OF AUDIT

1. Date on which Audit was Started: ______________________

2. Date on which Audit was completed: ______________________

3. Total Hours: ______________________

From the above specimen, it may be observed that it specifies the extent and the nature of checking and verification to be carried out in respect of different accounting records. Thus, audit programme is great guide to them.

VII. SALARY & WAGES BOOK:

(i) Calculations, additions, rates, test checked
(ii) Overtime payments checked.
(iii) Analysis checked & entries in cash book

VIII. LEDGER (GENERAL, DEBTORS, CREDITOR)

(i) Opening Balances checked.
(ii) Posting from original books of entries.
(iii) Balance of control A/Cs, if any tallied
(iv) Closing balance checked with Trial Balance
(v) Scrutiny for unticked items.

IX. STOCK LISTS:

(i) Test checking / full checking with stock book.
(ii) Mode of valuation examined with purchase and sales vouchers.
(iii) Stock list compared
(iv) Charges, if any created examined
(v) Calculations, additions, rates, test checked.
(vi) Certificate of stock obtained from director or Managing director
(vii) Whether allowances made for old depreciated goods and goods on consignment
(viii) Stock list compared with that of previous year for price mode of valuation etc

Q.3: "Vouching is the backbone of auditing". Explain this statement and define importance of vouching.

Ans: Vouching is the basis of auditing. The complete frame of audit is based on vouching and so vouching acts as a pillar of auditing. Since vouching is related to the examination of book of accounts with the help of vouchers and other valid documents, if this work is done with care, skill and intelligence, errors and frauds can be easily detected. Explaining the importance of vouching DePaula said "Vouching is the part and parcel of auditing and the whole success of an audit depends upon the intelligence and thoroughness with which this part of the work is done".

In the famous case of Armitage Vs. Brewer and Knott, 1932, the judge said that if the auditor had cautiously vouched the A/c.s, the defalcation of petty cash book and wages book would have been easily detected as they were suspicious on their face. The auditor was thus held guilty and consequently liable for his act of negligence.

Vouching is a sort of preliminary work which forms an important part of audit work. The accounts of a business begin with the passing of entries. It becomes a basis for further scrutiny to be made at a later stage. The purpose of checking entries with reference to appropriate documentary evidence is to ensure that the transactions relating to a particular period have been recorded and there is no voucher left unrecorded in the financial books. After satisfying himself with regard to the authority and authenticity of transactions the auditor can say that the books of accounts are correct and the Balance sheet and P&L A/c. exhibit the true and correct state of financial affairs of the business. If vouching is done with care and caution, the auditor can proceed well further in his work. Vouching is not only inspection of receipts with cash book but it also includes examination of transactions of a business with valid evidence and documents to ascertain that the transactions are in order, have been properly authorised and are correctly entered or recorded in the books. If he confines himself to the entries as they appear in the books of accounts, many frauds may go unnoticed because the books shows only such information as the book-keeper chooses to disclose and such information may be purposely incorrectly stated. An auditor can ascertain the real state of affairs only by examining external evidence. Therefore, it is essential that this part of an audit should be conducted with great care and intelligence.

Some learned people have considered vouching as the basis of the complete process of audit, which seems to be true. A/c. to them "Vouching is the essence of auditing" or "VOUCHING IS THE BACKBONE OF AUDITING". which indicates the importance of vouching. The fact in support of these statements is that:

1. <u>VOUCHING IS A PRIMARY WORK OF AUDITING</u>: The work of audit is performed on the basis of vouchers and vouching which indicates the importance of vouching. In absence of vouchers and vouching, audit work can not be imagined.

2. <u>VOUCHING IS A FUNDAMENTAL WORK OF AUDITING</u>: Vouching is the foundation of auditing. For example if the foundation of a building is strong, then certainly the building would stand for a long

desire, in the same way audit depends on vouching for attaining desired aims and thus, vouching acts as a backbone of audit.

