UNIT 1

INTRODUCTION TO AUDITING

Introduction – Meaning, Definition, Objectives Difference between Accountancy & Auditing, Types of Audits, Advantages of Auditing, Preparation before Commencement of new audit, Audit Notebook, Audit Working Papers, Audit Program, Audit Report, Recent Trends in Auditing - Digital Auditing, Forensic Auditing. Nature & Significance of Tax Audit, Cost Audit, Management Audit. Company Auditor, Appointment, Qualification, Powers, Duties & liabilities, Professional Ethics of Auditor

INTRODUCTION

Auditing is an important professional to carrying heavy responsibility & more skill with proper judgment. In olden days the methods of maintenance of account were not properly because size of the business is very small with small amount of capital for that purpose the number of transactions to be recorded by each individual himself.

The auditing may be introduced in the period of 18th century when the practice of large-scale production was developed with a result of industries revolution after the industrial revolution the number of business concern like sole trading, partnership firm & joint stock co developed in a greater extent. This will be led to compulsory maintaining of account of a business concern then the need of auditing will be aroused in 18th century.

ORIGIN OF AUDITING

History Auditing is as old as accounting. The practice of auditing existed even in the Vedic period. Historical records reveal that Egyptians, Greeks, Mesopotamians and Romans used to get these public accounts examined by an independent official.

In India also auditing exists in ancient period. Kautilya had mentioned in his book "Arthashastra", the detailed rules for accounting and auditing of public finances. But the auditing evolved and grew rapidly only after the industrial revolution in the 18th century.

Today, due to rapid increase in the growth of industries and commerce auditing gained much importance.

It has been the backbone of the complicated business world and has always changed with the times.

MEANING OF AUDITING

The word **Audit** has been derived from Latin word **'Audire'** which means 'to hear'. In the Middle Ages, an auditor used to listen to the accounts read over by an accountant in order to check them.

Auditing simply means verification and examination of accounts. It is done to ascertain the reliability and validity of information. The auditing process can be started only when accounting ends.

In other words, an audit is an attempt to find out whether the financial statements reflect the true and fair result and financial position of the company or institutions.

Audit

1. An official examination and verification of accounts and records, especially of financial accounts.
2. A report or statement reflecting an audit; a final statement of account.
3. The inspection or examination of a building or other facility to evaluate or improve its appropriateness, safety, efficiency, or the like.
4. A judicial hearing.
5. Verification of the books of accounts at the end of the fiscal year.
6. To examine and verify accounts, evidence and supporting vouchers.

DEFINITION OF AUDITING

According to **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."

In the words of **R.B. Bose**, "Audit may be said to the verification of the accuracy and correctness of the books of accounts by an independent person qualified for the job and not in any way connected with the preparation of such accounts".

According to **R. K. Moutz**, "Auditing is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statement and record."

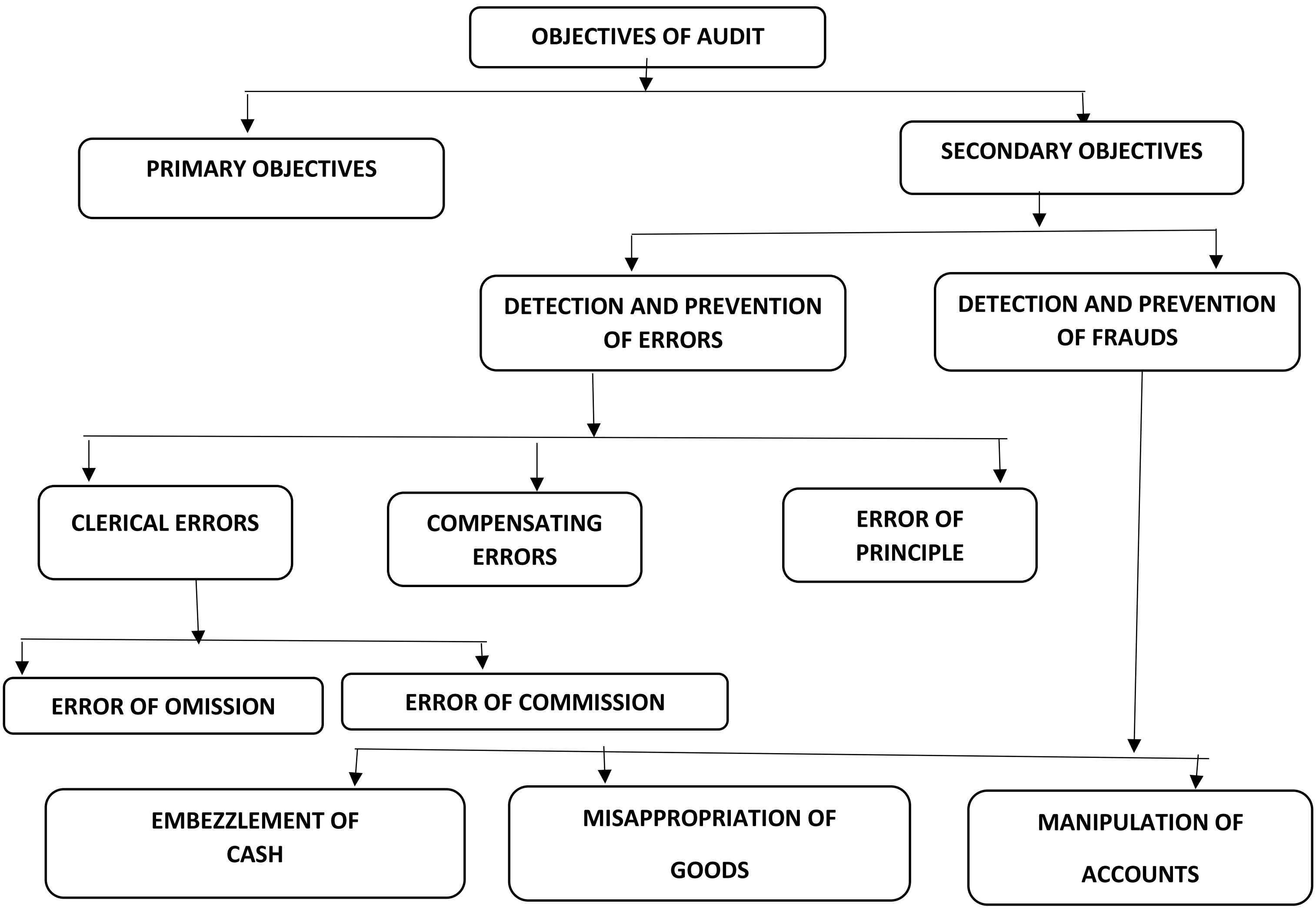
MEANING OF AUDITOR

An **auditor** is a trained professional who is responsible to review and verify the accounting data of any business undertaking pertaining to its business activities.

An auditor may be internal auditor or external auditor.

- **Internal auditors** are those auditors who are appointed by the company exclusively for their company's audit.
- **External auditors** are independent auditors having firms who are hired by the companies subject to an audit.

OBJECTIVES OF AUDITING



PRIMARY OBJECTIVES

The main or primary object of audit is to verify the accounts and to report whether the Balance sheet and Profit and Loss Account have been drawn properly according to the companies Act and whether they exhibit a true and fair view of the of the state of affairs of the concern. Such verification of accounts and reporting to management are vital factors for promoting efficiency and accuracy in maintenance of accounts so that the owners of business may get accurate information about the financial condition of their business.

