CLASSIFICATION, NEED AND PURPOSE OF AUDIT

Definition of Audit

- **Auditing** refers to a systematic examination of books, accounts, documents and vouchers of an organization to ascertain how far the financial statements present a true and fair view of the concern.

- <u>Spicer and Pegler:</u>
- "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."

Definition

- 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."

FEATURES OF AUDITING

a. Audit is a systematic and scientific examination of the books of accounts of a business;

b. Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

c. Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

d. Audit is a critical review of the system of accounting and internal control.

Features of Auditing.

e. Audit is done with the help of vouchers, documents, information and explanations received from the authorities.
f. 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.
g. The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

Differences Between Auditing And Accounting

- Accounting is related to the collection, recording, analysis and interpretation of financial transactions but auditing refers to the examination of books of accounts along with the evidential documents. So, following differences can be shown between auditing and accounting:

1. Meaning

- Accounting is the act of collecting, recording, analyzing and interpretation of financial transactions but auditing is the act of examination of books of accounts and evidential documents, so as to prove the true and fair view of profitability and financial position.

2. Beginning Of Work

- Work of accounting begins when financial transactions take place but work of auditing begins when work of accounting ends.

3. Scope

- Accounting prepares profit and loss account and balance sheet and other statements as per the instruction of auditor but auditor checks the books of accounts considering their fairness as well as complying with the provision of company act or not.

4. Nature Of Work

- Accounting keeps the record of financial transactions but auditor checks and verifies the books of accounts.

5. Staff

- An accountant is a staff of an organization and draws the salary from the business but an auditor is an independent person who is appointed for specific period and gets a sum of remuneration.

6. Preparation Of Report

- An accountant does not prepare report after the completion of his task but he has to give information to the management when needed but auditor needs to prepare and present report after the completion of his work to the concerned authority.

7. Responsibility

- An accountant remains responsible to the management but an auditor is responsible to the owners or shareholders.

Scope of Audit.

- The scope of audit is increasing with the increase in the complexities of the business. It is said that long range objectives of an audit should be to serve as a guide to the management future decisions.

- Today most of the economic activities are largely conducted through public finance. The auditor has to see whether these larger funds are properly used. The scope of audit encompasses verification of accounts with a intention of giving opinion on its reliability. Hence it covers cost audit, management audit, social audit etc. It should be remembered that an auditor just expressed his opinion on the authenticity of the account. He has no power to take action against anybody, in this regard its said that "an auditor is a watch dog but not a blood hound".

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.

- **Primary Objective.**
- 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 tot 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.
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- **Secondary Objective:**
- The following objectives are incidental to the main objective of audting.
- **Detection and prevention of errors:** errors are mistakes committed unintentionally because of ignorance, carelessness. Errors are of many types:
  - **Errors of Omission:** These are the errors which arise on account of transaction into being recorded in the books of accounts either wholly partially. 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.
  - **Errors of Commission:** When incorrect entries are made in the books of accounts either wholly, partially such errors are known as errors of commission. Eg: wrong entries, wrong Calculations, postings, carry forwards etc such errors can be located while verifying.
  - **Compensating Errors:** when two/more mistakes are committed which counter balances each other. Such an error is know an Compensating Error. Eg: if the amount is wrongly debited by Rs 100 less and Wrongly Credited by Rs 100 such a mistake is known as compensating error.
  - **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. Eg: Revenue expenditure may be treated as Capital Expenditure.
  - **Clerical Errors:** A clerical error is one which arises on account of ignorance, carelessness, negligence etc.

ADVANTAGES OF AUDIT:

- Audited account are detected as an authentic record of transaction.
- Errors and frauds are detected and rectified.
- It increases the morale of the staff and thus it prevents frauds and errors.
- Because of his expertise the auditor may advise on various matters to his clients.
- An auditor acts as a trustee of his shareholders. Hence he safeguards their financial interest.
- For taxation purpose auditing of account is amust.
- In case of any claim is to be made from the insurance company only audited account should be submitted.
- Even in case of partnership firm auditing of accounts helps in the settlement of claim at the time of retirement/death of a partner.
- Auditor account helps in managerial decisions.
- They are useful to secure loan at the of amalgamation, absorption, reconstruction etc.
- Auditing safeguards the interest of owners, creditors, investors, and workers.
- It is useful to take certain financial decisions like issuing of shares, payment of dividend etc.

