Unit - 1

INTRODUCTION TO AUDITING

1.1 MEANING AND DEFINITIONS OF AUDITING

Economic decisions in every society must be based upon the information available at the time the decision is made. Unreliable information can cause inefficient use of resources. This can be a loss to the society as well as to the decision-makers. As society become more complex, there is a chance of increase in the unreliable information. So, the decision-makers have to develop a method to overcome this problem. A common way to obtain such reliable information is to have some type of verification (audit) performed by independent persons. The audited information is then used in the decision-making process.

The term audit is derived from the Latin term 'audire,' which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. The original objective of auditing was to detect and prevent errors and frauds. In India the Companies Act, 1913 made audit of company accounts compulsory.

Definitions of Auditing

1. "Auditing is such an examination of the books, accounts and vouchers of a business's shall enable the auditor to satisfy himself whether or not the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the business according to his best of the information given to him and as shown by the book."

   - Spicer and Peglar

2. "Auditing is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements and reports."

   - Mautz

3. "Auditing is the examination of the books and records of a business in order to ascertain or verify and report up on the facts regarding the financial operations and the results thereof."

   - Montgomery

1.2 ORIGIN AND EVOLUTION OF AUDITING

In early days an auditor used to listen to the accounts read over by an accountant in order to check them. Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt, Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Kautilya's Arthasashthra emphasized the importance of accounting and auditing.

The original objective of auditing was to detect and prevent errors and frauds. Auditing evolved and grew rapidly after the industrial revolution in the 18th century. This was with the growth of the joint stock companies the ownership and management became separate. The shareholders (owners) needed a report from an independent expert on the accounts of the company managed by the board of directors who were the employees. The objective of audit shifted and audit was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds.

In India, the companies Act 1913 made audit of company accounts compulsory with the increase in the size of the companies and the volume of transactions. The emphasis was not on arithmetical accuracy but on a fair representation of the financial position. The Companies Act, 1913 also prescribed for the first time the qualification of auditors.

The International Accounting Standards Committee and the Accounting Standard board of the Institute of Chartered Accountants of India have developed standard accounting and auditing practices. These standards serve as a guide to the accountants and auditors. Later computers are being used in accounting and auditing.

Thus, auditing has come a long way from hearing of accounts to taking the help of computers to examine computerized accounts.

1.3 BOOK-KEEPING, ACCOUNTANCY, AUDITING AND INVESTIGATION

BOOK-KEEPING

Book-keeping, often called record keeping, is the part of accounting that records transactions and business events in the form of journal entries in the accounting system. In other words, bookkeeping is the means by which data is entered into an accounting system.

ACCOUNTANCY

Accountancy begins where book-keeping ends. It means, accountant comes with the picture where book-keeper has done his job. The accountant performs the following functions.

1. Checking the work of the book-keeper
2. Preparation of trial balance
3. Preparation of financial statements (Example : Profit and Loss Account and Balance Sheet)
4. Passing rectification entries and making necessary adjustments.

Thus, accountancy is concerned with classification and summarization of financial records and it is semi-analytical in nature.

AUDITING

"Where accountancy ends, auditing begins." It is slightly said. An auditor has to verify the entries passed by the accountant and the final accounts prepared by him. Thus, auditing is the checking of the accounts of a business with the help of vouchers, documents and the information given to him and the explanations submitted to him.

An auditor has to satisfy himself after due verification and complete. Checking of accounts as to whether the transactions entered into the books are accurate. An auditor is required to submit his report to the effect whether or not the balance sheet is a true and fair representation of the existing state of affairs of a business concern. Auditing is conducted to verify the extent of truthfulness and fairness of the financial records of an entity.

Auditing is a process of identifying whether the results of accounting information are accurate and according to the specified norms or not.

INVESTIGATION

Investigation involves inquiry into facts behind the books and accounts, into the technical, financial and the economic position of the business or organisation. Investigation is an examination of books and records preliminary of financing or for any specified purpose, sometimes differing in scope from the ordinary audit. Investigation implies an examination of and record for some special purpose.

When for a special purpose an inquiry is made into the accounts of the business it is called investigation. In other words, we may say that audit which is conducted for a particular object is called investigation.

