Auditing (BBA VIth sem)

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SCE

Unit 1- Introduction :Meaning and objectives of Auditing, Types of Audit, Internal Audit, Audit Programme, Audit Notebook, Routine checking and Test checking

UNIT 1

INTRODUCTION

MEANING OF AUDITING-

Auditing is defined as the on-site verification activity, such as inspection or examination, of a process or quality system, to ensure compliance to requirements. An audit can apply to an entire organization or might be specific to a function, process, or production step.

NARROW CONCEPT OF AUDITING-

Montgomery has defined auditing as

"A systematic examination of the books and records of a business or other organisations in order to ascertain or verify and to report up on the facts regarding the financial operations and the results thereof"

Narrow concept does not include any evaluation process in which non-financial data is used. It does not recognises the fact that evidence can be obtained from sources other than books, accounts and vouchers.

AUDITING IN A BROAD SENSE-

Institute of Chartered Accountants of India: "Auditing… is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis, formulates his judgment which is communicated through his audit report."

FEATURES OF AN AUDIT

- Auditing is a systematic process. It is a logical and scientific procedure to examine the accounts of an organization for their accuracy. There are rules and procedures to follow.
- The audit is always done by an independent authority or a body of persons with the necessary qualifications. They have to be independent so their views and opinions can be totally unbiased.
- Once again, an audit is the examination of all the books of accounts and financial information of the company. So it is essentially a verification of the final accounts of the organization, i.e. the profit and loss statement and the balance sheet at the end of the financial year.
- Auditing is not only the review of the books of accounts but also the internal systems and internal control of the organization.
- To conduct the audit we need the help of various sources of information. This includes vouchers, documents, certificates, questionnaires, explanations etc. He may scrutinize any other documents he sees fit like Memorandum of Association, Articles of Associations, vouchers, minute books, shareholders register etc.

- The auditor must completely satisfy himself with the accuracy and authenticity of the financial statements. Only then can he give the opinion that they are true and fair statements.

OBJECTIVE OF AUDITING-

1. Primary Objective

According to De Paula, the primary objective of auditing is to express an independent opinion on whether a company's financial statements are presented fairly, meaning they accurately reflect the company's financial position and results of operations, in accordance with applicable accounting standards; essentially, to assess the reliability and "truth and fairness" of the financial statements.

Key points about De Paula's perspective on auditing:

- **Focus on "true and fair" view:**

The auditor's main goal is to determine if the financial statements present a true and fair view of the company's financial position, not just to identify errors or fraud, although these are important considerations during the audit process.

- **Independent opinion:**

The auditor provides an independent opinion based on their examination of the financial statements and supporting documentation.

- **Compliance with accounting standards:**

The audit ensures that the financial statements are prepared in accordance with the relevant accounting standards.

2. Subsidiary Objective

These are such objectives which are set up to help in attaining primary objectives. They are as follows:

(A) Detection and prevention of errors

Errors are those mistakes which are committed due to carelessness or negligence or lack of knowledge or without having vested interest. Errors may be committed without or with any vested interest. So, they are to be checked carefully. Errors are of' various types. Some of them are:

1.Errors of Accounting principle-

When principles of book keeping and accountancy are not followed in recording of business transactions ,it is known as error of principle.

• Wrong allocation of expenditure between capital and revenue. Revenue expenditure may be treated as capital expenditure and vice-versa.

Such errors are not disclosed in trial balance, debit and credit sides of transactions are same. Such errors can be detected by thorough checking of each and every transaction.

Error of principle affect the reliability of financial statement. it is an accounting mistake in which entry is recorded in the incorrect account, the value recorded was the correct but placed incorrectly.

2. Errors of omission-

When a transaction is omitted fully or partly from books of accounts, such type of errors are known as error of omission. Usually it arises due to mistake of clerk.

• Omission of purchases from purchases book

• Omission of sales from sales book

• Omitting the entry for charging depreciation in the books.

• Rent or interest paid for 11 months, the remaining amount which is unpaid or outstanding has not been entered in the books.

3. Errors of commission-

When the entries made in the books of original entry or ledger are incorrect wholly or partly, such are called error of commission. Usually these error arise due to negligence in recording of some business transactions.

➢ Ex:-wrong recording in the books of original entry wholly or partly. Goods purchased for Rs.10,000 recorded in purchases book as Rs.1000

➢ Rs.500 purchased from m and co, recorded as from n and co.

