

UNIT-I: INTRODUCTION

Meaning of Auditing

Auditing is a systematic and independent examination of books, accounts, documents, and vouchers of an organization to ascertain how far the financial statements present a true and fair view of the actual financial position. It ensures accuracy, reliability, and fairness in the financial reporting process.

Definition of Auditing

One of the widely accepted definitions is by Spicer and Pegler:

“Auditing is such an examination of the books of accounts and vouchers of a business as will enable the auditor 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 whether the Profit and Loss Account gives a true and fair view of the profit or loss for the financial period.”

Evolution of Auditing

- **Ancient Times:** Auditing dates back to ancient civilizations like Egypt, Greece, and Rome where record keepers were appointed to manage state revenues and expenditures.
- **Industrial Revolution:** With the rise of joint-stock companies in the 19th century, the need for professional auditing increased.
- **Modern Era:** The evolution of complex business structures and globalization has made auditing a specialized and regulated profession, governed by national and international standards.

Objectives of Auditing

1. **Primary Objective:**
 - To express an opinion on the financial statements.
2. **Secondary Objectives:**
 - Detection and prevention of errors and frauds.
 - Evaluation of internal controls.
 - Providing assurance to stakeholders.

Importance of Auditing

- Builds trust and credibility in financial statements.
- Assists in regulatory compliance.
- Enhances operational efficiency through recommendations.
- Helps stakeholders make informed decisions.
- Reduces the risk of fraud and mismanagement.

Types of Audit

1. **Statutory Audit** – Mandatory by law (e.g., for companies).
2. **Internal Audit** – Conducted by internal staff to assess internal controls.
3. **External Audit** – Independent review usually by external auditors.
4. **Tax Audit** – Conducted to ensure compliance with tax laws.
5. **Cost Audit** – Examines the cost records and ensures cost control.
6. **Management Audit** – Evaluates management decisions and efficiency.

7. Operational Audit – Focuses on business operations for improvement.

Standards of Auditing

Auditing standards are established principles that guide auditors in performing their duties effectively. In India, the Auditing and Assurance Standards (AAS) are issued by the Institute of Chartered Accountants of India (ICAI).

Procedure for Issue of Standards by AASB (Auditing and Assurance Standards Board)

1. Identification of Areas requiring standards.
2. Formation of Draft by the AASB.
3. Exposure Draft is released for public and professional comments.
4. Review of Suggestions received from stakeholders.
5. Final Approval by the Council of ICAI.
6. Issuance of Final Standard which becomes applicable to audit practices

UNIT-II: AUDITOR AND EXECUTION OF AUDIT

I. Rights of an Auditor

(As per the Companies Act, 2013 & auditing standards)

An auditor has legal and professional rights to perform their work effectively:

1. **Right to Access Books of Accounts**
 - Auditor can access all books, accounts, vouchers, and financial records of the company at any time.
2. **Right to Obtain Information & Explanations**
 - Auditor can ask for any information or explanation from company officers and employees necessary for audit.
3. **Right to Visit Branches**
 - Auditor has the right to visit any of the company's branches and audit the branch accounts (unless a separate auditor is appointed for that branch).
4. **Right to Receive Notices & Attend General Meetings**
 - Auditor has the right to receive notices of general meetings and to attend and speak at meetings on matters concerning them.
5. **Right to Report to Members**
 - Auditor reports their findings directly to the shareholders (members) of the company.
6. **Right to Sign Audit Report**
 - Only the appointed auditor has the right to sign the audit report and express their opinion.
7. **Right to Remuneration**
 - Auditor is entitled to receive remuneration as fixed by the appointing authority.

I. Duties of an Auditor

(Statutory, ethical, and professional duties)

A. Statutory Duties (under Companies Act, 2013)

1. **Examine Financial Statements**

- Auditor must examine and ensure that the financial statements present a true and fair view.
- 2. **Compliance with Standards**
 - Auditor must follow the applicable **Standards on Auditing (SAs)** issued by ICAI.
- 3. **Reporting to Shareholders**
 - Auditor must submit a report to the members stating their opinion on the financial statements.
- 4. **Report on Fraud (if found)**
 - Auditor must report any fraud found during the audit to the Central Government (if material), or to the Board.
- 5. **Verify Proper Maintenance of Books**
 - Ensure that the company has maintained proper books of account as per the law.