(iii) We cannot imagine a healthy man with weak backbone. He cannot either stand or move and work properly. In the same manner, in the absence of vouching, the auditor cannot state properly that the books of accounts and statements reveal the true and fair view of financial state of business, because there are greater chances of frauds and informations at the preliminary stage may be purposely or unintentionally contrary to true facts.

In practice, vouching may be a lengthy process in many big organisations. For this, an auditor may apply test-checking depending on the system of internal check in existence in that organisation.

Lastly it may be said that without vouching auditing is like a human body without backbone. Therefore, we can say that for efficient audit, vouching is a must or vouching is the backbone of auditing or vouching is the essence of auditing.

period on that foundation and vice-versa. In the same way, if the work of vouching is properly done then the work of audit will also be perfect and the chances of errors and frauds in the books of accounts will be minimised and as a result the business may continue for a long period with effective performance otherwise it may be closed sooner.

3. VOUCHING IS THE ESSENCE OF AUDITING: This statement has been given by R.B. Bose. A/c. to him, with the help of vouching only an auditor can make complete verification of the books of accounts, and on the basis of which he can make audit work more reliable.

4. VOUCHING IS THE SOUL OF AUDITING: When there is soul in the human body only then its importance exists. In absence of soul human body becomes importanceless. In the same way, vouching is the soul of auditing because it is vouching on the basis of which the work of audit proceeds ahead.

5. VOUCHING IS THE BACKBONE OF AUDITING: This statement can be proved on the basis of the following facts:

(i) As human beings are able to stand with the help of backbone, in the same way vouching acts as a backbone and provides great support in the process of audit. If vouching is weak, the work of audit cannot be conducted efficiently, and the auditor too fails in achieving goals.

(ii) As a man with strong backbone walks, runs, moves according to his

Q.4: Explain briefly the different methods of charging depriciation.

Ans: There are various methods of charging depreciation on fixed assets of an enterprise. The Accounting standard -6 issued by the Institute of Chartered Accountants of India lays down that "the depreciable assets should be allocated on a systematic basis to each accounting period during the useful life of the asset." The Accounting standard, however does not mention any particular method for arriving at the amount of depreciation. But, once a method is selected, it should be consistently used and not changed as and when by the management. It should be strictly followed year to year. If the management wants to change the method of depreciation once used in the previous years due to some reason or the other i.e. for the compliance of the Accounting Standard or for making the financial statements more appropriate than the unamortised depreciable amount should be charged to revenue over the remaining useful life of assets.

Following are the some of the important methods of depreciation

1: FIXED INSTALMENT METHOD OR STRAIGHT LINE METHOD: This method is also known as Original Cost method. Under this method, the cost price, life period and scrap value of the asset are kept in mind. After deducting the scrap value from the cost price, the amount is divided by the life period of the asset. The amount arrived in this manner shall be debited to P&L A/c. every year so that at the time of the expiry of life of the assets, its value in books may remain almost equal to its scrap value. Under this method, the amt. of depreciation remains fixed every year and hence it is called Fixed Instalment method.

2. DIMINISHING BALANCE METHOD OR REDUCING BAL. METHOD:

This method is also called written down value method. Under this method a fixed percentage is written off every year on the reduced balance of the asset. Although the percentage of depreciation is fixed every year yet the amount of depreciation goes on every year reducing unlike the straight line method, in which percentage of depreciation is charged on original cost. In the reducing balance method, the percentage of depreciation is charged on the reducing balance remaining after charging depreciation for the previous year.

For example, if the rate of depreciation to be charged is 10%. The cost of a machine less scrap value is ₹ 1,00,000 and its useful life is 5 years. The annual amount of depreciation will be as follows:

I year 1,00,000 × 10% = ₹ 10,000

II year (1,00,000 − 10,000) × 10% = ₹ 9000

III year (90,000 − 9000) × 10% = ₹ 8100

IV year (81,000 − 8,100) × 10% = ₹ 7,290

V year (72,900 − 7,290) × 10% = ₹ 6,561.