In order to be assured about the accuracy of the books of accounts, so as to report up on the actual financial position the auditor should perform the following:

1. He should examine the system of internal check
2. He should check the numerical accuracy of the books of accounts by verification of posting, casting and balancing etc.
3. Verify the authenticity and validity of transactions entered into books with relevant supporting documents.
4. Ascertain that a proper distinction has been made between items of capital nature and those of a revenue nature and that the amounts of various items of income and expenditure correspond to the accounting period.
5. Confirm the existence and value of assets and to verify liabilities.
6. Verify whether all statuary requirements as regards the books of accounts that should be maintained.

SECONDARY OBJECTIVES

An auditor may come across some errors and frauds while examining the books of accounts in order to report the true financial condition of the business. This detection and prevention of frauds and errors are the secondary objectives of auditing.

These objectives are classified into following types:

A. Detection and Prevention of Errors.
B. Detection and Prevention of Frauds.

A. **Detection of and Prevention of Errors:** Errors refers to the mistakes which are committed unintentionally because of carelessness, ignorance etc.

Errors are of different types:

- Clerical Errors

a. Error of Omission

b. Error of Commission
- Compensating Errors
- Error of Principle

I. **CLERICAL ERRORS**: Clerical errors refer to those errors which arise due to wrong posting, ignorance, carelessness etc. If these errors are discovered in the process of audit, the auditor should get them rectified.

Clerical errors mainly are of two types:

a. **Errors of Omission**: These are the types of errors which arise on account of transaction omitted to be recorded in books of accounts wholly or partially. This omission of transaction does not affect the agreement of trial balance; hence it is more difficult to find out. Example: Furniture purchased for Cash Rs.5000 not recorded in the books of accounts.
b. **Errors of Commission:** These are the types of errors which arises due to wrong posting to ledger accounts, wrong totaling, wrong calculations or balancing in the books of accounts wholly or partially. These errors affect the agreement of trial balance. Example: Cash sales Rs.10,000 recorded as Rs.1,000

II. COMPENSATING ERRORS: When an error is counterbalanced with another error, such an error is known as compensating errors. These errors will not disturb the agreement of trial balance. Example: Geetha's account which was to be debited for Rs. 6,000 was credited for Rs. 6,000 and similarly, Seetha's account which was to be credited for Rs. 6,000 was debited for Rs. 6,000. These two errors will nullify the effect of each other.

II. **ERROR OF PRINCIPLE:** When transactions are not recorded in accordance with the fundamental principles of accounting, such errors are known as Errors of Principle. Example: Furniture purchased for Rs.5,000 debited to Purchases a/c. This is an error of principle.

Location of errors: Auditors are appointed to audit the books not to identify the errors but, in many cases, they are called to find out the difference in the books of accounts. The auditor should follow the following procedure in this regard:

a. Trial balance must be checked.
b. He should compare the list of debtors and creditors with the trial balance.

c. He should compare the names of account appearing in the ledger with the names of accounting in the trial balance.
d. He must check the totals and balances of all accounts and see that they have been properly shown in the trial balance.
e. He should also check the posting of entries from various books into ledger.

B. **DETECTION AND PREVENTION OF FRAUDS**:

Fraud refers to the intentional and deliberate misrepresentation of accounting records for a financial gain. These frauds are intended to deceive, to mislead or to conceal the truth or the material facts. They are more serious than errors. If these frauds are not detected it may affect the opinion of the auditor on the financial condition and the results of the organization. Hence, utmost care has to be taken by the auditor in respect of detecting the frauds.

Frauds are of three types:

- Embezzlement or Misappropriation of cash.
- Misappropriation of goods.
- Manipulation of accounts.

I. **Embezzlement of cash**: In big business organizations, where there is separate existence between ownership and management, it is impossible by the individual owners to have direct control over receipts and payments of cash. Hence, misappropriation of cash is more frequent in these organizations. This is very less in small organizations as there is direct control over the affairs of the business. Cash can be misappropriated by various ways which are as follows:

- Recording of fictitious payments.
- Recording more amount than the actual amount of payment.
- Suppressing receipts.
- Recording fewer amounts than the actual amount of payment.

In order to prevent these frauds, there should be strict control over receipts and payments of cash known as "Internal check system". For detecting these frauds, the auditor should check the cash book with original records, bills register, invoices, vouchers, counterfoils or receipt books, wage sheets, salesman's diary, bank statements etc.

II. **Misappropriation of goods**: The companies which are dealing with high value of goods are prone to this kind of frauds. These kinds of frauds are difficult to detect unless there are proper records of stock inward and outwards. Hence, proper stock records have to be maintained. The auditor can detect this fraud by checking the stock records and physical verification of goods.

III. **Misappropriation or Falsification of accounts:** Responsible persons who are in the top management of the organization will manipulate the accounts in order to achieve specific objectives. These frauds are intentional, predetermined and is more difficult to detect. The accounts are presented in such a manner that they are not disclosing true picture of the financial activities of the business. As such profits are reduced and true picture of the organization are concealed. This is also known as 'window dressing. The following are some of the ways used in manipulating accounts:

- Inflating or deflating expenses and incomes,
- Writing off of excess or less bad debts.
- Over-valuation or under-valuation of closing stock.
- Charging excess or less depreciation.
- Charging capital expenditures to revenue and vice-versa.
- Providing for excess or less doubtful debts.
- Suppressing sales and purchase or showing fictitious sales and purchases etc.

These frauds are very difficult to detect as they are committed by directors, managers, financial controllers who are the top responsible persons in the organization. In order to locate these frauds, the auditors should be vigilant and should make searching enquiries to arrive at the true position.

Window Dressing

This is the way of presenting the financial data in a much better position than the original position. It is known as window dressing. Some of the reasons for doing window dressing are as follows:

a. To win the confidence of shareholders.
b. To obtain further credit’s
c. To raise the price of shares in the market by paying higher dividend so that shares held may be sold.
d. To attract prospective partners or shareholders.
e. To win the confidence of shareholders.

Secret Reserves

In secret reserves, accounts are prepared in such a way that they disclose worse picture than actually what they are. The objectives of preparing accounts in this way are:

a. To conceal the true position from the competitors.
b. To avoid or reduce the tax liability.
c. To reduce the price of shares in the market by not paying dividend or paying lower dividend so that the shares may be bought at a much lower price.

DIFFERENCE BETWEEN ACCOUNTANCY AND AUDITING

BASIS	ACCOUNTANCY	AUDITING
Meaning	It is the process of recording, classifying, summarizing, and interpreting all the financial transactions.	It is the process of examining books of accounts and reporting on the financial statements.
Objectives	To find out profit earned or loss suffered by a Company To show the financial position of the company for a particular period	To examine the correctness of the accounts and financial statements. Certify that whether the company exhibits a true and fair view of the state of affairs of the concern.
Nature of Employment	An Accountant is a permanent employee of the organization.	An Auditor is an independent person and is not an employee of the organization.
Qualification	An Accountant does not require any formal qualification.	An Auditor should be a qualified Chartered accountant Certified by Institute of Chartered Accountant of India.
Reports	An Accountant is not required to submit the report on the financial statement prepared by him.	An Auditor should submit the report certifying the truth and fairness of the Financial Statement.

Remuneration	An Accountant is remunerated in the form of salary.	An Auditor is remunerated in the form of professional fees.
Commencement of Work	Accountancy starts where Book keeping ends.	Auditing starts where Accountancy ends.
Performance of Work	Accounting Job is performed by the accountant.	Auditing Job is performed by the Auditor.
Scope	Limited to the preparation of Financial Statements.	Concerned with the checking of accounts.
Period of Work	Carried throughout the year.	It is done usually at the end of the year.
Appointment	Accountant is appointed by the management.	Auditor is appointed by the shareholders.
Dependent	Accountancy is not dependent on Auditing.	Auditing is dependent on accounting because it starts when accounting ends.
Nature of Work	Accountancy is a constructive work.	Auditing is an analytical work.
Accountability	Accountant is accountable to management.	Auditor is accountable to shareholders.
Knowledge	Accountant must have the knowledge of accountancy.	Auditor must have the Knowledge of accounting as well as Auditing.