➢ Wrong totaling of original entry, while totaling sales day book or purchase day book mistake is made in the total sales. Sales day book is totaled Rs.100 short and posted to ledger. This error will affect trial balance, the credit side total will be short by Rs.100. it will lower the profit by Rs.100.

➢ Wrong subsidiary book used for recording a transaction .

For ex:-credit sales to x and co. Were recorded in purchase day book or credit purchases to y and co. were recorded in sales day book.

4. Compensating errors-

When an error offsets the effect of another error, such error is known as compensating error. These errors don't affect trial balance.

Sometimes under casting of one account is compensated by over casting of another account, such as 'X' a/c is under totaled by Rs.100 and' Y' a/c is over totaled by Rs.100.

5. Errors of Duplication-

When a transaction is recorded twice and also posted twice in the ledger. Such an error will not affect trial balance. It is more difficult to locate such errors. Only thorough checking and comparing of vouchers with entries in the books. If two entries on the same side are appearing with the same amount.

(B) Detection and Prevention of frauds

Frauds are those mistakes which are committed knowingly with some vested interest in the direction of top level management. Management commits frauds to deceive tax, to show the effectiveness of management, to get more commission, to sell a share in the market or to maintain the market price of share etc. Detection of fraud is the main job of an auditor. Such frauds are as follows:

1. Misappropriation of cash-

Misappropriation of cash is done by theft of cash receipts, petty cash, cheques, negotiable instruments, showing fictitious (false, fake) payments to workers, creditors, purchases etc; misappropriation of cash is very easy. With the increase in size of business, the opportunities of committing fraud also increase because the owners of the business have no direct control over receipts and payments of cash.

Examples of misappropriation of cash:-

• Recording fictitious purchases and thereby cash involved there in is misappropriated.
• Omitting credit note received from the supplier and discount allowed by them.
• Showing payment of wages to dummy workers in wage sheet.
• Various receipts like bad debts recovered ,sale of scrap or rejected stock etc;
• Omitting the records of donations receipts or recording lower amounts.
• The credit sales may not be recorded and money received from customers pocketed.

2. Misappropriation of goods-

The misappropriation of goods is easy in case of a business which produces or deals in goods of high value and less bulky.

• Issuing false credit note to customers for sales returns and such goods are misappropriated.
• Goods may be stolen by employees from the godowns.

It is not easy to detect the misappropriation of goods. Only the efficient system of record keeping, periodical checking, internal check etc; will be helpful to avoid misappropriation of goods.

3. <u>Manipulation of accounts or falsification of accounts without any misappropriation</u>-

This type of fraud is committed by upper level of management with the different objectives to mislead certain parties within or outside the business. Whenever such fraud is committed, it usually involves large amounts and it is intentional. This type of fraud is usually committed by Managers, Directors, Board of directors etc;

(a) Showing low profits than the actual ones:-
To give wrong impression about success of business to competitors.
To reduce or avoid payment of income tax.
To purchase shares at a lower price in the market.

(b) Showing more profits than what actually are:-
-The manager may get more commission if such commission is calculated on the basis of profits earned.
-To sell the shares at high prices by declaring higher dividends, this is done when such person hold shares of the company.
-The services of such person may be retained by showing more profits to the shareholders thereby the confidence of shareholders is maintained.
-To mislead financial institutions for obtaining further credit, the financial position of the business is shown better than what actually it is.
-When the company is in the process of issuing shares to the public, to attract more subscribers for such shares. Manipulation of accounts may be resorted /use the following devices:----- Purchases/expenses may be inflated / suppressed.
-Sales or other incomes may be inflated /suppressed.
-Stocks may be over or under valued.
-Omission of adjustment of expenses outstanding or prepaid expenses
-Depreciation of assets may be over or under charged or omitted altogether
-Assets or liabilities may be over or under valued.
-Treating capital expenditure as revenue expenditure or vice-versa.

<u>Window dressing</u>

The financial position of the business is shown in such a way that it seems better than what actually it is window dressing is more of misrepresentation than fraud. it is done in the following ways:-
(a) Purchases of current year may be shown as next year.
(b) Income of previous year may be shown as current year.
(c) Expenses of current year may be shown as next year.
(d) Showing short-term liabilities as long term liabilities.
(e) Charging revenue expenses as capital expenditure.
(f) Over-valuation of closing stock.
(g) Over-valuation of assets or undervaluation of liabilities.