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Example: A, B and C partners in ABC Company. They have requested Mr. B to join as partner. Mr. Z is an experienced chartered accountant and he is requested by B to conduct investigation on ABC and Company to know about profitability and financial position. So here purpose is to know about profitability, financial positions etc.

1.4 ACCOUNTANCY VS. AUDITING

Accountancy	Auditing
Scope	
Accounting is concerned with preparing of financial statements.	Auditing is concerned with checking of financial statements.
Purpose	
The purpose of accounting is to show the performance and financial statement.	The purpose of auditing is to certify the true and fair view of financial statement.
Nature	
Accounting is concerned with current data. It constructive in nature.	Auditing is concern with past data. It is analytical nature.
Knowledge	
Accounting works requires that accountant must have accounting knowledge.	Auditing work required that an auditor must have accounting as well as auditing knowledge.
Status	
The accountant is permanent employee of the business.	The auditor is an independent person.
Start	
The work of an accountant starts when the work of bookkeeper ends.	The work of an auditor starts hen the work of an accountant ends.
Qualification	
An accountant may not be a Chartered Accountant as per law.	An auditor must be Chartered Accountant for public companies.

Principles	
The accounting principles include going concern accrual consistency and prudence.	The auditing principles include independence, objectivity, full disclosure and materiality.
Methods	
The accounting methods include depreciation, amortization and valuation.	The auditing method include manual and computerized.
Techniques	
Accounting technique includes depreciation rate interest rate and instalment payment.	Auditing technique include vouching, verification and valuation.
Rules	
Accounting is not governed by any code of	Auditing is governed by code of conduct

1.6 SCOPE OF AUDIT

1. **Legal Requirements :** The auditor can determine the scope of an audit of financial statements in accordance with the requirements of legislation, regulations or relevant professional bodies. The state can frame rules for determining the scope of audit work. In the same way professional bodies can make rules to conduct the audit. The auditor can follow all the applicable on the audit work while checking the accounts of a business concern.

2. **Entity Aspects :** The audit should be organized to cover all aspects of the entity as far as they are relevant to the financial statement being audited. A business entity has many areas of working. A small entity may have few functions while a large concern has many functions. The auditor has duty to go through all the functions of a business. The audit report should cover all function so that the reader may know about all the working of a concern.

3. **Reliable Information :** The auditor should obtain reasonable assurance as to whether the information contained in the underlying accounting record and other source data is reliable and sufficient as the basis for preparation of the financial statements. The auditor can use various techniques to test the validity of data. All auditors while doing the auditor work usually apply the compliance test and substance test. The auditor can show such information in the report.

4. **Proper Communication :** The auditor should decide whether the relevant information is properly communicated in the financial statements. Accounting is an information system so facts and figures must be so presented that reader can get information about the business entity. The auditor can mention this fact in his report. The principles of accounting can be applied to decide about the disclosure of financial information in the statements.

5. **Evaluation :** The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source date by making a study and evaluation of accounting system and internal controls to determine the nature, the nature, extent and timing of other auditing procedures.

6. **Test :** The auditing assesses the reliability and sufficiency of the information contained in the underlying accounting record and other source data by carrying out other tests, enquiries and other verification procedures of accounting transaction and account balance as he considers appropriate in the particular circumstances. There are compliance test and substantive test in order to examine the date. The vouching, verification and valuation technique are also used.

7. **Evidence :** The audit evidence available to auditor is persuasive rather than conclusive in nature. Due to judgment and persuasive evidence absolute certainty in auditing is really attainable. That is why the auditor can express an opinion as true and fair instead of exact and cent percent correct. The personal judgments affect the value of many items. The value of such items becomes an opinion so cent percent accuracy is not there.

1.7 FEATURES OF AUDITING

Following are the features of Auditing :

1. **Systematic and Scientific Examination :** Audit is a systematic and scientific examination of the books of accounts of a business.

2. **Done by Qualified Person/Group :** Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

3. **Shows the Profitability & Financial Position :** Audit is a verification of the results shown by the Profit and Loss Account and the Balance Sheet.

4. **Review of Internal Control :** Audit is a critical review of the system of accounting and internal control.