Under this method, the amount of depreciation goes on decreasing year to year. It is more in earlier years as compared to later years. This method is useful in the case of such assets which have a longer life and require repairs etc. on a large scale in later years. Another drawback of this method is that it is more complicated as compared to the straight line method. The problem becomes more acute when there is frequent addition and sale of part of the asset

3. **ANNUITY METHOD:** Under this method of depreciation, not only the value of asset but also the interest on capital invested on the asset is written off by way of depreciation. The logic behind it, had the investment on the asset been deposited in banks, then it would have earned interest on this amount. Thus, this interest is to be recorded as a part of the cost of the asset, and to be written off as depreciation. In this method, depreciation chargeable every year is of equal amount. The amount of depreciation, under this method, is calculated with the help of Annuity Table. This method is used for depreciating assets which are used for a very long period, such as long lease of land or property, and also assets which involve a very high amount.

4. **DEPRECIATION FUND METHOD:** This method is also known as Sinking Fund Method. Under this method, every year an equal amount is taken out from P&L A/c. and credited to a separate account known as Sinking Fund A/c or Depreciation Fund A/c. This amount is invested outside the enterprise every year and the interest received on these investments is reinvested. At the end of the expected life of the asset or at the time of replacing such asset, the investments are sold out. The money so received is utilised for purchasing the new asset.

5. **INSURANCE POLICY METHOD:** Under this method of depreciation, the enterprise takes an insurance policy on the life of the asset and at the end of the estimated life of the asset, the Insurance company pays the policy money by which the asset is replaced. In this method, the amount of annual depreciation is not invested in the Government

Securities or other approved investments but is used for the payment of annual premium for the Endowment policy. Thus, the enterprise is saved from the risk of price fluctuation of the investment

6. REVALUATION METHOD: Under this method, depriciation is calculated on the basis of valuation of assets done every year. If the revalued amount is less than the last revalued amount, the diff. is considered to be depreciation of the asset.

For example if the revaluation of the asset in the P.Y. was ₹ 15,000 and at the end of the current year is ₹ 12,000, then the difference of the revalued amounts of the two years ₹ 3000 is treated as depreciation. This method of depreciation is used for assets whose value is not fixed such as small instruments, loose tools etc.

7. MACHINE HOUR RATE METHOD: Under this method, the effective life of a machine in hours is pre-conceived. By dividing the cost of machine by the hours arrived at, the depreciation rate per hour of the machine can be ascertained. For example, a machine is purchased for ₹ 50,000 and the estimated life of the machine is ₹ 10,000 hours the rate of depreciation shall be ₹ 5 per hour i.e. (50,000 / 10,000) If a machine is operated for 1,000 hours in a certain year ₹ 5000 i.e. (1,000 × 5) shall be written off as depriciation in that year. This method seems to be appropriate for changing depreciation.

8. DEPLETION UNIT METHOD: This method is best suited for writing off depriciation of wasting or exhaustible assets. Under this method, an amount equal to the depleted asset is written off as

depreciation. For example, if a coal mine is estimated to possess coal reserve to the tune of 30,000 tonnes and mine is purchased for ₹ 75,000, an amount of ₹ 2.50 per tonne of excavated coal shall be written off as depriciation. Thus, in a specific year, 10,000 tons of coal is extracted ₹ 25,000 shall be written off as depriciation.