TYPES OF AUDITS

Auditing is a comprehensive and multi-dimensional discipline. The process of auditing depends upon the type of audit requirements of the company. Hence the types of audits which are classified as follows:

TYPES OF AUDITS

ON THE BASIS OF ORGANIZATION

Statutory Audit

Voluntary Audit

Government Audit

ON THE BASIS OF FUNCTIONS

Internal Audit

External Audit

ON THE BASIS OF APPROACH

Time Basis

Continuous Audit

Interim Audit

Periodic Audit

Scope Basis

Complete Audit

Partial Audit

Objective Basis

Balance sheet Audit

Occasional Audit

ON THE BASIS OF AUDIT DIMENSION

Tax Audit

Management Audit

Cost Audit

System Audit

Cash Audit

Social Audit

Energy Audit

Proprietary Audit

Secretarial Audit

Performance Audit

The different classifications of audit are explained below:

I. CLASSIFICATION ON THE BASIS OF THE ORGANIZATION:

The audits under this classification are further divided into two types:

1. Statutory Audits
2. Voluntary or Non-statutory Audits.
3. Government Audit.

a. **Statutory Audit**:

Statutory audit refers to the audit of an organization performed under (a statute. For Certain business organization or institutions, audits are mandatory, such organizations comes under this category. In this type of audit, the rights, powers, duties and responsibilities of auditors are laid down by the statute which cannot be altered or curtailed by the client or auditor himself.

The following are some of the organizations which requires statutory audits:

- Companies - According to Companies Act 1956.
- Banking Companies - According to The Banking Regulations Act, 1949.
- Co-operative Societies - The Co-operative Societies Act, 1912.
- Insurance Companies- The Insurance Act, 1938.
- Public and Charitable Trusts-Various Religious and Other Endowment Acts.

Essential characteristics of statutory audit.

1. It is a compulsory audit under law. Dall
2. Statutory audit must be a complete audit, it cannot be a partial audit The auditor must be a qualified accountant.
3. The auditor must not be disqualified as per the provision of the law. In the normal course, this type of audit is conducted periodically.
4. Auditor is an independent person. Management has no control over him.
5. The rights, duties and liabilities of the statutory auditors are laid in the statute, these cannot be altered.

b. **Voluntary or Non-statutory Audits**:

Voluntary audit refers to the audit performed by the auditors because the proprietors or the Government bodies of the organization wants their accounts to be audited as it provides the assurance on the reliability of accounts and the financial results of the organizations.

These audits are also known as **'Private Audits'**.

In this type of audit, the duties, powers and responsibilities are decided as per the agreement between the auditor and the client. The following are some of the organizations which go for voluntary audits:

- Proprietary Concerns
- Partnership firms
- Unregistered clubs and societies.

c. Government Audit

The audit of accounts of Government departments and institutions, Government companies and statutory or public corporations is known as government audit. A separate department is maintained by Government of India, known as Accounts and Audit Department. This department is headed by Comptroller and Auditor General of India. This department works only for government offices and departments. This department cannot undertake audit of non-government concerns! Its working is strictly according to government rules and regulations.

Objectives of Government Audit

- To ensure that every payment is made as per rules and regulations.
- Payments have been sanctioned by the proper authority.
- To see that the expenditure is incurred by the right person.
- To ensure that the expenditure is not excessive.
- To verify the allowances granted to employees as per sanctions and rules.
- To ensure that payment is made by the office to the right persons.
- To check the existence of stock and stores and their proper valuation.
- To see that no authority sanctions an expenditure which is for the personal benefit of such authority.
- To see that the payments are properly classified as Capital and Revenue.
- To ensure that a proper system of stock taking has been adopted.
- While verifying the receipts, whether money due from others has been regularly recovered.
- To make suggestions to the proper authority for improvements in rules and regulations for greater efficiency and economy.

II. CLASSIFICATION ON THE BASIS OF THE FUNCTIONS:

The function of the auditor depends upon the capacity of conducting the work by the auditor. Based on this, the audit is classified into two types:

a) Internal Audit.
b) External Audit.

a) **Internal Audit:** Internal audit is a type of audit conducted by the own staff of the organization specially assigned for that purpose. In this type of audit, thorough examinations of the accounting transaction as well as the system according to which transactions are recorded are conducted. It is done to verify the reliability and authenticity of the financial accounting and other records presented to the management. The scope and objectives of this type of audit vary widely and are dependent on the size and nature of the business.

b) **External Audit:** It is a type of audit performed by the auditors outside the business organizations. They are no way related with the preparation of accounts or management of the organization Qualified Chartered Accountants are appointed as external auditors of the organization. This audit is conducted in order to fulfill the legal requirement of the business. The various procedures relating to this type of audit is laid down in the concerned statute.

III. ON THE BASIS OF APPROACH

On the basis of practical approach of audit work, audit can be classified into;

a. TIME BASIS

Time Basis: Further audit can be divided on the time basis which is as follows:

1. CONTINUOUS AUDIT:

Continuous audit is also known as Detailed Audit'. Under this type of audit, detailed examinations of books of accounts are conducted at regular intervals say weekly, monthly or once in three months. The auditor checks and verifies each and every transaction by visiting clients place regularly during the financial year. This type of audit is carried in large organizations where bulk and variety of transactions are involved.

Business where continuous audit is applicable:

- Where it is desired to present the account just after the close of the financial year, as in the case of a bank.
- Where the volume of the transactions is very large.
- Where the statements of accounts are required to be presented to the management after every month or quarter.
- Where no satisfactory system of internal check is in operation.

Advantages of Continuous Audit

1. **Easy to quick discovery of errors**: Errors and frauds can be discovered easily and quickly as the auditor checks the accounts at regular intervals and in detail. As an auditor visits the client after a month or two or so on, the number of transactions will be small and hence, the errors will be detected easily and quickly.
2. **Knowledge of technical details**: Since the auditor remains more in touch with the business, s/he is in a position to know its technical details and hence can be of great help to her/his clients by making valuable suggestions.

3. **Quick presentation of accounts**: As most of the checking works are already performed during the year, the final audited accounts can be presented to the shareholders soon after the close of the financial year at annual general meeting.
4. **Keeps the client's staff alert:** As the auditor visits the clients at regular intervals, the clerks are very regular in keeping the accounts up-to-date. They will see that there is no in accuracy or frauds as it would be detected by the auditor at the next visit.
5. **Moral check on the client's staff**: If the auditor pays surprise visit, it will have a considerable moral check on the clerks preparing the accounts as they do not know when the auditor may pay a visit to check. Moral check will be more valuable to make staff alert and careful.
6. **Special Attention**: Before the finalization of accounts an auditor has a sufficient time to pay proper attention to the checking of account and detection of frauds and errors. with the business
7. **Guidance to Client**: The auditor remains in touch with the business details, so he also indicates about the mistakes and gives valuable suggestions to the client to keep the accounts in proper manner.
8. **Useful for Declaration of Dividend:** The continuous audit is also helpful for the declaration of the dividend. As the accounts are checked throughout the year, so the audit accounts are ready for the declaration of dividend.
9. **Up to Date Accounts:** Accounts of the business are kept up to date by the staff because they know that auditor may visit and check the accounts at any time.

