AUDITING

VI SEMSTER

E- CONTENT

MEANING OF AUDITING :

Economic decisions in every society must be based upon the information available at the time the decision is made. For example, the decision of a bank to make a loan to a business is based upon previous financial relationships with that business, the financial condition of the company as reflected by its financial statements and other factors. If decisions are to be consistent with the intention of the decision makers, the information used in the decision process must be reliable. Unreliable information can cause inefficient use of resources to the detriment of the society and to the decision makers themselves. In the lending decision example, assume that the barfly makes the loan on the basis of misleading financial statements and the borrower Company is ultimately unable to repay. As a result the bank has lost both the principal and the interest. In addition, another company that could have used the funds effectively was deprived of the money. As society become more complex, there is an increased likelihood that unreliable information will be provided to decision makers.

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 Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt. Rome, U.K. and India. The Vedas contain reference to accounts and auditing.

Arthasashthra by Kautilya detailed rules for accounting and auditing of public finances. The original objective of auditing was to detect and prevent errors and frauds

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DEFINATION OF AUDITING

1.Prof. L.R.Dicksee. "auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate.

2.Spicer and Pegler: "Auditing is such an examination of books of accounts and vouchers of business, as will enable the auditors to satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and that the profit and loss account gives true and fair view of the profit/loss for the financial period, according to the best of information and explanation given to him and as shown by the books; and if not, in what respect he is not satisfied."

OBJECTIVES OF AUDITING

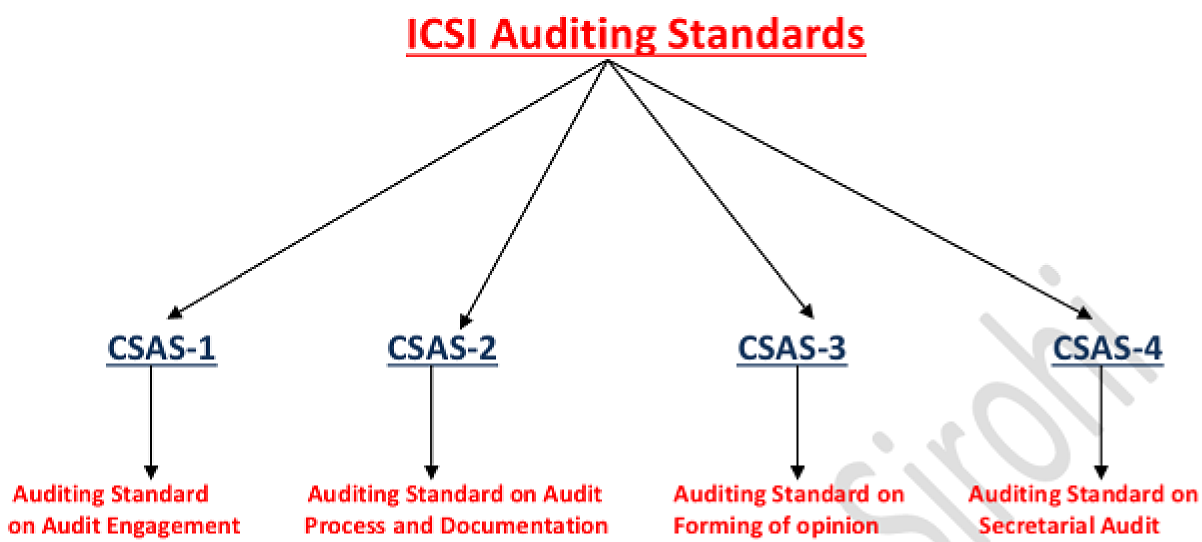
There are two main objectives of auditing.

The primary objective and the secondary or incidental objective. A Primary objective – as per Section 227 of the Companies Act 1956, the primary duty (objective) of the auditor is to report to the owners whether the balance sheet gives a true and fair view of the Company's state of affairs and the profit and loss A/c gives a correct figure of profit of loss for the financial year.

b. Secondary objective – it is also called the incidental objective as it is incidental to the satisfaction of the main objective. The incidental objective of auditing are: i. Detection and prevention of Frauds, and ii. Detection and prevention of Errors.

Classes of auditing

1.Financial audit 2. Internal audit
3.External audit 4. Information system audit
5.Operational audit 6. Regulatory compliance
7.Forensic science 8. Tax audit
9.statutory auditing



Role of Internal Auditor in Fraud Risk Management

Historically, approach towards managing the fraud risk in an organization has been reactive; however, with the increase in the incidence of fraud (due to the pandemic, and in general), the boards of the companies are now more pro-active in discussing and implementing measures to manage the fraud risk for their organization.

With the increase in the risk of the occurrence of fraud which got further accentuated by the global pandemic situation, IA function has to be more proactive, and adaptive, in order to be able to identify, detect and investigate the fraud risks within an organization. Key considerations discussed in our second joint Protiviti and IIA India webinar, for the IA function, to be able to defend an organization against the fraud risk were:

1. Extensive use of data analytics, artificial intelligence and machine learning models, to identify patterns which indicate fraud scenarios with in an organization;
2. Use of the Benford Law to detect unusual patterns within the large volumes of random data of natural numbers such as invoice values and payments;
3. Proper use of bio-metrics to control the misuse of organization assets and resources;
4. Board level security committees to monitor and control the anti-fraud systems within an organization;
5. Implementing an independent whistleblowing program to promote transparency and discourage retaliation;
6. Use of professionals and independent investigation experts to defend against the emergence of the fraud risks.