Book-Keeping, Accountancy and Auditing

Book-Keeping is the art of recording the business transactions in the books of original entry. It involves the process of recording all the transactions, journalising, posting to the relevant ledger accounts and balancing.

Accountancy involves the process of recording, classifying, summarising and interpreting all the financial transactions that take place during a particular period in a concern. It is the work of an accountant in maintaining financial books, checking of numerical accuracy of the books of accounts, preparation of trial balance, trading account, profit and loss account and balance sheet. Hence, it is commonly said *"**Accountancy begins where Book-keeping ends**"*.

Auditing involves a detailed and critical examination and verification of accounts by an independent and qualified person to ascertain the true and fair view of the financial position of the concern. For example after verification the auditor has to submit a report to the management that the financial statement represents a true and fair view of the statement of affairs of the business. Hence, it is said *"**Auditing begins where Accountancy ends**"*.

TYPES OF AUDIT-

A. ON THE BASIS OF ORGANISATIONAL STRUCTURE-

1. Private Audit-

Private audit refers to an examination of an organization's financial records, internal controls, and operations carried out by an independent third-party firm. Unlike a public audit, which is conducted to meet regulatory requirements, a private audit is typically initiated by the organization itself, often to gain insights into its financial health, identify areas of improvement, and ensure compliance with internal policies and procedures.
private audit is of the following types :
1. audit of sole proprietorship
2. partnership firms
3. individuals accounts
4.institutions not covered by statutory audit

2. Government audit -

A government audit is a systematic examination of a government's financial, administrative, and other operations. Government audits are conducted to verify and evaluate these operations. They also help to ensure accountability of government officials.

Purpose

- To ensure that government funds are accounted for publicly
- To ensure that government operations are efficient and effective
- To ensure that government officials are accountable
- To ensure that government expenditure is in line with the rules and regulations
- To ensure that government receipts are accurate

Who conducts government audits

- In India, the Comptroller and Auditor General of India (CAG) is responsible for conducting government audits
- The CAG reports to the president or state government
- Statutory corporations may be audited by the CAG or independent auditors
- Government companies are audited according to the Companies Act

3. Statutory audit –

Statutory Audit means a type of audit mandated by the law or a statute to make sure that the book of accounts is true and fair which is presented to the public and regulators. If the business meets certain criteria, then the statutory audit is mandatory. Generally, statutory audit means financial audit.

Examples of statutory audits

- **Tax audits -**The IRS examines a company's tax returns to verify that income and deductions are accurate.
- **Company audits -**An auditor audits a company's balance sheet, profit and loss account, cash flow statement, or other financial statements.
- **Compliance audits -**Certain industries, like banking and insurance, may require compliance audits to ensure they adhere to specific regulations.
- **Public company audits -**Public companies are required to have their financial statements audited annually to ensure they are free from material misstatement.
- **Private company audits -**Many jurisdictions require private limited companies of a certain size to undertake annual statutory audits.

B. ON THE BASIS OF SPECIFIC OBJECTIVE-

1. Independent Financial audit-

An independent financial audit is a review of a company's financial records by an objective third party. It's usually performed by a professional auditor who is not affiliated with the company.

Purpose

- To ensure financial accuracy
- To ensure regulatory compliance
- To build stakeholder confidence
- To identify operational improvements
- To facilitate access to capital
- To detect and prevent fraud
- To support strategic planning

2. Internal Audit-

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The following definition of internal audit, as described in the Preface to the Standards on Internal Audit, issued by the Institute of Chartered Accountants of India, amply reflects the current thinking as to what is an internal audit: "Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system."

3. Cost audit -

Cost audit is an important and continuous process that a company has to execute properly during its entire existence in the market. It accounts for the complete verification of the cost records of the company and also takes into consideration the other different types of accounts. Tracking the cash flow in a company and correcting the instances where wrong data exists is the main objective of the cost audit. To understand in-depth what cost audit is, you have to understand its functions, importance, and advantages.

4. Management audit-

   A management audit is an independent and systematic analysis and evaluation of a company's overall activities and performances. It is a valuable tool used to determine the efficiency, functions, accomplishments and achievements of the company.

   The primary objective of the management audit is to identify errors in management activities and suggest possible changes. It guides the management to manage the operations most effectively and productively.