ICivil Liability of Auditors

Meaning:

Civil liability arises when an auditor fails to perform duties with due care and causes **loss or damage** to the company or third parties due to **negligence, breach of duty, or misrepresentation**.

Cases Where Civil Liability Arises:

1. **Negligence in Audit Work**
 - Failure to detect errors or fraud due to careless examination of accounts.
2. **Misstatement in Audit Report**
 - Giving a clean opinion when financial statements are misleading or misstated.
3. **Breach of Duty**
 - Failure to follow auditing standards, resulting in financial loss to stakeholders.

UNIT–III: INTERNAL CONTROL, INTERNAL CHECK AND INTERNAL AUDIT

Meaning and Objectives of Internal Control

Meaning of Internal Control

Internal control refers to the **systems, policies, and procedures** implemented by an organization to ensure:

- The **accuracy and reliability of accounting data**
- **Safeguarding of assets**
- **Compliance** with laws and regulations
- **Efficiency and effectiveness** of operations

It is a **management tool** used to ensure the organization runs smoothly and efficiently with reduced risks of errors or fraud.

Objectives of Internal Control

1. **Accuracy of Financial Records:** Ensuring reliable and accurate accounting records.

2. **Operational Efficiency:** Promoting efficient use of resources and operations.
3. **Asset Protection:** Safeguarding the assets of the business from misuse or theft.
4. **Compliance:** Making sure laws, regulations, and internal policies are followed.
5. **Error and Fraud Prevention:** Minimizing the risk of unintentional errors and intentional fraud.
6. **Timely Reporting:** Enabling timely preparation of financial and operational reports for decision-making.

2. Internal Check

Meaning of Internal Check

Internal Check is a part of internal control system where **duties are allocated in such a way** that the work of one person is automatically checked by another. It's a **continuous process** and operates as part of day-to-day routine.

Features of Internal Check

- Division of work among employees.
- Automatic cross-checking of work.
- Designed to **detect and prevent errors/fraud**.
- Involves **job rotation and responsibility sharing**.

Objectives of Internal Check

- To prevent and detect errors and frauds at early stages.
- To ensure accurate and reliable accounting records.
- To make staff more responsible and accountable.
- To increase efficiency and avoid duplication of work.

3. Internal Audit

Meaning of Internal Audit

Internal Audit 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 **risk management, control, and governance processes**.

Features of Internal Audit

- Conducted by **internal staff or outsourced professionals**.
- Continuous and regular.
- Reports to management.
- Helps identify inefficiencies and compliance issues.

Objectives of Internal Audit

- To assess the effectiveness of internal control.
- To evaluate the accuracy of accounting and operational data.
- To ensure compliance with policies and procedures.
- To suggest improvements in operational efficiency.
- To detect and prevent frauds and errors

4. Internal Check Vs. Internal Audit

Basis	Internal Check	Internal Audit
Meaning	A system of checks within daily work	A review function for control assessment
Purpose	Prevent errors/frauds during work	Evaluate and improve control systems
Nature	Preventive	Detective and corrective
Conducted by	Regular staff	Internal auditors or professionals
Timing	Concurrent with operations	Periodically after operations
Focus	Division of work & responsibilities	Evaluating entire control and governance

5. Internal Control Vs. Internal Audit

Basis	Internal Control	Internal Audit
Meaning	System to ensure efficient operations	Independent review of operations and controls
Objective	To prevent errors and ensure efficiency	To evaluate the effectiveness of control
Nature	System-based	Evaluation-based
Scope	Wide – covers all controls	Focused – mainly financial and operational audit
Implemented by	Management	Internal auditors
Function	Operational and preventive	Assurance and advisory