5. **Requires Evidences :** Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

6. **Requires Authentication :** The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

7. **Requires Thorough Examination :** The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of shareholders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

1.8 OBJECTIVES OF AUDITING

Auditors are basically concerned with verifying whether the account exhibit true and fair view of the business. The objectives of auditing depends upon the purpose of his appointment.

I. Primary Objective

II. Secondary Objective

I. Primary Objectives

The primary objective of an auditor is to respect to the owners of his business expressing his opinion whether account exhibits true and fair view of the state of affairs of the business. It should be remembered that in case of a company, he reports to the shareholders who are the owners of the company and not to the director.

The auditor is also concerned with verifying how far the accounting system is successful in correctly recording transactions. He had to see whether accounts are prepared in accordance with recognized accounting policies and practices and as per statutory requirements.

To ensure that the primary objective of audit is achieved, an auditor must:

(a) Examine the Internal Control and Internal Check.

(b) Verify whether all the books of accounts as required by law are kept.

(c) Verify whether proper accounting principles and procedures are followed.

(d) Check the arithmetical accuracy of the books of accounts.

(e) Verify the authenticity and validity of the transactions.

(f) Confirm the existence and the values of the assets and liabilities by physical verification.

(g) Find out whether the financial statement is properly drawn up.

(h) Report whether the profit and loss gives a true and fair view of the profit or loss for the year and Balance sheet gives a true and fair view of the financial position of the business at the end of the financial year.

II. Secondary Objectives

Following are the secondary objectives of Auditing :

1. **Detection and prevention of errors:** Errors are mistakes committed unintentionally because of ignorance, carelessness.

   Errors are of many types:

   (a) Errors of Omission

   (b) Errors of Commission

   (c) Compensating Errors

   (d) Error of Principle

   (e) Clerical Errors

(a) **Errors of Omission :** These are the errors which arise on account of transaction into being recorded in the books of accounts either wholly omitted or partially recorded. If a transaction has been totally omitted it will not affect trial balance and hence it is more difficult to detect. On the other hand if a transaction is partially recorded, the trial balance will not agree and hence it can be easily detected.

(b) **Errors of Commission :** When incorrect entries are made in the books of accounts either wholly, partially such errors are known as errors of commission.

E.g: Wrong entries, wrong calculations, postings, carry forwards etc., such errors can be located while verifying.

(c) **Compensating Errors :** When two/more mistakes are committed which counter balances each other, such an error is known as Compensating Error.

E.g: If the amount is wrongly debited by ₹100 less and wrongly credited by ₹100 such a mistake is known as compensating error.

(d) **Error of Principle :** These are the errors committed by not properly following the accounting principles. These arise mainly due to the lack of knowledge of accounting.

E.g: Revenue expenditure may be treated as capital expenditure.

(e) Clerical Errors : A clerical error is one which arises on account of ignorance, carelessness, negligence etc.

Location of Errors: It is not the duty of the auditor to identify the errors but in the process of verifying accounts, he may discover the errors in the accounts. The auditor should follow the following procedure in this regard.

1. Check the trial balance.
2. Compare list of debtors and creditors with the trial balance.
3. Compare the names of account appearing in the ledger with the names of accounting in the trial balance.
4. Check the totals and balances of all accounts and see that they have been properly shown in the trial balance.
5. Check the posting of entries from various books into ledger.

2. Deduction and Prevention of Fraud: A fraud is an error committed intentionally to deceive/to mislead/to hide the truth or the material fact.

Frauds may be of 3 types. They are :

(a) Misappropriation of Cash

(b) Misappropriation of Goods

(c) Manipulation of Accounts

(a) Misappropriation of Cash: This is one of the major frauds in any organisation. It normally occurs in the cash department. This kind of fraud is either by showing more payments/less receipts.

The cashier may show more expenses than what is actually incurred and misuse the extra cash.

E.g: Showing wages to dummy workers.

Cash can also be misappropriated by showing less receipts

Eg: Not recording cash sales. Not allowing discounts to customers.

The cashier may also misappropriate the cash when it is received. Cash received from 1st customer is misused when the 2nd customer pays it is transferred to the 1st customer's account. When the 3rd customer pays it goes forever. Such a fraud is known as "Teaming and Lading". To prevent such frauds the auditor must check in detail all books and documents, vouchers, invoices etc.