5. Tax audit -
   A tax audit is when the Internal Revenue Service (IRS) conducts a formal investigation of financial information to verify an individual or corporation has accurately reported and paid their taxes. Selection can be at random, or due to unusual deductions or income reported on a tax return.
   Section 44AB of Income Tax Act, 1961 defines the rules and regulations for the tax audit of an entity or a firm. This tax audit is conducted to ensure that the taxpayer has offered all the required details about his income, taxes, deductions, etc. Note, this tax audit is run by a Chartered Accountant (CA).

6. Secretarial audit-
   A Secretarial Audit is a mechanism to check the compliance of an organization to the laws, rules, regulations, notifications etc prevalent at the time of the audit. In this case, it is to check if a company has been complying with the provisions of the Companies Act 2013 and all of its rule therein.
   The rules and regulations around companies are very complex and ever increasing. The responsibilities of the directors, promoters and other managerial positions are also very complicated and crucial. So it is important that a Practicing Company Secretary (PCS) be hired to conduct a secretarial audit.

7. Propriety Audit
   Generally, in companies and other big organizations, ownership and management are separate. This means the real owners of the business have to rely on executives to make the correct decisions and take the due course of action as per the law. This is where the concept of propriety audit is born.
   Propriety audit has been described as an audit of the actions and decisions of the executives. The focus of such an audit is on the financial discipline, the authority structure, efficiency, rules and regulations and the protection of public interest.

C. ON THE BASIS OF TIMING-

1. Annual Audit-

An annual audit in India refers to the process of examining and evaluating a company's financial records, statements, and transactions to ensure accuracy, compliance with accounting standards, and adherence to applicable laws and regulations. It is a statutory requirement for most companies in India to conduct an annual audit.

2. Interim audit-

An interim audit involves preliminary audit work conducted prior to the financial year-end of a client, usually covering six or nine months. Generally, interim audit work involves tests of controls and certain substantive procedures. Such testing mainly focuses on income statement items, although some balance sheet work may also be performed.
There is not always the need to perform an interim audit, depending on the audit strategy, and especially in the case of smaller clients. This is because the auditor would be able to carry out and finalise all audit procedures within a short period of time after year-end. Accordingly, interim audits are often conducted for larger audit clients with a strong internal control function. Such an audit is sometimes also requested by the client itself or required by local regulators.

3. Balance sheet audit

Balance sheet audit means the examination of a credit union's assets, liabilities, and equity under generally accepted auditing standards by an independent public accountant for the purpose of opining on the fairness of the presentation on the balance sheet. It is done to list down all the assets and liabilities of the organization on a particular date. This requires the verification of all records related to the items of balance sheet i.e. assets and liabilities.

C. ON THE BASIS OF SCOPE-

1. Complete audit -

Thorough examination and verification of a company 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. Other audits may not be as comprehensive as a complete audit, and while not completely unreliable, they may still leave room for misstatements.

2. Partial Audit -

An audit which is conducted considering the particular area of accounting is known as partial audit. Under partial audit, audit of whole account is not conducted. Audit of particular area where the owner thinks essential to conduct audit will be conducted. Generally, transaction of business is related to cash, debtor, creditor, stock etc. A business may conduct an audit of any of these transactions. An auditor should conduct audit of that transaction as per the scope determined by the agreement. Method of conducting such audit is similar to other audit but an auditor should sign the report clearing stating the partial audit if it is not done so, an auditor will be liable for the loss which is caused due to using the report as complete audit.

3. Detailed Audit-

A detailed audit is used to examine a large proportion of the transactions of a business. It is typically used to search for cases of suspected fraud, where there may be a few fraudulent transactions hidden amongst a mass of legitimate transactions. This type of audit may also be used to locate opportunities for cost reductions and process improvements. In these situations, detailed audits are normally conducted by the internal audit staff, perhaps over an extended period of time.

Detailed audits are not commonly used by outside auditors, who instead use a much smaller sample size as part of their auditing activities. This is because it would not be cost-effective for outside auditors to spend inordinate amounts of time examining very large sample sizes.

	Independent audit	**Internal audit**
Who performs it	Independent third-party auditor	Internal employee or department
Focus	Financial statements	Internal controls and operational effectiveness
Purpose	Ensure financial transparency and accountability	Improve operational effectiveness
Scope	Financial structure that affects financial statements	Entire business organization
When it happens	Usually after the end of the year	Continuously throughout the year

Key differences between Continuous audit and Balance Sheet audit

- Meaning:

A continuous audit involves monitoring financial data and processes in real-time throughout the year, providing ongoing insights, while a balance sheet audit focuses on verifying the accuracy of a company's balance sheet at a specific point in time, typically at the end of an accounting period, only examining the assets and liabilities listed on that statement; essentially, a continuous audit is a more dynamic and frequent assessment compared to a static balance sheet audit.