<u>Disadvantages of Continuous Audit</u>

The Disadvantages of Continuous Audit are as follows:

1. **Alteration of figures**: Figures in the books of account which have already been checked by the auditor at previous visit, may be altered by a dishonest clerk and the frauds may be committed.
2. **Disturbance of client's work**: The frequent visits by the auditor may disturb the work if the client and cause inconvenience to the latter.
3. **Expensive:** Continuous audit is an expensive system of audit because an auditor devotes more time. So, company needs to pay more amount as the remunerations of an auditor.
4. **Queries may remain outstanding:** The audit clerk may lose the thread of work and the queries which s/he wanted to make may remain outstanding as there might be a long interval between two visits.
5. **Extensive note taking:** Extensive note taking may be necessary in order to avoid any alteration in the figures after the audit.

2. INTERIM AUDIT

Interim Audit is a type of audit which is conducted in between two annual audits with a view to find out the interim profits. It is done for the purpose of declaring interim dividend to the shareholders. In simple words, it is an audit which is conducted between two balance sheet audits

In normal word Interim means half yearly. It is conducted usually between two annual general meetings and only one time, not in intervals

Advantages of Interim Audit

1. Interim audit is good where the publication of the interim figure is necessary.
2. The final audit can be completed very soon if there has been an interim audit.
3. Errors and frauds can be detected more quickly during the final audit.
4. There is moral check on the staff of the client as the accounts are checked, say after three or six months in the interim audit.
5. To find out interim Profit

Disadvantages of Interim Audit

1. Figures may be altered in the accounts which have already been audited.
2. The audit staff will have to prepare notes when they finish the interim audit.
3. Interim audit is an additional work and expensive because final audit must be conducted after conducting this audit too.

3. PERIODICAL OR FINAL OR COMPLETE AUDIT:

It is a type of audit where the checking and verification of books of accounts are conducted only at the end of the accounting period. It is taken up by the auditor when all transactions for the year are completely recorded, balanced and final accounts have already been prepared. In this case, the auditor visits the clients place once in a year and takes up his work until it is completed for the whole period. It is also known as 'Complete Audit'.

In the case of such an audit, the auditor visits the client only once a year and goes to the account’s units audit work for that whole of the period is completed.

Following methods can be applied to conduct periodical audit:

- Periodical audit is conducted after the preparation of final account. So, an auditor needs to check all those statements and accounts.
- Auditor should prove the final accounts correcting irregularities as far as possible.
- Auditor should use special sign after the completion of audit work.

Objectives of Periodical Audit

1. To know whether the organization has maintained regularity at the time of maintaining books of accounts.
2. To know that the profit or loss presented by the business is true and fair.
3. To know that the financial position presented by the balance sheet is true and fair.

Merits of Periodical Audit

1. **Less Expensive**: Periodical audit is conducted once in a year. So, an auditor devotes less time and labor. So, the remuneration paid to him will be less.
2. **No Disturbance in the Work of Client:** An auditor continuously checks the books of accounts until and unless the work of audit is over. So, the work of accountant of the client will not be disturbed for a long period of time.
3. **Less Chance to Alter Figure:** An auditor conducts audit regularly; so, there is less chance to alter figure which minimizes the chances of frauds.

Demerits of Periodical Audit

1. **Unsuitable**: Big organization has large number of transactions. So, audit of such organization requires more time. Thus, periodical audit is unsuitable for big organizations.
2. **Possibility of Errors**: Detail checking of books of accounts is not possible under this method. Thus, there are chances of errors and frauds.
3. **Difficult To Detect Planned Frauds:** Generally, the frauds are committed in the direction of top-level management. So, such frauds are committed in planned way. Periodical audit does not check in detail. So, such planned frauds cannot be detected.
4. **Impossible To Prepare Final Account in Time:** Periodical audit begins after the completion of accounting year. It takes long time to complete the work of audit.

Difference Between Continuous Audit and Final Audit

Points of Differences	Continuous Audit	Periodical Audit
Audit process	The auditor's staff visits and checks the accounts frequently	The auditors staff visits the business only once in a year after the accounts are closed.

Period of audit work	Audit is carried throughout the year	Audit is carried out only once at the close of the accounting period
Publication of annual report	It ensures early publications of annual report.	Publication of annual report may be delayed.
Cost involvement	It is very expensive.	It is economical.
Detection of errors and frauds	It is very effective for early detection of errors and fraud.	Errors and frauds are left in the books till audit is conducted at the close of the year
Applicability	It is applicable to a large business organization	It is applicable to a small (business organization.
Chance of fraud	Chance of fraud are less.	Chance of fraud are more.

b. SCOPE BASIS

The types of audits on the basis of scope are as follows:

1. Complete Audit:

Thorough examination and verification of a company's financial and accounting records, and internal controls that are deemed to be comprehensive or relatively comprehensive depending on the size of the company being audited. Complete audits are more reliable for the portions audited because complete audits will include the audit of subsidiary documents and records as well as supporting documents.

2. Partial Audit:

It is a type of audit where an auditor is asked to check and verify only few books of accounts for a particular work. This type of audit curtails the work of auditor. The auditor should mention that he has done partial audit as per the instructions of the clients in his reports in order to avoid dispute. Generally, transactions related to cash, debtors, creditors, stock etc. where partial audit is done.

c. Objective basis:

On the basis of the objective of audit, it can be classified into two types:

1. **Balance Sheet Audit**:

This type of audit is of recent origin. Under this type of audit, the checking and verification of books of accounts starts from the balance sheet and working back to the original books of entry and other related documents. In this audit, all the balance sheet accounts and the related items are verified. This is more widely used type of audit.

2**.Occasional Audit**:

It refers to a type of audit which is carried out whenever the clients desire it and whenever there is need. This type of audit cannot be carried out in case of joint stock companies, Banking, Insurance companies. Only proprietary concerns can opt for this type of audit.

IV. ON THE BASIS OF AUDIT DIMENSION

The following are the different types of audits which are classified on the basis of audit dimension:

a. Tax Audit: A tax audit refers to examining of an organization or individuals' incomes or expenses and claims of deductions or exemptions for the purpose of assessment of tax. It is compulsory in addition to financial audit. It has to be done by the qualified Chartered Accountant.

b. Management Audit: Management audit is one of the techniques of management control. It refers to the systematic examination of the activities of management at all levels of management. It covers all the areas of management such as Planning, Organizing, Directing, Controlling etc. This type of audit helps in improving the efficiency of management.

c. Cost Audit: Cost audit simply means audit of cost records. In other words, it refers to detailed checking and verification of correctness of cost accounts, costing techniques and system. It acts as an effective managerial tool for detection of frauds, errors and inconsistencies of cost records.

d. System Audit: System audit refers to an audit concerned with evaluation of accounting practices which is directed to ascertain whether they are up-to-date and economical. It also involves ascertainment of whether the existing accounting practices are required to be modified so as to carry on the work quicker, better and at less cost.

e. **Cash Audit:** Cash audit involves the evaluation of all the cash transactions of the organization for a given period of time. In this type of audit, the auditor will check all the cash receipts and payments with the vouchers and documents. It is the oldest concept of auditing.
f. **Social Audit:** This type of audit is concerned with examination of performance of an organization or an entity towards the fulfillment of social obligation. The purpose of this audit is to present the organizational image among the public as to how an organization has discharged its responsibility to the society, but this is not much in practice in India.
g. **Energy Audit:** It is of new origin. It is a factor for the present world to conserve the energy resources. This type of audit aims at evaluating whether the right type of energy is used in the organization and also confirming that there is no waste of energy due to human difference.
h. **Proprietary Audit:** Proprietary audit aims at examining the allocations of resources and also ascertaining whether there is any violation of legal, economic or financial aspects of the organization. This audit ensures the public money has not been utilized for the benefit of a particular person or a community.
i. **Performance Audit:** In this type of audit, the auditor examines the growth of the organization in terms of production, sales and profitability of the organization. The purpose of this audit is to evaluate and compare the optimum return with the amount of capital invested.
j. **Secretarial Audit:** This is also a new concept of auditing. It is an audit which ensures that the corporate body's legal requirements have been duly complied with and in time. If there is any non-compliance noticed by the auditor, the management will have time to rectify the situation with less problem and cost.