(b) **Misappropriation of Goods:** Here records may be made for the goods not purchased/ not issued to production department, goods may be used for personal purpose. Such a fraud can be deducted by checking stock records and physical verification of goods.

(c) **Manipulation of Accounts:** This is finalizing accounts with the intention of misleading others. This is also known as "Window Dressing". It is very difficult to locate because its usually committed by higher level management such as directors. The objective of Window Dressing may be to evade(avoid) tax, to borrow money from bank, to increase the share price etc.

1.9 ADVANTAGES OF AUDITING

Following are the advantages of auditing :

1. **Verification of Books and Statement :** The main object of audit is the verification of the books and the financial statements of the company concerned.

2. **Discover and Prevention of Error :** While examining the books, auditors detect some errors. These are various kinds of errors. So audit is very useful in preventing and detecting the errors.

3. **Discovery and Prevention of Fraud :** Fraud means false representation made intentionally with a view to defraud somebody. It is the duty of the auditor that he should detect the fraud. So auditing is used for detecting and preventing frauds in an organisation.

4. **Moral Check :** When each staff of the company knows that this financial transactions will be examined by the auditor then he fears to do that fraud. The fear of their detection acts as a moral check on the staff of the company.

5. **Independent Opinion :** Auditing is very useful to obtain the independent opinion of the auditor about the business condition. If the accounts are audited by the independent auditor, the report, of the auditor will be a true picture and it will be very important for the management. Keeping in view the report, owner of the business will be able to prevent frauds and errors in future.

6. **Protects the Interest of Shareholder :** Audit protect the interest of shareholders in the case of joint stock company. Through audit, shareholders are assured that the accounts of the company are maintained properly and their interest will not suffer.

7. **Check on Directors :** Audit acts a check upon the directors and precaution against fraud on the part of the management.

8. **Proper Supervision :** Sometimes owner of the business cannot look after the business personally. Audit acts as a check on employees and it saves the owner from losses.

9. **Valuable Advice :** The auditor has expert knowledge about the accounts and finance problems, so he may be consulted about these problems.

10. **Disputes Settlement :** In case of partnership, audit is very useful in settling the disputes among the partners. If any partner dies, or retires, the audited balance sheet will be very useful in estimating the value of goodwill.

11. **Loan Facility :** If accounts are audited, then true picture will be known to the financial institutions and they will never hesitate to lend the money.

12. **Insurance Claim :** In case of fire insurance and participation of fraud, claims can be settled on the basis of audited accounts of the previous years.

13. **Property Value Assessment :** If the accounts have been audited, then it is easier to value property when the business is sold. In the eyes of law, audited accounts are considered more reliable.

14. **Correct Information about Business :** Due to the fear of audit work accounting always remains up to date and correct information is given to the members in time.

15. **Advantage for General Public :** Audited financial statements present the real position of the company before the general public. Keeping in view the position of a company one can do the investment.

16. **Useful for Tax Department :** Assessment of tax becomes very easy job for the tax department. Keeping in view the audited accounts they impose the taxes.

17. **Information about Economic Condition :** Economic conditions of various companies can be judged through their audited accounts. If these companies are improving their economic condition, it mean it is a good sign for the economy.

1.10 LIMITATIONS OF AUDITING

Though auditing has several advantages, it suffers from several limitations. Some of the limitations are as follows:

1. **Non-detection of errors/frauds :** Auditor may not be able to detect certain frauds which are committed with malafide intentions.

2. **Dependence on explanation by others :** Auditor has to depend on the explanation and information given by the responsible officers of the company. Audit report is affected adversely if the explanation and information prove to be false.

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

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

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

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

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

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

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

10. **Difficult to verify certain items :** It is very difficult to verify certain items i.e., stock-in-trade.

1.11 AUDITOR IS WATCHDOG, NOT A BLOOD HOUND

Case: Kingston cotton mills company (1986)

"An auditor is not bound to be detective and to work with their suspicion, that there is something wrong. He is a watchdog not a blood hound. He is justified in believing tried servant of the company and is entitled to rely upon their representation provides he takes reasonable care"

Auditor is Watchdog, not a Blood Hound it means as the dog always think about the owner as it the same way an auditor always think about the owner of the company. It is the responsibility to find true and fair value of the business and gives all the details (errors and frauds) of all the business. But this task is so difficult because people tried who arise fraud in the company gives wrong information to the company.