- Timing:

Continuous audit happens in real-time or near real-time, while a balance sheet audit is conducted at a single point in time.

- Scope:

A continuous audit examines all financial transactions and controls throughout the year, whereas a balance sheet audit primarily focuses on the data presented on the balance sheet.

- Purpose:

Continuous audit aims to identify potential issues and concerns early on for proactive risk management, while a balance sheet audit is primarily used to verify the accuracy of the company's financial position at a specific date.

	Annual audit	**Continuous audit**
Frequency	Once a year	Ongoing, in real-time or near real-time
Focus	Financial statements and accounts	Operational processes, controls, and risk management
Method	Manual processes, like data collection and analysis	Automated processes, like machine learning, artificial intelligence, and robotic processes
Suitability	Small business	Big or medium sized business organization
Benefits	Demonstrates transparency	Identifies risks and issues in real-time
Cost	Expensive	Less expensive

INTERNAL AUDIT

Meaning and Definition

Internal audit is an evaluation and analysis of the business operation conducted by the internal audit staff. It is the part of overall system of internal control established in an organization.

Internal audit is the independent appraisal activity within an organization for the review of accounting, financial and other business practices as protective and constructive arms of management. It is a type of control which functions by measuring and evaluating the effectiveness of other type of controls.

According to Professor Walter B. Meigs, Internal Auditing means "Internal auditing consist of a continuous, critical review of financial and operating activities by a staff of auditors functioning as full time salaried employees."

In big organization, an internal audit is carried out by the team of professionals in the organization. The internal audit is not mandatory but organization gets the internal audit done with a view to evaluate the effectiveness of internal control, the soundness of financial system, effectiveness of business processes etc. This provides management an assurance about the control process in the organization and it aids in early detection of inefficiencies/fraud etc. it helps the statutory auditors too in getting the statutory audit done effectively. As per company audit report order, 2003, statutory auditor also requires to comment whether the company is having sound internal audit system or not.

Objective of Internal Audit

(i)Proper Control:The purpose of internal Audit is to keep proper control over business activities. When there is proper control there is maximum efficiency. The internal control can determine the degree of control over work.

(ii)Accounting System:The purpose of internal audit is to evaluate the accounting system. It is concerned with checking proper authority for transactions like purchase, retirement and disposal of fixed assets. The voucher can be compared with entries in order to determine that figures and facts.
(iii) Help Management: The purpose of internal audit is to help the management. Internal auditor can point out the weaknesses. The internal audit can be used as a tool to correct the situation. The management functions can be performed properly.
(iv)Working Review:The purpose of internal audit is to review the working of business. The working of current year can be reviewed in detail. There is a need to locate the weak points. The corrective measures can be taken for proper working.
(v) Asset Protection: The purpose of internal audit is to protect the assets. The proper records of assets must be there. Internal auditor can examine the valuation, verification and possession. The purchase and sale of assets must be made under proper authority.
(vi) Internal Check: The purpose of internal audit is to evaluate the internal check system. There is division of duties among the employees. When all staff member are working properly it means there is effective internal check system. The work of an auditor is reduced. He can apply test checks to complete audit duty.
(vii)Fair Statements:The purpose of internal audit is to detect the error in the accounting records. The work of internal audit can help the management to see that accounting record is in order
(viii) Check Error: The purpose of internal audit is to detect the errors in the accounting records. If the work of internal auditor goes side by side therefore there are minimum chances of errors. The accounting staff can rectify mistake to prepare accounts at the end of year in order to help the external auditor.
(ix) Detect Fraud: The purpose of internal audit is to detect frauds in the books of accounting. When the work of accounting staff is over the internal audit is started. Accounting staff remains alert because there is no time gap between recording and checking. Thus detection of fraud is possible with it.
(x)New Ideas:The purpose of internal audit is to seek new ideas relating to procedures, marketing, financing and other business matters. The internal audit staff can provide new ideas about various business matters. The viable ideas can be put in to practice for the benefit of business.