ADVANTAGES OF AUDITING

For Business

a. **Errors are Located:** Auditing is helpful for business. The error can be located through it. The location and correction of error is possible through auditing. The true and fair information about business is available.
b. **Frauds are discovered**: Auditing is helpful for business. The discovery of fraud is possible through it. The guilty persons can be held responsible. The auditing accounts show fair about business.
c. **Loans Become Easy**: Auditing is useful for business. Lenders for granting loans accept the auditor's accounts. The reputation of borrowers increases due to auditing. Thus, auditing accounts help the businessman to expand his activities.

d. **Advice about Weakness:** Auditing is useful for business. The people can seek advice from auditors. The auditors are professional and they know their work very well. They can spotlight the grey area. It is the duty of the business man to act upon the advice of the auditors.
e. **High Moral Values**: Auditing is essential for business. There is moral check on the management and other staff. Auditing puts the pressure on the staff of work honestly. There is no pending work so there is less chance of errors and frauds.
f. **Tax Payments**: Auditing is useful for business; tax authority accepts audited accounts for assessment of taxes. There is no further inquiry or investigation from department. The audited accounts lessen the worries of business people.

For Owners

a. **Efficiency Improves:** Auditing is beneficial for business. The auditing determines the efficiency of employees. The training and qualifies management are an asset for any business. Such management can play dynamic role in framing and implementing the policies.
b. **Dispute is settled**: Auditing is essential for business. The audited accounts are helpful to settle the disputes. The audited accounts become the basis of making decisions. The dispute may relate to infringement of patents or trademarks.
c. **Planning Becomes Possible:** Auditing is helpful for business. The audits accounts present true and fair view of business activities. The facts and figures can be used to prepare budget and estimates for the next years The projected cash receipts and payments, income statement and balance sheet can be prepared.
d. **Improvement of Internal Control**: Auditing is helpful for business. The auditor can point out the weakness of internal control system. The business management can take steps to remove these weaknesses, The effective control systems are essential for large-scale business enterprises.
e. **Fluctuation in Profits:** Auditing is helpful for business. The auditor can make the detailed study to find of fluctuation in profits. There are various reasons for changes in profits. The auditor can determine the true cause of such changes.
f. **High Credit Rating**: The auditing is beneficial for business. The auditing accounts increase the credit standing of any business house. The lenders can rely on audited accounts for granting credit facility in fact auditing is a screening test of business entity
g. **Shareholders Protection**: Auditing is beneficial for owners. The shareholders feel that their rights are protected through auditing. They can know the performance of management. Audited accounts help to determine the value of shares.

h. **Partner Satisfaction**: Auditing is helpful for partners. The sleeping partner feels satisfactions when there are audited. The managing partners can use business property for their personal benefit. There is moral check on managing partners.
i. **Proprietors:** Auditing is useful for proprietors. The audited accounts help the sole traders that their business is going on properly. The error and fraud are pointed out auditors. The owners can determine the efficiency of their employees or assistants.
j. **Beneficiary:** Auditing is valuable for beneficiaries. The auditor of a trust can nominates any person as trustee to look after the property of a trust. Auditing can safeguard the right of beneficiaries. There is a moral check on the trustee to follow the by-laws of trust.
k. **Deceased Estate**: The auditing is helpful for dependents of decreased person. The audited account presents true and fair view of financial statements. The family can rely on audited accounts for distributing the estate of deceased person.
l. **Insolvency:** The auditing is beneficial for creditors. The audited accounts show true and fair view of state of affairs of sole proprietorship or partnership. The creditor can get their money first and then owners can get refund of capital. The audited accounts help to settle the cases at an early date.

For Government

a. **Better Performance of Tax Department:** Auditing is beneficial for government Tax officers accept the audited accounts. The assessment order can be issued without further clarification. There is saving of money and time due to audited accounts. The performance of tax officers is improved.
b. **Exact Revenue Amount:** Auditing is beneficial for government. The collection of revenue is possible at an early date. The people are allowed to deposit various kinds of taxes. The recovery of income is made at the start of the year. The government can start welfare project on the basis of total revenue collected.
c. **Progress of Economy:** Auditing is essential for government policies. The true fair view is stated in audited accounts. The stage of economic progress can be determined. The government can take measures to raise the rate of economic growth.
d. **Purchase of Private Business**: Auditing is helpful for government. The private business houses may not work in favor of general public. The government can take over such business units. The purchase price is decided on the basis of auditing of accounts.
e. **Sale of Government Business:** Auditing is useful for government. The policy can be framed on the basis of audition accounts. The management comes to know

the value of business. The government can sell state-owned unit to private sector. The bid price is settled on audited accounts.

For General Public

a. **Insurers can settle Claims:** Auditing is essential for insurers. The settlement of fire or marine insurance claims is easy through audited accounts. The policy holders and insurance company can settle actual loss of property.
b. **No Loss to Lenders:** Auditing is essential for lenders. The banks and other lenders ask the borrowers to submit audited accounts before granting loans. The audited accounts are helpful to check the trust worthiness of customers
c. **Creditor are Protected:** Auditing is essential for creditors. They can know the true performance of their debtors. The creditor can accept this promise only when he feels that debtor is reliable businessman. Auditor accounts provide basic information about reliability.
d. **Bidders Can Offer High Rate**: Auditing is helpful for bidders. Audited accounts provide information about net worth of any business. The people interested in purchasing the business can rely on such information. They know the fair value of business. They can offer reasonable price through open bidding.
e. **Better Pay to Employees**: Auditing is helpful for employees. They are interests in profits, Auditing accounting proves true and fair view of profit. The employees can demand higher pay, fringe benefits and participating in profits. Audit of accounts with the independent person help the employees to make settlement with the employers.
f. **Investors Can Take Decisions:** Auditing is helpful for inventors. The audited accounts can be used to calculate value of shares and other securities.

Disadvantages of Auditing

The limitations/disadvantages of auditing are as under:

1. **Planned Frauds by Management**: Sometime the management commits a planned fraud. And for the auditor it is not possible to find out that fraud. In this case the audited account cannot describe the true and fair view of the business.
2. **Wrong Certificates:** Auditing is based on many certificates taken from management and other persons. These certificates may not disclose true information because of which auditing may fail to provide desired results.

When certificates provide wrong information, the financial statement cannot show correct position.

3. **Misleading Clarification:** Auditing fails to disclose correct information. The background of entries may not be clear to the audit staff. The management may not provide correct clarification. The auditing fails to help many persons who rely on audit report.
4. **No True Picture**: The auditor is concerned with the fact's figures shown in the books of accounts. When figures have been manipulated, the auditing fails to disclose true picture. The purpose of audit fails when it is unable to depict real scene of business affairs.
5. **No Correct View:** The auditing fails to present correct view. There are limitations of accounting. So, accounting figures are not facts. There are based on opinion. Moreover, the auditor has to make judgement on various matters. The personal judgement may be wrong in certain cases. Thus, auditing is unable to disclose correct view.
6. **No Suggestion**: The audit is conducted to show the fair view of financial statements. Auditing is not concerned with management policies. The auditor cannot guide the management for better use of capital. The auditor examines what has been done. He is unable to suggest how it should have been done.