Duty of the auditor is not harm to the other person. He is always sincere, systematic, honest, truthful, and tactful. An auditor has a professional knowledge and expert in own field. In case of any unwanted situation. The remedial action has to come from the owner of the entity. He has to discharge his responsibility by informing about the irregularity found in the audit.

1.12 TYPES OF AUDITING

Audit can be classified on different types. They are :

1. Classification on the basis of Ownership
   (a) Proprietorship Audit
   (b) Partnership Audit

(c) Companies Audit

(d) Trusts Audit

(e) Cooperative Societies

(f) Government Departments

2. Classification on the basis of Time

(a) Interim Audit

(b) Final Audit

(c) Continuous Audit

(d) Balance Sheet Audit

3. Classification on the basis of Objectives

(a) Independent Audit

(b) Financial Audit

(c) Internal Audit

(d) Cost Audit

(e) Tax Audit

(f) Government Audit

(g) Secretarial Audit

1. Classification on the basis of Ownership

(a) Proprietorship Audit : The sole proprietors are not required to have their accounts audited under any specific statute. However, some proprietary businesses where there is large number of transactions and huge amount is involved in the business get their accounts audited.

The proprietor himself takes decision about the scope of audit and the appointment of auditor. Under this type of audit, the auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.

(b) Partnership Audit : There is no legal compulsion to get partnership accounts audited. But in partnership, there are possibilities of mistrust and dissatisfactions among the partners. So, an independent external auditor's view regarding the correctness of accounts is desirable. The partnership deed includes the provision of audit of their accounts.

In this type of auditing, the auditor has to refer to the partnership deed. But in the absence of partnership deed or any aspect which is not included in the deed, the auditor may refer to the Partnership Act, 1932.

(c) **Companies Audit :** Audit of accounts of companies registered under the Companies Act is compulsory. The Companies Act, 1956 outlines the procedure of audit work, the different books of accounts to be maintained, rights, duties and liabilities of the auditor. With this, the interest of shareholders over the company is protected.

(d) **Trusts Audit :** As per the trust deed, the trusts properties are distributed by the trustees to their beneficiaries. As the beneficiaries of the trust in most of the cases do not have the accounting knowledge, there are many chances of frauds. This type of audit protects the beneficiaries against such frauds.

(e) **Cooperative Societies :** Audit of co-operative societies is conducted by the co-operative department of the state government or by the Registrar of co-operative societies. The co-operative societies are governed by the Co-operative Societies Act, 1912. This Act provides the detailed procedures and guidelines for the audit of co-operative society. There is a statutory obligation to audit this type of co-operative societies.

(f) **Government Departments :** Government audit refers to the audit of accounts of Government departments and offices, Government companies and statutory or public corporations.

Features : The features of government audit are :

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

Different government departments and public utilities are also subject to independent financial audit. Government departments and public utilities also have the internal audit system of their own.

2. Classification on the basis of Time

(a) **Interim Audit :** It is an audit conducted between two annual audits. It is the audit conducted in the middle of the financial year. It is carried out for some specific purpose for declaring interim dividend, ascertaining interim profit. It is a kind of audit which is conducted between the two periodical or balance sheet audits.

Objectives Of Interim Audit

- To know profit or loss of interim period.
- To distribute interim dividend.
- To get loan on the basis of interim account.
- To get information about the financial position of interim period.

Advantages :

- There is a quick discovery of errors and frauds.
- It imposes moral check on client staff.
- It is helpful for speedup the final audit.
- This type of audit is useful for publication of interim figures.
- Audit becomes easy and can be completed without lapse of time.

(b) **Final Audit :** It is an audit carried out after the preparation of financial statement. It is an audit where the auditor takes up his work of checking the books of accounts only at the end of the accounting year. In this case, the audit work is commenced and completed in a single uninterrupted session. It is also called Annual Audit or Periodical Audit.

Advantages:

- Cost of audit is less than that of continuous audit.
- Audit work is completed in one continuous sitting.
- There is no possibility of any dislocation of client work.
- There is no possibility of alteration of figures.
- It is not mechanical and monotonous.
- There is less chance for collusion between client staff and audit staff.
- There is no lose the thread of the work.