BASIC PRINCIPLES OF ESTABLISHING INTERNAL AUDIT

The basic principal of establishing internal audit in a business concern are
1. Independence : the internal audit department should have an independent status in the organization. He may be required to report directly to the board of directors.
2. Objectives: the objectives of the internal audit function should be made very clear and unambiguous. The objectives should be properly communicated so that internal audit is not viewed as "over-the-shoulder check" by other departments.
3. Clarity in Scope: the scope pf internal audit department must be specified in a comprehensive manner. The department must at all times, have authority to investigated from the financial angle, every phase of organizational activity under any circumstances.
4. Definition of Duties: The internal audit Department's duty is to review operations as part of the internal control system. It should not be involved in performance of executive actions.
5. Internal Audit Department: The size and qualification of staff of the internal audit department should be commensurate with the size of the business. The cost of internal audit department should not exceed the benefits expected to be derived from it.
6. Reporting: The Programme of internal audit should be time-bound. There should be provisions for periodic reporting on various operational and other aspects.
7. Follow Up and Review: There should be sufficient scope for the follow up actions on the various points raised in internal audit report. Top management should take active part in ensuring compliance with actions points raised in the report.
8. Relationship with statutory auditor: The copy of the internal audit report should be made available to the statutory Auditor, who can deal with the same in the manner as he deems fit.

Advantages of Internal Audit

1] More Effective Management

One of the biggest benefits of an internal audit is that it facilitates more effective management of the organization.The internal auditor will be able to point out any weaknesses of the organization in the operations or internal controls of the company. So the management can use these insights to better the chances of achieving their goals.

2] On going Review

The process of internal audit gives the organization a unique opportunity to conduct a review of the performances in the ongoing year itself.

They do not have to wait for the end of the year to review the company's performance. This also means that if they are not on the correct path, this will help them change course and correct their mistakes immediately.

3] Performances of Staff Improve

The staff of the company remains alert and active. This is because there is the fear of their mistakes being caught by the internal auditor almost immediately.

This will help improve their efficiency and performance. Also, they do not attempt to defraud the company for the same reasons. And on the other hand, it is a good morale booster for honest employees.

4] Ensures Optimum Use of Resources

One other benefit of the process of internal control is that it can be used as a tool to promote the optimization of resources. It will help point out the areas in which resources are being underutilized or wasted. And then these can be corrected. It will help control the costs and expenses of the company.

5] Division of Work

Internal audit helps promote the division of labor. It is important to keep a check on and observe the activities of all the departments and all of their employees. Division of labor will help in achieving this.

Limitations of Internal Audit

Now let us move on to the limitations of internal audit. Like every good thing has a flip side, there exist some concerns about these limitations of internal audit. Let us take a look.

1] Shortage of Qualified Staff

The work of an audit requires years of study and experience. An inexperienced auditor can cause more damage than good. So usually, the company will find it somewhat difficult to find enough qualified staff members for the process of an internal audit.

2] Time Lag

There will always be a time lag between accounting and auditing. Internal audit cannot begin till the accounting is complete. They cannot be done simultaneously. So if the accounting process is delayed, so is the internal audit.

3] Ignorance of Management

Unlike a statutory audit, the findings of an internal audit are not published or made available to all. Their findings are only forwarded to the management.

Now even if an internal audit reports points out to the shortcomings of the company or the errors in the financial statements, the management may not take corrective action.

They can choose to ignore such findings and then there will be no benefit gained from the internal audit.

Audit Programme

MEANING - An audit programme is a detailed, written statement designed by the auditor indicating the work to be performed by the audit assistants, specifying the time limit for completion of work, instructions and guidance to the audit staff. In short, it is a tool for planning, directing and controlling the audit work. An audit programme is a detailed plan of the auditing work to be performed. It specifies the procedures to be followed in the conduct of audit more efficiently. The auditor outlines the whole procedure of audit from beginning till the finalization of audit report. Audit programme is generally contained in the audit notebook.

Objectives of Audit Programme

The following are the objectives of audit programme:

1. To provide clear instructions to the audit assistants specifying the nature of work to be performed and fixing the time span for completion of each work.
2. To facilitate coordination among various parts of audit work.
3. To ensure uniformity in the performance of audit work and to avoid duplication and repetition of work.
4. To attain a fair allocation of work among audit team.
5. To fix responsibility and accountability of each audit assistant.
6. To serve as a guide for planning the audit work in future.
7. To serve as evidence in future showing the date of completion of audit work, methods or procedures undertaken, persons involved in completion of audit work

Contents of an Audit Programme

The following are the details of an audit programme:
1. Name of the client.
2. Nature of operations and business of client.
3. Review of system of internal check.
4. Date of commencement of audit work.
5. Duration of audit work.
6. Accounting system followed in client organization.
7. Review the report of the previous auditor.
8. Review the remarks, instructions or objections raised in the previous audit report.
9. Examine the various ledger accounts and subsidiary books.
10. Examine the statutory books and registers, profit and loss account, and balance sheet.