PREPARATION BEFORE COMMENCEMENT OF THE AUDIT

An auditor after receiving the appointment letter should communicate his acceptance/otherwise in writing to the company. The following steps are necessary to commence the audit work:

Instruction given by the auditor to his client

Following instructions must be given to the client by the auditors before commencing the audit:

- A list of books with the list of employees should be provided to the auditor.
- A system of book keeping and internal connect should be provided.
- Final trial balance and draft of final account should be ready for audit examination.
- All supporting vouchers should be ready.
- All types of schedules supporting the accounts should be prepared and kept in original form.

An auditor should pay proper attention to the following points before taking up a new audit:

1. **Appointment Letter:** An auditor should confirm his appointment letter first of all. In this regard he should get and examine the copy of resolution passed by the shareholders in the general meeting.
2. **Nature of Audit**: Auditor should know about the nature of audit. If he does not know the nature of audit then he cannot prepare himself for that audit.
3. **Verification of Memorandum:** Memorandum is started of the company. It deals with external affairs of the company. Out of its clauses, the information Written under objects clause, liability) clause and capital clause is useful to auditor. Therefore, he should refer to memorandum and such information should be taken to audit note book.
4. **Verification of Articles**: Articles read about internal affair of the Company. payment of dividend etc. All these things are useful to Company auditor and hence abstracts from articles should be taken to audit note book.
5. **Verification of Certificate of incorporation and certificate of Commencement of business**: If it is first audit of the company, auditor is fully should refer to Certificate of Incorporation and Certificate of Commencement of Business issued by registrar of Companies to conform that the company has got formed properly in accordance with requirements of companies act.
6. **List of Books**: He should obtain a list of all the books of account which are in the use of business.
7. **Names of Officers**: The auditor should take the list of all the officers with their name's duties and powers, He should also get their specimen signatures.
8. **Documents:** He should also get the copy of memorandum and articles of association. He should study them carefully and check that company is running the business according to them or not.
9. **Prospectus**: The auditor should examine the prospectus to know the relevant matters affecting the accounts.
10. **Accountancy System:** The system of accounting which is employed by client must be examined by the auditor before taking the new audit.
11. **Minute Book**: The auditor should get the minute book and read it carefully. He should also take the notes of important decision made by the directors and shareholders in the various meetings.
12. **Internal Control System:** Internal control system prevailing in the business must be studied by the auditor. He should examine the record and observe the actual procedure in operation.
13. **Personal Visit of Site: T**he auditor should visit the site of the business personally and he should know maximum about the technical nature of the business.
14. **Study of Contracts**: The auditor should study all those contracts which are made by the company with the outsiders and with employees, He should note down the important mailers.

15. **Case of Joint Auditors:** If there is more than one auditor and they have decided to audit the company jointly in that situation they should divide the work among themselves and then start the auditing.
16. **Previous Report Inspection in Case of Old Company**: If the company not a new but old, in this situation auditor should also inspect the report of previous auditor.
17. **Audit Programme:** The auditor may chalk out the audit programme keeping in view above points.
18. **Timing:** Auditor should fix the time of audit before starting the new audit. He should also decide the time for the completion of audit work.
19. **Legal Formalities**: Auditor should also check that legal formalities have been completed by the management or not.
20. **Historical Background**:Auditor must know business history like nature of business, number of products, year of establishment. He should also keep himself in touch with the operation of the company.

AUDIT NOTE BOOK

A note book which is prepared by the audit staff to note down all the uncleared queries which she may find in the course of audit and requires further clarification and explanation is known as audit note book. Audit note book contains information regarding day-to-day work performed by the audit staff on any particular date. Notes about all types of errors, difficulties and uncleared queries or points to be discussed with the auditor or clients and the points which are to be incorporated in the report are noted down.

Contents of Audit Note Book

General Information

Generally, the following information is incorporated in audit note book:

1. The nature of the business carried on and the important documents relating to the constitution of the business, i.e., Memorandum of Association, Articles of Association (in the case of limited companies) and Partnership Deed (in the case of partnership firm) and other legal documents.
2. The name of the client and the audit year.
3. A list of books of accounts in use.
4. Names of principal officers, their duties and responsibilities.
5. Particulars of the accounting and financial system followed and the internal check in operation in the business.
6. Details regarding accounting and financial policies followed in the business.
7. A copy of the audit program.

Special Matters to Be Recorded in the Audit Note Book

1. Routine queries not cleared i.e., missing receipts and vouchers etc.
2. Details of mistakes and errors discovered.
3. Failure of the company to comply with the provisions of the Companies Act or of the Memorandum of Association and other legal requirements.
4. Extracts from minutes books and contracts and other correspondence with various government agencies, financial institutions, debtors, creditors etc.
5. The points to be incorporate in the audit report.
6. The points which need further explanation and clarification e.g., a change in the basis of valuation of finished stocks or in the computation of depreciation, etc.
7. Date of commencement and completion of the audit.

Objectives of Audit Note Book

Audit note book is prepared with the following objectives:

1. To know about the nature of business le regarding provision of memorandum, articles of association etc.
2. Not to leave any errors and frauds this helps to make audit more effective and efficient.
3. To make the future audit work easier. Auditor can get information regarding nature of business from previous audit note book.
4. To check the list of debtors and creditors so that false list can be detected.
5. To know about the facts where clarification and explanation are essential.
6. To present as proof by the auditor to get clearance over the cases if auditor has been accused for misfeasance and negligence.
7. To assure the audit of major function or items of the business where there are chances of frauds and errors.
8. Helps in preparation of audit report.

Advantages of Audit Note Book

The major points which are detected or found during the course of audit can be noted in audit note book. So, an auditor can get the following benefits by maintaining audit note book properly:

1. **It Saves Cost and Time:** All the facts related to audit are noted down in the audit note book. While auditing the books of accounts of same organization auditor does not need to do the same work. So, s/he can save time and cost.
2. **Helps to Get Clearance against the Case OF Misfeasance and Negligence**: If any person files the cases against the auditor charging misfeasance and negligence, an auditor can present audit note book in the court or concerned authority and can get clearance against such cases.

3. **Helps to Refer in Future:** Auditor can refer such noted point in the future which helps to continue the work of audit in future to the auditor.
4. **Reference book for new staff:** All the points about the progress of audit, nature of audit and problems are noted down in the audit note book. new If any staff leaves the job new staff can refer note book of previous staff and books and can continue the work of audit.
5. **Helps to Measure Efficiency of Staffs**: An auditor gets information about the performance of individual staff which helps to measure the efficiency of staffs. An auditor can allocate the job to the staffs on the basis of their efficiency.

AUDIT WORKING PAPERS

Audit working papers are the written private records kept by the auditor as regards evidence accumulated during the course of audit, this describes the accounting information he has received from the client, methods, procedures followed and the conclusions drawn. These papers contain information about important facts and explanation of working notes in connection with the accounts under audit.

Filing of working papers

Working papers are valuable documents for the clients as well as for the auditor. Hence, they should be filed systematically. They must be preserved in a proper manner. For the sake of convenience, working papers may be divided in to

(1) Current file

(2) Permanent file

Permanent file

It is a file which contains papers of continuing importance affecting the company and the audit. The purpose of this file is to provide background information about the company. The file should include the following papers:

Contents of Permanent Audit File

1. The legal and organizational framework of the client's entity, for example, the Memorandum of Association (MOA) and Articles of Association (AOA) in the case of a company
2. Extracts or copies of essential legal papers, agreements (e.g., loan agreements), and minutes that may be important and relevant for the audit
3. A record of the study and evaluation of the internal control system of the entity.
4. The letter of engagement
5. A list of client's investments

6. An analysis of critical ratios concerning the performance of the business and their trends.
7. Copies of the audited financial statements of the previous year.
8. Notes regarding significant accounting policies being followed by the company
9. Important audit observations made in the earlier financial years
10. Details of leases, if any.