TYPES OF AUDIT:

- **Statutory Audit:** any audit carried on as per the requirement of law is called as a statutory audit. eg: all companies have to get their accounts audited as per the provision of the company's Act of 1956.
- **Periodical/ Annual Audit:** it is a kind of audit where the auditor verifies the account at the end of the financial year. He starts the audit work after the closure of financial year. This is a common audit and is mostly used by small organizations.
- **Interium audit:** its an audit conducted in the middle of the accounting year before the accounts are closed. In other words any audit conducted between two financial audit is known s interium audit. The objective is to get periodical results, to declare interium dividend.
- **Partial Audit:** when an auditor is asked to audit only a part of the account system. Its called partial audit. Eg: he may be asked to audit only the payment side of cash book.
- **Balance sheet audit:** it's a kind of partial audit and is concerned with the verification of only those items appearing in the Balance Sheet. It is more popular in the USA. Infact while verifying BS items the auditor verifies/ checks all related items/accounts.
- **Cost audit:** cost audit is defined as the verification of cost accounting records. Data and techniques for its accuracy and authenticity. It gets as effective managerial tool for the detection of errors and frauds in cost accounting records. The companies act implies the central government to order cost audit incase of specifies companies.
- **Management audit:** Management audit may be defined as a comprehensive examination of an organizational structure of a company, institution/government and its plans and objectives it means of operations and use of human and physical facilities. The main objective of mgt audit is to see how far the objectives of mgt are fulfilled. It aims to ascertain whether sound mgt prevails throughout the organisation and evaluates its efficiency in the system of its operation.
- **Continuous audit:** a continuous audit is one in which the auditor visits his clients office at regular intervals through out the year to verify the account. The objective of CA may be-
  - To get final account audited immediately after the closure of accounting year.
  - When the business is very large.
  - When interval control system is into effective.
  - When regular final accounts are required.

- **ADVANTAGES:**
  - Errors and frauds are discovered and rectified quickly.
  - The chances of fraud are reduced.
  - The workers will be careful in their work.
  - Continuous audit acts as a valuable morale check on the staff.
  - Final audit becomes easier and faster.
  - If the company wants to declare interium dividend its easier to prepare interium account.
  - It increases the efficiency and accuracy in the accounts.
- **DISADVANTAGES:**
- After the auditor's visit is over, alternative may be made.
- It affects the regular work.
- Its not suitable for small organizations.
- The auditor may loose the line of work if he does not complete his work in a visit.

These are descrived as follows-

1. Detection and prevention of errors

- Errors are generally innocent but sometimes errors which might appear. The following are the various types of errors-
  - **Clerical Errors**
- These errors are committed in posting, totalling and balancing. Such errors may again be subdivided into-
    - Errors of omission; and
    - Errors of commission.
  - **Error of Principle**
  - **Compensating errors or off- setting errors.**
  - **Errors of duplication.**

2. Detection and prevention of Fraud

- Fraud means false representation or entry made intentionally or without belief in it true with a view to defraud somebody.
- The following are the chief ways in which fraud may be perpetrated:

1. Embezzlement of Cash
2. Misappropriation of Goods
3. Fraudulent manipulation of accounts.

Cont:

Fraud risk factors relating to susceptibility of assets to misappropriation.

Entities assets may likely be misappropriated and misstatements arising therefrom are likely to appear in financial statement depending on-

A. The nature of assets the entity possesses like high balances of cash on hand, easily negotiable instruments like bearer cheques, small sized inventory with high values like say diamonds.

B. Nature of control environment- like lack of supervision, non balancing of books daily, lack of record keeping, non segregation of duties, poor custodial responsibility etc.

Statutory Audit:

- Statutory Audit is the audit carried out compulsorily under any statute, any law.
- *It includes the following types:*

- Companies governed by Companies Act,2017
- Banking Companies governed by Banking Ordinance,1962
- Co-operative societies registered under Co-operative societies Act,1925.
- Electric Supply Companies
- Government departments/public utilities.

Government Audit:

- Government audit refers to the audit of accounts of Government departments and offices, Government companies and statutory or public corporations.

Private/Voluntary Audit:

- Where an audit is not compulsory under any statute, but is undertaken by the owners voluntarily to get the benefit of audit, the audit is called private audit.
- The audit of accounts of sole proprietorship is optional.

Internal Audit:

- Internal Audit is the audit of accounts by the staff specially appointed for the purpose.

External Audit:

- An external audit is an independent examination of the financial statements prepared by the organization. It is usually conducted for statutory purposes (because the law requires it).

Continues Audit:

- When an audit is conducted at a regular or irregular intervals throughout the year, it is called continuous audit.

Final/Annual Audit:

- Audit at the end of year is known as Final audit.

- It is an audit carried out after the preparation of financial statement.

Interim Audit:

- An audit which conducted between two annual audits is known as interim audit.

Balance Sheet Audit:

- Balance sheet audit is a type audit which concentrates mainly on the verification of the items in the balance sheet

Complete Audit:

- Complete audit is a kind of audit under which all the records and books of accounts are audited by an auditor.

Cash Audit:

- Cash audit is Audit which is undertaken for only cash receipts and cash payment.


Thanks all!
to stay with us.