Advantages of an Audit Programme

An audit programme can give the following advantages:
1. *Helps in Estimation and Division of Work*: Audit Programme helps in estimating the quantum of audit work in advance and also helps in dividing the work among the audit assistants based on their capabilities. 2
2. *Helps in Fixation of Responsibility*: It enables to fix responsibility on the audit assistants by clearly defining the scope of work.
3. *Helps in Future Planning*: Audit programme serves as a basis for planning the audit work for subsequent year.
4. *Serves as a Guide*: It serves as a valuable guide for the audit staff in execution of the audit work for succeeding years.
5. *Valuable Evidence*: It serves as an evidence for the work done as initials of those who have done the particular work are appended to it. The auditor can produce the audit programme as a proof when a charge of negligence being brought upon him.
6. *Uniformity:* It provides for uniformity in audit work as the same work will be done every year.
7. *Continuity*: When an audit staff goes on leave others can continue the work by referring to the audit programme, hence, audit programme provides for continuity of work.
8. *Coordination*: If facilitates coordination and helps in supervising the work of the audit staff

Disadvantages of an Audit Programme

The disadvantages that may be experienced by conducting audit as per predetermined audit programme are –

1. *Mechancial:* When audit work is conducted mechanically every year based on the audit programme, it causes monotony and boredom to the auditor and audit staffs.
2. *No Quality in Work*: The audit staff will be more interested to complete the work in time rather than to maintain any standard in the work.
3. *Loss of Initiative*: Audit staff cannot take their own decisions and they are compelled to comply with the audit programme. Hence, an efficient audit clerk loses his initiative and interest as he cannot make any suggestions.
4. *Rigidity*: A rigid and inflexible audit programme cannot be laid for all types of business. During the course of audit, new areas to be verified may come to the notice of the audit staff. Unless the audit programme is revised, such areas may escape from auditing.
5. *Shelter for Inefficient Staff*: Inefficient audit staffs conceal their mistakes or weakness on the basis of audit programme. Hence, it provides shelter for inefficient audit staff.

Audit Notebook

Audit Note Book is a register maintained by the audit staff to record important points observed, errors, doubtful queries, explanations and clarifications to be received from the clients. It also contains definite information regarding the day-to-day work performed by the audit clerks. In short, audit note book is usually a bound note book in which a large variety of matters observed during the course of audit are recorded. The note book should be maintained clearly, completely and systematically. It serves as authentic evidence in support of work done to protect the auditor against any legal charge initiated against him for negligence. It is of immense help to the auditor in preparing the audit report. It also acts as a valuable guide for conducting audit for future years.

Contents of Audit Note Book:

The following matters should have been incorporated in an Audit Note Book.

1. A list of the account books normally used and maintained.
2. Names of the principal officers, their duties and responsibilities.
3. Nature of business carried on and important documents relating to the constitution of business like Memorandum of Association, Articles of Association, Partnership deed etc.,
4. Extracts of minutes and contracts affecting the accounts.
5. Extracts of correspondence with statutory authorities.
6. Copy of audit programme.

Advantages of Audit Note Book:

1. *Facilitates Audit Work*: It facilitates the work of an auditor as all important details about the audit are recorded in the note book which the audit clerk cannot remember everything at all the time. It helps in remembering and recalling the important matters relating to the audit work.
2. *Preparation of Audit Report*: Audit note book helps in providing required data for preparing the audit report. An auditor examines the audit note book before preparing and finalizing the audit report.
3. *Serves as Documentary Evidence*: Audit note book serves as a documentary evidence in the court of law when a suit is filed against the auditor for his negligence.
4. *Serves as a Guide*: When a audit assistant is changed before the completion of audit work, audit note book serves as a guide in completion of balance work. It also acts as a guide for carrying on subsequent audits.
5. *Evaluating Work of Audit Staff*: It helps to assess the work performed by the audit staff and helps in evaluating their level of efficiency.

6. *Fixation of Responsibility*: Audit note book helps in fixing responsibility on concerned clerk who is responsible for any undetected errors and frauds in the course of audit.
7. *No Dislocation of Audit Work*: An audit note book contains all important details about audit hence any change in the audit staff will not disturb or dislocate the audit work.