<u>Contents of Current Audit File</u>

1. It is a file which contains working papers of the year under audit. The current file should include the following documents:
2. Correspondence on the acceptance of the annual reappointment of the auditor
3. Copies of management letters and representations
4. Letters of attorneys
5. Extracts of significant matters contained in the minutes of Board Meetings and General Meetings relevant to the audit
6. An analysis of business transactions and ledger balances
7. Copies of communication with other auditors, experts and third parties
8. Overall Audit plan, risk assessments, and Audit programme
9. Conclusions obtained on important audit issues
10. Copies of financial statements and the audit report
11. Workings of the entity's trial balance and worksheets
12. Details of adjusting journal entries and reclassification entries
13. Confirmation responses
14. A record of queries raised during the course of the audit and their clearance, with notes for future reference (if, any).

<u>Objectives of Audit Working Papers</u>

1. It provides evidence of the work carried out by the auditor.
2. Represent the volume of work performed by the auditor and the staff.
3. Auditor can protect himself from a suit brought against him for negligence
4. The client can make use of these Working papers if his records the altered or lost.
5. Provides assurance that work delegated by the auditor has been properly drawn.
6. It contains sufficient detailed up to date facts which justifies auditors' conclusions.
7. To know assistants have followed his instruction. (Assist auditor in coordinating and organizing the work of audit assistant.)
8. They can be used as a permanent record for future reference.

<u>Advantages of Audit Working Papers</u>

1. Important data are available in one file.
2. It is convenient for handling.
3. Previous year's files enable the auditor to prepare the audit Program.
4. It acts as handy reference to the newcomers.
5. It is useful for finalizing the accounts.
6. It helps the auditor to review the complete working of the client.
7. It provides evidence of the work carried by the auditor.
8. They are used as a permanent record for future reference.

AUDIT PROGRAM

It is a set of policies & procedures that of a dictate how an evaluation of a business is done, it involves specific instructions as to what, how much evidence must be collected & evaluated, who will collect, who will analyze and when this should be done.

An Audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in Verification of each item in the financial statements & giving the estimated time required to complete the audit process.

An audit programme contains information about the following:

1. Name and object of the under taking.
2. Date of commencement of audit and duration of audit.
3. System of accounting, internal check, internal control and its effectiveness.
4. Previous year's accounts with report of the auditors.
5. Outline of various books of accounts to be examined.
6. Type and number of transactions to be selected.
7. Nature of documents to be examined.
8. Persons in-charge of audit work.
9. Date wise schedule of work to be carried.

a. Routine audit items,
b. Checking of evidence
c. Review of transactions.
d. Examination of final statements.
e. Comparison of figures of this year with previous year.
f. Comparison of ratios.
g. Checking of minutes book
h. Preparation of audit reports.

Types of Audit Program

Audit program can be classified into following two groups:

Fixed Audit Program

Auditor prepares audit program on the suggestions and recommendation of assistant staffs but such program cannot be changed during the course of audit which is known as fixed audit program.

Flexible Audit Program

An audit program which can be changed as per the need, time, nature of business and auditing standard is known as flexible audit program. Such program should be reviewed on the recommendations and suggestions of assistants.

Objectives of the Audit Program

The objectives of the audit program are to:

1. Determine compliance with company policy and procedures.
2. Determine the effectiveness of the policy and procedures.
3. Determine the accuracy of reports generated by department personnel.
4. Evaluate the adequacy of internal controls.
5. Determine compliance with applicable state and federal regulations of the function under review.

Advantages of Audit programme

1. **Supervision of Work:** The auditor can judge the efficiency of his audit team by holding of an audit programme. He is in a position to know the progress of the work. He can see at any time that what part of the work has been completed and what remains to be done.
2. **Distribution of Work**: Audit programme is very useful in distributing the audit work properly among the members of the audit team according to their talent.
3. **Uniformity of Work:** Audit programme helps in settling all the things in advance, so the uniformity of work can be achieved.
4. **Basic Instrument for Training**: Audit programme is very useful for the new auditor It provides training and guidance to him. So, it is rightly called the basic instrument for training.
5. **Legal Evidence:** Audit programme is legal evidence of work done by every assistant of the audit team. It can be presented in the court of law if any client is taken against the auditor for negligence.

6. **Fixation of Responsibility:** If any error or fraud remains undetected the responsibility of negligence will fall on the particular assistant who has performed that job.
7. **Several Audits may be controlled**: The auditor controls the audit of various companies at the same time. In the absence of audit programme, he cannot supervise them effectively.
8. **Easy Transfer**: If one assistant is unable to continue the work given to him, it can be given to another person. Audit programme guides him that what is done and what is remaining.
9. **Final Review**: Before signing the report, final review is made and for this purpose also auditing programme is very useful.
10. **Useful for Future:** On completion of an audit, it serves the purpose of audit record which may be useful for future reference.

Disadvantages of audit programme

1. **Not Comprehensive:** Even if the audit programme is well drawn up, it may not cover everything that might come up during the course of audit.
2. **Rigidness:** Each business may have a separate problem of its own and hence a rigid programme cannot be laid down for each type of business.
3. **Too mechanical**: The audit programme may be followed mechanically year often year though the business may change in its operation or conduct.
4. **No Initiative**: An efficient clerk loses his initiative because he adheres to the programme which has been fixed for him. He may not make any suggestions.
5. **Not Suitable for small units:** It is proved that audit programme is not suitable for small units.
6. **Time Constraints:** Auditor staff may be hurried in order to complete it within the prescribed schedule.

AUDIT REPORT

Meaning:

Audit is the examination of the accounts of a concern by an independent expert, with a view to expressing an opinion there on. This opinion of the auditor is contained in the audit report.

The auditor's report is the end product of every audit. It is the medium through which an auditor expresses his opinion on the financial statements or other data under audit. It is an important part of the audit process. Since it summarizes the results of the work conducted by the auditor.

FEATURES OF AUDITOR'S REPORT

1. Auditors report is the statement of facts collected and considered by the auditor drawn in clear and concise words.
2. It is the end product of every audit as it summarizes the result of audit work of an auditor.
3. It is the medium through which an auditor expresses his opinion on the financial statement or other data under audit
4. Audit report is based on facts various information's and evidences collected by an auditor on the financial affairs of the company.
5. According to provisions of companies act auditor is required to make the report to the shareholders of the company.
6. Auditor's report may be either in the form of letter or in the form of statement.
7. The wordings of the auditor's report are of prime importance. It is on the wording of such report that the auditor's
8. Duly signed by the auditor and attached to the balance sheet of the company.

Importance of Audit Report

The importance of an audit report can be judged from the following points:

1. **The end product of auditing**: The audit report gives an overview of the evaluation of the correctness and reliability of the financial statements of a company.
2. **Auditor's opinion on accounts:** The audit report expresses the auditor's opinion on the company's accounts and records as examined by him. The auditor analyses the financial statements and determines if they are prepared in conformity with appropriate financial reporting standards or principles applicable to the company under audit.
3. **Reflection of auditor's work**: The work done by the auditor is reflected in the audit report. It showcases the nature and extent of audit procedures adopted by the auditor to carry out the examination of accounts.
4. **Measures auditor's responsibility:** The audit report is the instrument that measures the auditor's responsibility with regard to the assessment of financial statements.
5. **Used as a reliable source of evidence:** The audit report reveals the true state of the company's financial situation. It is recognized as a reliable document by a variety of people. It assists the users of financial statements in determining whether or not the financial information is correct.