9. SUM OF THE YEARS DIGIT METHOD: This method has been introduced by the American Accountants recently. In this method, scrap value is deducted from the original cost of the asset, depriciation is charged on the amount so left. If suppose, the estimated life of the asset is 5 years, then the order of those years are arranged in the descending order according to the Inverse Progress Method, i.e. those five years are arranged as 5, 4, 3, 2, 1 and the residual value of the assets is divided by a proportionate amount of the years arranged in the descending order:

Example: Cost of the machine = ₹ 36,000
expected life = 5 years.
Scrap value = ₹ 6,000

∴ Total of 5 years digit = 5+4+3+2+1 = 15

$\frac{\text{Cost price} - \text{scrap value}}{\text{Total no. of digit}} = \frac{36000 - 6000}{15} = ₹ 2,000.$

depriciation for 1st year = 2000 × 5 = ₹ 10,000.
depriciation for 2nd year = 2000 × 4 = ₹ 8000.
depriciation for 3rd year = 2000 × 3 = ₹ 6,000
depriciation for 4th year. = 2000 × 2 = ₹ 4,000
depriciation for 5th year = 2000 × 1 = ₹ 2,000

10: <u>KILOMETRE METHOD</u>: This method of charging depreciation is used for those assets who life depends upon their use i.e. how many kilometers a bus is used during a year. The rate of depreciation is calculated at the original cost minus scrap value divided by the life in Kms during the whole life of the asset. The more the asset is used, the more will be its depreciation during a year. This method is used for charging depreciation on buses, cars, trucks etc.

Q.5: What is secret Reserve? How it is created? Explain the duties of an auditor in this respect.

Ans: Secret Reserve is a reserve which is not disclosed. It is also called Hidden Reserve or Internal Reserve. It is not shown in the Balance sheet. It does not mean that secret Reserve cannot be detected. A close and intelligent scrutiny may reveal the existence of a secret Reserve. Existence of secret Reserve will not show a true and fair view of the financial affairs of the concern. It is because of this reason creation of secret reserve, except in case of Banking and Insurance Company, is not permitted by the Companies Act, 1956.

"Secret Reserves are also referred as Hidden Reserves or Inner reserves."
— <u>R.G. Williams.</u>

"A Secret Reserve is a reserve that is not disclosed in the Balance sheet so that the financial position is, in fact, better than appears from the Balance sheet"
— <u>De Paula.</u>

"A Secret Reserve may be defined as a reserve, the existence and for amount of which is not disclosed on the face of Balance sheet"
— <u>Spicer and Pegler</u>

METHODS OF CREATING SECRET RESERVES:

1. BY TREATING CAPITAL EXPENDITURE AS REVENUE EXPENDITURE: By treating capital expenditure as revenue expenditure, secret reserve can be created. For example, furniture worth ₹ 5,000 was purchased and instead of debiting it in Furniture A/c, it was debited in office expenses A/c. and written off in the P&L A/c. As a result both profit and asset were reduced by ₹ 5,000 and a secret reserve was created.

2: BY NOT MAKING ADJUSTMENT OF ACCRUED INCOMES: By not making adjustment of accrued incomes, secret reserves can also be created. For example, an accrued interest worth ₹ 500 was neither shown in credit side of P&L A/c. nor in asset side of Balance sheet. As a result both profit and asset were reduced by ₹ 500 and a secret reserve was created to that extent.

3: BY NOT MAKING ADJUSTMENT OF PREPAID EXPENSES: By not making adjustment of prepaid expenses, secret reserve can also be created. For example salaries paid ₹ 5000 for the year 2001 which includes ₹ 500 salaries paid for the year 2002. This ₹ 500 is prepaid expenses. If this ₹ 500 is not deducted from salaries in debit side of P&L A/c. and omitted from Balance Sheet in the asset side, then profit and asset both will reduce by ₹ 500 and secret reserve will exist to that extent in the books of the organisation.

4: BY OVER-VALUATION OF LIABILITIES: By over-valuation of liabilities and showing contingent liabilities as actual liabilities, secret reserve can be created. For example, understanding contingent liabilities as actual liabilities or real liabilities will increase liabilities and decrease profit as this loss shall have to be written off in the P&L A/c. and a secret reserve will exist in the books of the firm. Another example is to show general reserve combined with the creditors. Thus, reserve shall be hidden and secret reserve created.