Limitations

- Errors and frauds remains in the accounts for long period of time.
- There is little time for checking.
- It relies upon test checking.
- It is not suitable for imposing moral check on the client staff.
- This type of audit is not helpful for preparing interim accounts.
- It is not suitable for large size organizations.

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

Advantages

- It is easy to discover of errors and frauds.
- There is a quick presentation of accounts.
- It provides moral check on the client's staff.
- It is an efficient audit.
- Preparation of interim accounts is very easy.
- Audit staff can be kept busy.

Limitations

- There is possibility for alteration of figures.
- There can be dislocation of the work of the client staff.
- It is expensive.
- Some queries may remain outstanding.
- Extensive note taking may be necessary.
- There is a chance for collusion between client staff and audit staff.
- It is mechanical and monotonous.

(d) **Balance Sheet Audit :** In this type of audit, all the balance sheet accounts are verified and tests imposed only on those profit and loss items which are directly related to the assets and liabilities such as repairs and maintenance, provision for depreciation, bad debts, etc. This type of audit is more popular in USA. This type of audit is more widely used. It concentrates mainly on the verification of the items in the balance sheet such as capital, reserves, profit and loss account balance, liabilities and provisions and all the assets of the business.

Advantages :

- It records the changing events of the period. The change in working capital can be reflected through Balance Sheet audit.
- This type of audit establishes proper relationship between assets and liabilities of the business.
- It guides different parties interested in the affairs of the business in taking business decisions.
- It furnishes different information relating to over-capitalisation, under-capitalisation, over-trading and under-trading of the business.

Disadvantages :

- It lacks in disclosing certain material information needed to evaluate different measuring bases.
- Comparison between the two periods may be known, but the causes for the change of figures between the two periods are not stated.
- Information regarding the generation of profit or loss of the business is not stated in the balance sheet.

3. Classification on the basis of Objectives

(a) **Independent Audit :** An independent audit is a systematic review of the accuracy and truthfulness of the accounting records of a particular individual, business, or organization by a person or firm skilled in the necessary accounting methods. These people or firms are not related in any way to the person or firm undergoing the audit.

During the independent audit, the auditor will review the organization's financial statements to determine whether they adhere to "Generally Accepted Accounting Principles" (GAAP). When these principles are not followed, the auditors are required to note that in their report.

(b) **Financial Audit :** A financial audit is an independent, objective evaluation of an organization's financial reports and financial reporting processes. The primary purpose for financial audits is to give regulators, investors, directors, and managers reasonable assurance that financial statements are accurate and complete. Financial audits provide reasonable assurance, not absolute guarantees.

Financial auditing process involves using an individual body for evaluating the financial transactions and statements of a business. The ultimate purpose of financial audit is presenting an accurate amount of the business transactions of a company. Besides, it ensures that the accounts presented to the public and shareholders are accurate and justified. The results of financial audit are useful for banks, shareholders, and anybody else with an interest in the company.

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

Internal audit is an audit conducted on behalf of the management of an enterprise with the object of assisting the management discharge of responsibilities effectively and involves an examination and evaluation of various activities of the enterprise. It is a review of the operations and records, sometimes continuously undertaken, within a business, by specially assigned staff.

(d) **Cost Audit :** It is a thorough examination of the cost accounting records of a company by a cost auditor to ensure that they are accurate and they also follow to the cost accounting principles, procedures and plans.

Definitions

1. "It is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan."

- ICWA London

2. "System of audit introduced by the government of India for the review, examination, and appraisal of the cost accounting records and attendant information required to be maintained by specified industries"

- ICWAI

OBJECTIVES OF COST AUDIT

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

ADVANTAGES OF COST AUDIT

To The Management

1. Cost audit helps in the detection of errors and frauds.
2. The management gets correct and reliable data based on which they can make day-to-day decisions like price fixation.
3. It helps in cost control and cost reduction.
4. It assists the system of standard costing and budgetary control.
5. It helps the management in inter-unit / firm comparison.
6. It enables the management to identify loss making propositions.

1. Compulsory tax audit under section 44 AB of the Income tax Act 1961.
2. Tax audit for claiming deductions and Reliefs under the Income Tax Act.
3. Tax audit for Tax Consultancy and Representation.