6. **Filing of Income Tax Return**: The majority of the time, income tax authorities accept the profit and loss statement that has been prepared and certified by a qualified auditor and they do not go into the details of the accounts.
7. **Borrowing of money from external sources**: Based on an audited balance sheet, money can be borrowed from external sources with ease. The majority of financial institutions approve various loans on the basis of audited financial statements and accompanying audit reports.
8. **Statement of Insurance Claim**: In the event of a flood, fire, other natural calamities, or similar unexpected incidents, the insurance company may settle the claim for loss or damages based on the audit reports of the previous year.
9. **Sales tax payments:** The audited books of account may generally be accepted by the GST & sales tax authorities.
10. **Bankruptcy cases:** The audited accounts serve as a basis to determine action in insolvency and bankruptcy cases.
11. **Advice to the management**: Internal auditors offer advice to management on business & operational areas that require improvement. They evaluate a company’s internal controls, including its corporate governance and accounting processes.

Contents of Audit Report

1. Whether he has obtained all the information and explanations which, to the best of his knowledge and belief which are necessary for the purpose of audit.
2. Whether the information and explanation given to him and the books of accounts presented gave the true and fair view or not in case of Profit and loss account and Balance sheet.
3. Whether proper books of accounts as required by law have been kept by the company or not.
4. Whether the report on the accounts of any branch office audited by any other auditor has been forwarded to him and how he has dealt with the same in preparing his report.
5. Whether the company's B/S and P&L A/C are in agreement with the books, accounts and returns.
6. Whether any other statements have been included as required by the central Govt.
7. His opinion on financial statements whether they comply with accounting standards.
8. His comments, observations on financial transactions which have adverse effect on the functioning of the company.

9. Whether it has adequate internal control system and it is operated effectively.
10. Any qualifications, reservations or adverse remarks relating to the maintenance of accounts and matters related thereto.
11. Whether his opinions and to the best of his information and according to the explanation given to him a true and fair view:

a) In the case of the B/S, of the state of the company's affairs at the end of its financial year.
b) In the case of the P&L A/C, of the P/L for the financial year.

TYPES OF AUDIT REPORT

1. CLEAN OR UNQUALIFIED REPORt

When the auditor is satisfied as to the fairness of the balance sheet and profit and loss account of the concern, he gives his report without any reservations, qualifications or modifications., i.e., clean or unqualified report or opinion. In other words when the auditor gives a positive opinion on all the matters contained in the audit report, it is said to be unqualified or clean report. In that case an auditor report states “Subject to above, we report that balance sheet shows a true and fair view".

Before Giving a Clean Report, An Auditor Must Observe the Following:

- He must examine the books of accounts of the company as per the accepted accounting principles.
- He must observe all the audit procedures necessary under the circumstances.
- He must see that all the relevant provisions of the companies act and other important laws or complied with.
- He must be satisfied with the truthfulness and fairness of the accounts and the financial statements of the company.

2. QUALIFIED REPORT

When the auditor is not satisfied with the accounts presented to him or if he finds some discrepancy in the treatment given to him or if he thinks that the profit and loss account and the balance sheet do not exhibit "a true and fair view" of the state of company's affairs and the management is not prepared to make desired changes, he will qualify his report.

In other words, the auditor gives an opinion subject to some reservations it is said to be qualified audit report.
In that case an auditor, may include his objection in the audit report and state "subject to the above, we report that the balance sheet shows a true and fair view".

A Qualified Report is given by the auditor only under certain circumstances,

- When he is not satisfied with the accounts or the financial statements presented to him.
- When proper books of accounts as required by law have not been maintained.
- When there is a violation of the companies act and any other important laws.
- When there is a substantial departure from the generally accepted accounting principles.
- When there is a material mis-statement in the financial statements.
- When there is an of a material disclosure.
- When the explanations sought by the auditor are not made available to him.
- When the auditor is not satisfied with the information and explanations given to him.
- When he finds some discrepancy in the treatment of certain items.
- When the assets are over-valued or under-valued.
- When stock in trade has been valued at the market price which is more than the cost price. When there is insufficient provision for depreciation on fixed assets.
- When there is inadequate provision for bad and doubtful debts.
- Where secret reserves have been created.

A Qualified Report Has Certain Adverse Consequences:

- It is an adverse reflection on the activities of the directors.
- It may lead to fall in the value of the company's shares in the stock market.
- It may lead to the appointment of investigators by the central Govt to investigate the affairs of the company.

DISCLAIMER REPORT

When the auditor is unable to give any opinion, in absence of necessary information or explanation, or when the auditor is unable to get sufficient and appropriate evidence, he is said to make a "No opinion report or a disclaimer of opinion. Thus, an audit report may state that “In the absence of the books and vouchers, we are unable to express any opinion on the accounts.

There may be many reasons for disclaimer of opinion thus,

- Auditor may be unable to obtain all the information and explanation necessary for the purpose of his audit.
- Auditor may not have received the branch audit report from the branch auditors in respect of many branches.
- The profit and loss account as well as the balance sheet may not be tallying with the books of accounts i.e., the difference in trial balance may be large and untraceable and so on.

ADVERSE OPINION REPORT

Where the auditor gives a negative or adverse report on the accounts, When the auditor discovers a high level of material misstatement or irregularities which contains gross misstatements, have the potential for fraud, which shows a high alert that the company records haven’t been prepared according to GAAP, he is said to give a negative or adverse report. Thus, an audit report is “We believe that audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion and hence the financial statements DO NOT PRESENT a true and fair view”.

The auditor gives a negative or adverse report in the following circumstances.

- When the auditor is dis-satisfied in material respect with regard to disclosure of financial information.
- Where a material mis-statement has been made by the management in the financial statement.
- When the auditor is satisfied that financial statements prepared by the management do not comply with the provisions of companies act 1956.
- Where the company fails to adopt generally accepted accounting standards or principles.
- Where there is an omission of material disclosure in the financial information.
- When he is dis-satisfied in material respect with regard to truth and fairness of financial statements.

BASIC ELEMENTS OF AUDITOR'S REPORT

The following essential contents of an auditor’s Report:

1. **Title:** The audit report should be issued on the printed letterhead of the auditor. It should bear a title "Audit Report"

2. **Addressee:** The audit report should be addressed to the shareholders in case of company. In other cases, it should be addressed to the proprietor, partners etc. i.e., to the person who has appointed the auditor.
3. **Introductory Paragraph**.
- **Management Responsibility**: The report should state that the financial statements are basically the responsibility of the management. It should state that the responsibility of the auditor is to express an opinion on the financial statements based on his audit.
- **Auditors Responsibility:** Expressing his opinions on the financial statements based on the audit done.

4. **Identify Financial Statements:** - The audit report should clearly identify the financial statements e.g., the balance sheet, and the profit and loss account of XYZ company limited for the year ended 31.3.200........
5. **Scope:** The report should describe the scope of the audit. It should state that the audit was planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement (error or fraud). It should state that the audit covered examining,

(a) supporting evidence on test basis

(b) the accounting principles used

(c) estimates made by the management, and

(e) the presentation.

6. **Auditors Opinion on Accounts**: The audit report should clearly give the auditor's opinion whether the financial statement gives a true and fair view of the affairs of the concern as at the end of the year and of the profit or loss for the year. The report should state whether the financial statements comply with applicable laws and rules (e.g., The companies Act) and the accounting standards, principles and practices recognized in India. It should include a statement by the auditor that his audit provides a reasonable basis for his opinion.

7. **Signature of the Auditor**: The audit report should be properly signed by the auditor or the partner of the auditor's firm. It should mention the auditor's membership number assigned by the ICAI

8. **Date of report**: The audit report should indicate the date when the audit was completed and the report was signed.

9. **Place of signature**: The audit report should give the place of signature.