<u>Disadvantages of Audit Note Book;</u>
1. *Fault-finding Attitude*: It leads to development of a fault-finding attitude in the minds of the staff.
2. *Misunderstanding*: Very often maintenance of audit note book creates misunderstanding between the client's staff and the audit staff.
3. *Improper Preparation*: Since it serves as evidence in the court of law, it needs to be prepared with great caution. When the note book is prepared without due care it cannot be used as evidence against the auditor for negligence.
4. *Adverse Effects on Subsequent Audits*: Since audit note book is used in performing subsequent audits, any mistakes in the note book may have adverse impacts on the next audit.

Routine Checking

Regular checking of all the daily transactions is known as Routine Checking. Routine checking incorporates the following tasks:
* Checking of record in primary books, costing, transfer etc.
* Checking transfer of transactions from original books of accounts to ledger account.
* Checking debit and credit side of various accounts.
* Checking transfer of balances of various accounts to other pages or accounts or statements.

Various signs are used while conducting routine check. Such signs provides the proof of routine checking of transactions. Signs which are used in audit should be small and clear. Generally red or pink colour is used while conducting routine check. But green colour is used while conducting final audit.

Advantages Of Routine Checking

Following benefits can be obtained from the routine checking:
1. All the original entries will be checked; so all the errors and frauds can be detected easily.
2. All the entries and posting will be tested.
3. Routine checking helps to conduct final audit because all the balancing and totals have already been checked.
4. Separate and specific staffs are not needed because it is a regular process.

Disadvantages Of Routine Checking

Followings are the limitations of routine checking:
1. Routine checking is a mechanical test, so the staff who performs this work does not have inspiration. So, there are chances of leaving errors and frauds.
2. Routine checking can only detect small errors and frauds but not the planned frauds.
3. Routine checking is not needed where self balancing system is applied.
4. Routine checking cannot detect principle and compensating errors.

Test Checking

Test checking in Audit means checking a few transactions selected at random from a large number of transactions. It is also known as "Selective Verification" or "Sampling Process". It is a substitute for detailed checking. It involves only a partial checking. It is based on a simple theme thatIf a representative number of transactions, randomly selected by the auditor for test checking is found to be correct, the rest might be correct too.

In simple words in test checking a representative number of entries of each class is selected and checked and, if they are found correct, the remaining entries are also taken to be correct. Test checking is an accepted substitute of detailed checking, which in most of the cases from the economic point of view is unwarranted.

Adoption of test checking methods by auditors

The decision to adopt testing methods depends entirely on the auditor's judgement and discretion depending on the individual cases and circumstances. Test checking should be applied and carried out intelligently and carefully; otherwise, it may lead to dangerous consequences. However, the use of test checking depends much upon the system of internal check in operation and the intelligence of the auditor.

Safeguards for the Application of Test Checking

While applying test checks the auditor should take the following precautions:

1. As far as possible sample transactions should be selected from every book.
2. The selection of transactions should be so distributed that the work of almost all the clerks of the client is checked.
3. The items should be selected at random.
4. As fraudulent manipulations are common during the first and last months of the period under audit, the entries made during these periods should be checked thoroughly.
5. In the selection of entries and accounts for applying test checks, care should be taken to check the different portions of the work at each audit.
6. Cash book and pass book should be checked thoroughly.
7. The auditor should select the transactions on his own. He should not consult the staff of the client while selecting the transactions.

If the auditor exercises the above safeguards with care and caution, the results are bound to be encouraging and satisfactory.

Advantages of Test Checking

Test checking enjoys the following advantages:

1. It saves time and energy.
2. If the selection of transactions is done intelligently, test checking is useful and purposeful.
3. The volume of work is reduced. So the auditor can carry on many audit simultaneously.
4. It helps the auditor to arrive at a definite conclusion in regard to the true and fair view of the state of affairs of the concern.
5. It helps in reducing the cost of audit.

Disadvantages of Test Checking

Test checking suffers from the following disadvantages:

1. It is not possible to detect all the errors and fraud.
2. The clerks of the client may become careless because they know that their work will not be checked in detail.
3. Under test checking, although the auditor checks the whole of the work through test checking, suspicion and doubt will remain in his mind.
4. It is of no use if proper and effective systems of internal checks and controls are not being adopted in business.
5. It is not suitable for small business concerns.