(f) **Government Audit :** Government audit means the audit of accounts of departments and offices of the central government, the state governments and the union territories. Under Article 149 of the Constitution of India, the C&AG (Comptroller and Auditor General) of India is empowered ot conduct complete audit of accounts of governments and of those undertakings, which are directly under a ministry or government department.

The objective of Government auditing is that of systematic, professional and independent examination of financial, administrative and other operations of a public entity made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

Objectives of Government Audit

The objectives of government audit are as follows :

1. To make sure that the expenditure is incurred out of the fund, which the competent authority has sanctioned.
2. To verify that the expenditure of the government department is sanctioned as per the rules and regulations of the department concerned.
3. To see that the expenditure already sanctioned has been incurred by an officer who is authorized to do so.
4. To ensure that the payments have been made to the right persons and they are duly entered in the books on the basis of receipts received from them.
5. To see that the payments have been properly classified into capital and revenue.
6. To check the existence of stock and stores and their proper valuation.
7. To ensure that expenditures have been incurred in the interest of public.
8. To ensure that stocktaking is done periodically and stock registers are maintained up-to-date.
9. To ensure that whether money due from others has been regularly recovered while verifying the receipts.

(g) **Secretarial Audit :** 'Secretarial Audit' is introduced by recently enacted Companies Act, 2013. It is a process to check compliances made by the Company under Corporate Law & other laws, rules, regulations, procedures etc. It is a mechanism to monitor compliance with the requirements of stated laws and processes. Periodically examination of work is necessary to point out errors & mistakes and to make a robust compliance mechanism system in an organization.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed due processes. It is essentially a mechanism to monitor compliance with the requirements of stated laws and processes.

Objectives of Secretarial Audit

- To check & Report on Compliances.
- To Point out Non-Compliances and Inadequate Compliances.
- To Protect the interest of the Customers, employees, society etc.
- To avoid any unwarranted legal actions by law enforcing agencies and other persons as well.

Advantages of Secretarial Audit

- Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
- Provides a level of confidence to the directors, officers in default, Key Managerial Personnel etc.
- Directors can concentrate on important business matters as Secretarial Audit ensures legal and procedural requirements.
- Strengthen the image and goodwill of a company in the minds of regulators and stakeholders.
- Secretarial Audit is an effective compliance risk management tool.
- It helps the investor in analyzing the compliance level of companies, thereby increases the reputation.
- Secretarial Audit is an effective governance tool.

1.14 MANIPULATION OF ACCOUNTS

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

Depending upon the nature ... specific audit.

1.15 STANDARDS OF AUDITING (SA) ISSUED BY ICAI

1. **SA 200 :** Basic Principles Governing An Audit
2. **SA 210 :** Terms of Audit Engagement
3. **SA 220 :** Quality Control For Audit Work
4. **SA 230 :** Audit Documentation
5. **SA 240 :** The Auditor's Responsibilities Relating To Fraud In An Audit Of Financial Statements.
6. **SA 250 :** Consideration Of Laws And Regulations In An Audit Of Financial Statements.
7. **SA 260 :** Communication With Those Charged With Governance.
8. **SA 265 :** Communication Deficiencies In Internal Control To Those Charged With Governance
9. **SA 299 :** Responsibility Of Joint Auditors
10. **SA 300 :** Planning An Audit Of Financial Statements
11. **SA 315 :** Understanding The Entity And Its Environment And Assessing The Risk Of Material Misstatement.
12. **SA 320 :** Audit Materiality
13. **SA 330 :** The Auditor's Responses To Assessed Risks
14. **SA 402 :** Audit Considerations Relating To Entities Using Service Organizations
15. **SA 450 :** Evaluation Of Misstatement Identified During The Audit
16. **SA 500 :** Audit Evidence
17. **SA 501 :** Audit Evidence – Additional Consideration For Specific Items
18. **SA 505 :** External Confirmations
19. **SA 510 :** Initial Audit Engagements – Opening Balances
20. **SA 520 :** Analytical Procedures