5. BY UNDER-VALUATION OF ASSETS : By under valuation of assets, secret reserve can be created. For example, business has a fixed asset worth £ 20,000 and normal rate of depreciation to be charged is 10% but having the object of secret reserve, depreciation is charged at 20%. Thus, additional depreciation at 10% ie will be charged on £ 20,000 which will be equal to £ 2,000. This £ 2000 will be debited to P&L A/c. as a result profit will come down by £ 2000 and further it will be debited, deducted by asset in Balance sheet.

6. BY WRITING OFF FULL VALUE OF GOODWILL : By writing off full value of goodwill secret reserve can also be created. P&L A/c will be debited with the amount of goodwill stated in Balance sheet and as a result net profit will decrease by that amount and goodwill will not be shown in Balance sheet.

7. MISCELLANEOUS METHOD : (i) By writing of some part of goodwill (ii) By showing stock at less value (iii) Some goods not being included in the list of stock (iv) By not recording permanent increase in fixed assets (v) Excess provision for outstanding expenses (vi) Excess provision for bad and doubtful debts.

DUTIES OF AN AUDITOR WHILE CREATING SECRET RESERVE:

1. **FOR SPECIAL COMPANIES:** Under this category come Bank, Insurance and Electricity Companies. Legally, these companies can create secret reserve.

(i) **EXAMINATION OF SECRET RESERVE:** The auditor must examine the Secret Reserves and know their extent.

(ii) **EXAMINATION OF ARTICLES OF ASSOCIATION:** The auditor must go through the Articles of Association to know the rights of the Director in this regard.

(iii) **UTILISATION OF SECRET RESERVE:** The auditor has to be satisfied that secret reserves have been utilised in the interest of the Company and that the management has done so honestly. The management has not misutilised them to conceal their drawbacks.

(iv) **INFORMATION TO SHAREHOLDERS:** If complete information is not imparted to the auditor regarding secret reserves by the company or he is not fully satisfied with the measures and appropriateness of Secret Reserves, he must inform the shareholders accordingly.

2. **IN CONNECTION WITH OTHER COMPANIES:** The auditor must note that companies other than Banks, Insurance and Electricity companies cannot create secret reserves under the law of the land. Even the shareholders, memorandum and Articles cannot authorise the directors to do so. In case, secret reserves have been created, the auditor must ask ~~the~~ Directors to adjust in P&L A/C so that no secret reserve remains. If the Director refuses to accept the auditor's suggestion, the auditor must express this fact in his report.

3. IMPORTANT DECISIONS OF COURTS :

(a) NEWTON VS. BERMINGHAM SMALL ARMS CORPORATION LTD. (1906) : In this case, the auditor of the company could have examined the Secret Reserves but he did not inform the shareholders about it. The Directors were authorised to utilise the Secret Reserves in any way they liked and used these for the increase in the reputation of the company. The Court held "It is a statutory duty of the auditor to inform the shareholders about Secret Reserves. Restriction laid down by Articles of the company about it is ultra vires to the extent that it restricted the powers of the auditor".

(b) SHAMPASNI VS. POCHANWALA (1927) : In this case, secret reserves were used for bad and doubtful debts, but this fact was not shown in the Balance sheet. The judges decided, "If Secret Reserves are utilised for bad and doubtful debts, then the fact must be started in the Balance sheet. It must be revealed not conceded".

(c) ROYAL MAIL SYSTEM PACKET COMPANY LTD. (1931) : This company suffered losses for several years yet declared dividend to the shareholders out of Secret Reserves. The auditor of the company also never disclosed in his audit report that the economic position of the company is bad and the P&L A/C and B/S of the company are not showing true picture of the financial position of the company. In this case, the judges gave decision that the auditor should never allow the company to distribute dividends out of secret reserves.