In addition to the above, the panelists highlighted the risks related to current situation where majority of the work was being performed over vulnerable and sometimes exposed networks at home which needs to be evaluated and proper IT controls need to be put in place to prevent any incidence of cybercrime, data breaches or theft.

Audit procedures

Audit procedures are the techniques, processes, and methods that auditors use to obtain reliable audit evidence, which enables them to gain a sound judgment about an organization's financial status. Audit procedures are conducted to help determine whether or not a company's financial statement is credible and factual.

Auditing In-depth

the Auditing in-depth refers to an examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. While auditing in depth, the auditor reviews all the accounting and operational aspects of the transaction from origin to the end.

Author approach to statistical sampling

Statistical Sampling in Audit. Sample design covers the method of selection, the sample structure and plans for analyzing and interpreting the results. Sample designs can vary from simple to complex and depend on the type of information required and the way the sample is selected.There are five types of sampling: Random, Systematic, Convenience, Cluster, and Stratified. Random sampling is analogous to putting everyone's name into a hat and drawing out several names.

VOUCHERS

voucher is known as the documentary or other evidence for the support of a transaction in the books of account. The act of examining vouchers is defined as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transactions recorded in the primary books of account. It essentially consists of verifying a transaction recorded in books of accounts with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mention in the voucher has been posted to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account.. that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and 5. that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

Voucher can be two types

1. Primary Vouchers: It is written documentary evidence available in original such as purchase order, original invoices, counterfoil of cash receipts etc.

2. Collateral/Secondary Vouchers: When evidence in original is not available, copies of original evidence are made available for the purpose of audit such as xerox copies of demand draft etc.

VERIFICATION

Verification is the proof of accuracy of extension, footings, posting, existence and ownership of assets." (Arthur Holmes)

"The duty of an auditor in verifying the assets is two-fold. He must satisfy himself that they really existed at the date of the balance sheet and were free from any charge and that they have 4 been properly valued. In verifying the liabilities he has to see that all liabilities have been inserted at their proper figures and that no liability has been omitted**." J.R. Batliboi**

REGARD TO VERIFICATION

"Auditor is not a valuer and cannot be expected to act as such. All that he can do is to verify the original cost price and to ascertain as far as possible that the current values are fair and reasonable and are in accordance with the accepted commercial principles.**" Lansacart**

VERIFICATION OF ASSETS

"Verification of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any change on the assets." Spicer and Pegler According to Joseph Lancaster "Verification of assets is a process by which the auditor substantiates the accuracy of the right-hand side of the Balance Sheet, and must be considered as having three distinct objects : (a) the verification of the existence of assets (b) the valuation of assets and (c) the authority of their acquisition".

Balance Sheet

A balance sheet reports a company's assets, liabilities, and shareholder equity at a specific time. It provides a basis for computing rates of return and evaluating the company's capital structure. This financial statement provides a snapshot of what a company owns and owes, as well as the amount invested by shareholders.

Profit & Loss Account

- Meaning: Account that shows the company's revenue and expenses over a period of time
- Time frame: Financial changes during the period
- Type: Account

- Information disclosed: Income, expenses, gains, and losses
- The sequence of preparation: It is prepared before the preparation of the Balance Sheet

- **Auditing of Limited Company**

fter registering a private limited company, there are many compliances that the company has to follow under the Companies Act, 2013 (‘Act’). One such mandatory requirement a company must follow is to conduct an audit irrespective of its turnover or nature.

A **company audit means** the **inspection of its books of account** to ensure that they are correct. The company must **appoint** **an auditor to conduct the audit**. The objective of an audit of the company’s financial statements is to allow the auditor to express his/her opinion.

The auditor will have to check various books of accounts, vouchers and bills to check if they are accurate and properly maintained. The audit of a private limited company is an annual compliance requirement under the Act and Company Law Rules.There are **different types of audits of a private limited company** carried out for various purposes. A few important types of audit of a private company are as follows:

Statutory Audit

The **statutory audit is a mandatory audit** that **every private limited company** must conduct irrespective of its profit or turnover. A company incurring loss must also conduct a statutory audit. Every private limited company must compulsorily get their annual accounts audited each financial year as per the Act and the Companies (Accounts) Rules, 2014. The objective of the statutory audit is to determine if a company is providing an accurate representation of its financial situation after examining the information in the books of account, bank balance and financial statements.

Internal Audit The internal audit of the private limited company is conducted as per the suggestion of its internal management. The Act and the Companies (Accounts) Rules, 2014, provides that the prescribed companies must appoint an internal auditor to conduct an audit of their activities and functions. The **prescribed private limited companies that need to conduct internal audits** are: Internal audits are done to check the status of the company’s finances and analyse its operational efficiency. They help the internal management review the finances and make the required changes to increase efficiency in its operations.

Cost Audit The Companies (Cost Records and Audit) Rules, 2014 prescribes that the **following private limited companies must perform cost audit**:Private limited companies engaged in the production of goods or providing services listed in table 3(A) of the Companies (Cost Records and Audit) Rules and having:

Statutory Auditor Every private limited company must appoint its first auditor to conduct the statutory audit of the company **within 30 days from its registration date**. At the company’s **first Annual General Meeting** (AGM), the shareholders will **confirm the appointment of the first auditor** who will hold the office of auditor for a term of five years. The company can appoint only an independent practising Chartered Accountant (CA), CA firm or LLP with the majority of partners practising in India as its auditor.

Cost Audit: The cost audit report is to be **submitted to the board within 30 September** **every year** in form CRA-3. After receiving the cost audit report, the board will consider and examine the cost report. The board must **submit the cost audit report** with relevant information to the **Central Government within 30 days** of receiving the cost audit report in form CRA-4.