21. **SA 530 :** Audit Sampling

22. **SA 540 :** Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures

23. **SA 550 :** Related Parties

24. **SA 560 :** Subsequent Events

25. **SA 570 :** Going Concern

26. **SA 580 :** Written Representations

27. **SA 600 :** Using The Work Of Another Auditor

28. **SA 610 :** Relying Upon The Work Of An Internal Auditor

29. **SA 620 :** Using the Work Of An Expert

30. **SA 700 :** The Auditor's Report On Financial Statements

31. **SA 705 :** Modifications To The Opinion In The Independent Auditor's Report

32. **SA 706 :** Emphasis Of Matter Paragraphs And Other Matter In The Independent Auditor's Report

33. **SA 710 :** Comparatives Information

34. **SA 720 :** The Auditors Responsibility In Relation To Other Information In Documents Containing Audited Financial Statements.

1.16 SA - 230 AUDIT DOCUMENTATION

1. Audit Documentation refers to the working papers which are prepared by the auditor to show that the audit has been conducted in accordance with the SA on Auditing. It contains all the :

   - Procedures applied
   - Evidences obtained
   - Response of the management
   - Conclusion drawn

2. They may be in physical and electronic form. The purpose of the working papers are

   - To plan the audit based on previous years working papers
   - It acts as an evidence that the auditor was not negligent
   - Can be used to form conclusions
   - To supervise the work of audit assistants

1.21 PROCEDURE FOR ISSUE OF STANDARDS BY AASB

AASB stands for Auditing and Assurance Standards Board. AASB works towards developing uniform standards on auditing at international level. AASB reviews existing and formulates new engagement standards, standards on quality control and statements on auditing.

The Auditing and Assurance Standards Board of the Institute (AASB) formulates the auditing standards. Broadly, following is the procedure for formulating auditing standards:

1. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.
2. In the preparation of the auditing standards, the Board is normally, assisted by study groups comprising of a cross section of members of the Institute.
3. On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members.
4. After taking into the comments received, the draft of the proposed auditing standard is finalised by the Board and submitted to the Council of the Institute.
5. The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council.

While formulating the auditing standards, the Board also takes into consideration the applicable laws, customs, usages and business environment in the country.

In doing so, the IAASB seeks to enhance the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession. Considering the developments in the help of auditing at international level, the need for issuing Standards and Guidance Notes in tandem with international standards but conforming to national laws, customs, usages and business environments was felt. With this objective, ICAI constituted the Auditing Practices Committee (APC) on September 17, 1982, to spearhead the new framework of Statements on Standard Auditing Practices (SAPs) and Guidance Notes (GNs) inter alia to replace various chapters of the old omnibus Statement on Auditing Practices issued in 1964. In July, 2002, the Auditing Practices Committee has been converted into an Auditing and Assurance Standards Board by the Council of the Institute, to be in line with the international trend.

The main function of the AASB is to review the existing auditing practices in India and to develop Statements on Standards on Auditing (SAs) so that these may be issued by the Council of the Institute. While formulating the SAs, the AASB takes into consideration the ISAs issued by the IAPC, applicable laws, customs, usages and business environment in India. The SAs are issued under the authority of the Council of the Institute.

The AASB also issues Guidance Notes on the issues arising from the SAs wherever necessary. The AASB has also been entrusted with the responsibility to review the SAs at periodical intervals.

1.20 OBJECTIVES OF AUDITING AND ASSURANCE STANDARDS BOARD

1. To review the existing and emerging auditing practices worldwide and identify areas in which Standards on Quality Control, Engagement Standards and Statements on Auditing need to be developed.
2. To formulate Engagement Standards, Standards on Quality Control and Statements on Auditing so that these may be issued under the authority of the Council of the Institute.
3. To review the existing Standards and Statements on Auditing to assess their relevance in the changed conditions and to undertake their revision, if necessary.
4. To develop Guidance Notes on issues arising out of any Standard, auditing issues pertaining to any specific industry or on generic issues, so that those may be issued under the authority of the Council of the Institute.
5. To review the existing Guidance Notes to assess their relevance in the changed circumstances and to undertake their revision, if necessary.
6. To formulate General Clarifications, where necessary, on issues arising from Standards.
7. To formulate and issue Technical Guides, Practice Manuals, Studies and other papers under its own authority for guidance of professional accountants in the cases felt appropriate by the Board.