SARIYA COLLEGE, SURIYA

B. COM. (Hon. & Gen.)
SEMESTAR: VI
PAPER: AUDITING AND CORPORATE GOVERNANCE
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Q.1: What are the different kinds of Audit? State the merits and demerits of each.

Ans.: The classes of an audit depend on the nature of work undertaken. Moreover, the classification of audit under this head are based on the organizational structure of the business. The classes of audit are stated below:

(a) Statutory audit: Again statutory audit can be classified under the following heads: (i) Company Audit, (ii) Bank Audit, (iii) Trust Audit, (iv) Insurance Audit, (v) Co-operative Society Audit, (vi) Other Corporate and Public Body Audit.
(b) Private Audit: Private audit can be classified under three heads, which are as follows: (i) Audit of accounts of Sole0traders, (ii) Audit of accounts of Partnership Firm, (iii) Audit of accounts of Hospitals, Schools, Colleges, etc.
(c) Government Audit
(d) Internal Audit

The classification of an audit from the point of view 'types' depends on the practical approach to the work. However, the types of an audit are stated below:

(1) Continuous Audit
(2) Periodical/Annual/Final Audit
(3) Interim Audit
(4) Procedural Audit
(5) Standard Audit
(6) Occasional Audit
(7) Partial Audit
(8) Cost Audit
(9) Management Audit
(10) Balance Sheet Audit
(11) System Audit
(12) Complete Audit and Partial Audit
(13) Internal Audit
(14) External Audit
(15) Cash Audit
(16) Propriety Audit

Statutory Audit: An audit which is authorized and governed by law and which is made compulsory under statute is known as Statutory Audit. An audit is compulsory in case of the following undertakings which are governed by different Acts. Such as: (i) Companies Act, 2013 (ii) Banking Companies Act, 1949, (iii) Insurance Companies Act, (iv) Trust Act, 1950 (v) Co-operative Societies Act, 1912 etc.

It should be noted in this context that the rules and regulations, nature and scope of audit work, qualifications, rights, duties, appointment and retirement of auditors, all are governed by different laws and statutes which the stated undertakings belong to:

(i) Company Audit: Audit of accounts of Companies, registered under Companies Act, is compulsory. Prior to the introduction of the Companies Act, 1913, which for the books of accounts audited by independent qualified accountant, there was no compulsion that books of accounts be audited by independent auditor. But by the introduction of Companies Act, 2013, the audit of accounts and annual financial statements of a Company has been made compulsory by an independent and competent auditor. The auditor is appointed or re-appointed and his remuneration is fixed as per the provisions of the Companies Act. The auditor's qualifications, powers and duties are clearly provided in the Companies Act and the auditor has definite liabilities under the Companies Act. There are several regulating provisions in the Companies Act relating too different types of transactions, accounts and financial statements. The statutory auditor has to check the compliance of those provisions in the course of audit and submit his report in the manner required by the Companies Act. So Company audit is fully under the regulations of the Companies Act. However, the advantage enjoyed by Limited Companies in getting the books of accounts audited.

(ii) Bank Audit: It has been pointed out earlier that the audit of Banking Company or Companies is made compulsory under statute, since it is governed by special Act, known as Banking Companies Regulation Act, 1949. However, a few general advantages arising from bank audit, are stated below:

(a) Overall picture about the progress of the business can be made available through audit techniques.
(b) Regular audit procedure and introduction of strong internal check or internal audit system may bring a sense of confidence amongst the customers.
(c) The chances of defrauding of cash by top official may be minimized to a great extent.

(iii) Trust Audit: Trust, as the very name implies, are created out of Catholic mind on the part of the persons making the trust in order to protect the beneficiaries *viz*., minors, widows and other institutions created under Indian Trust Act. The trustee looks after the different assets and properties as per testament. A trust deed is created for the purpose which provides the manner in which the different aspects *viz*., collection of rent from property, dividends on shares, and procurements of crops from landed property etc. to be dealt with.

(iv) Insurance Audit: The Insurance Companies which are governed by the Insurance Act, 1938 include fire, marine and other miscellaneous insurance business, *viz.,* Workmen's Compensation Insurance, Motor Care Insurance, Accident Insurance, etc. The books of accounts that are to be maintained by the Insurance Companies are governed in accordance with the provisions of the said Act. The auditor will examine the details of the books of accounts and check the reliability of the internal check system or internal audit system.

(v) Co-operative Society Audit: Audit of Co-operative Institutions or societies is conducted by the Co-operative Department of the State Government or by Registrar or Co-operative Societies as the case may be. Section 17 of the Co-operative Societies Act, 1912 gives the details about the responsibility of the State Govts. regarding the audit procedures of Cooperatives Societies. A Chartered Accountant or any retired official of the C-operatives Departments are eligible for the appointment as Auditor.

(vi) Corporation Audit: Other corporate public bodies include electricity and gas companies. These companies are formed by the enactment of different Acts. Other public bodies which are known as Public Corporations are Industrial Finance Corporation, Reserve Bank of India, Life Insurance Corporation, Damodar Valley Corporation, Air Corporation, etc. These Public Corporations were set-up in accordance with the different Acts of the Parliament. The audit is a must for all these corporations and other public bodies.

Private Audit: The audit which is not required by statute is known as Private Audit. Audit of proprietary or sole traders, partnership firms and other non-profit motive organizations may be considered as private audit. Such persons want to know their actual cash position as well as the positions of solvency, profitability and operating efficiency of their organizations.

(i) Sole Proprietor Audit: Sole proprietor audit means audit of accounts of sole traders or proprietor. Although the audit of accounts of sole traders are not made compulsory by law, yet it has, become since long years, customary that the books of accounts are to be audited by qualified accountants. This is because in some cases the income of the sole traders is manifold. So, it becomes essential to get the accounts verified and checked by a qualified auditor.

(ii) Partnership Audit: The audit of partnership firm is not compulsory. That is to say, it is not required by the statute. The audit of a partnership firm may be governed either by partnership agreement or by mutual agreement between the partners. So, the auditor is employed by the partners. The auditor must examine the partnership deed. Moreover, he should have a look into different aspects of the business in relation to partnership agreement. These aspects are nature of business, the accounting year of the firm, the duration of partnership business, partners, share capital, profit-sharing ratio, interest on partners capital, partners drawing and salary, the basis of valuation of goodwill arising in connection with admission, retirement and death of partners, change in profit-sharing ratio, sale of partnership to limited company, the priority of capital.

(iii) Non-Profit Motive Organisation Audit- It is also known as audit of accounts of non-trading and non-profit motive bodies. Audit of accounts of educational institutions, clubs, hospitals, public libraries, academic, professional and cultural societies, etc. are known as non-profit motive organization audit. Although the audit of non-profit motive organizations is not required by statute, yet it is observed in actual practice that their books of accounts are audited customary.

Government Audit: Government audit embraces the audit of different Government Companies including the different parts of Government Accounts. Section 394 of the Companies Act, 2013, states that Government Company means any Company in which not less than 51% of the paid-up share capital is held by the Central Government or by any Government or Governments or partly by the Central Government or partly by one or more State Governments and includes a Company which is subsidiary of a Government Company as thus defined. Thus, it can be stated that Public Enterprises that are established under the provisions of the Companies Act are termed as Government Companies. The examples of Government Companies which are fully owned by the

Government of India are, H.M.T. Ltd., Heavy Electrical Ltd., Fertilizer Corporation of India Ltd., Hindustan Steel Ltd., and Hindustan Antibiotics Ltd. etc.

Internal Audit: The audit of accounts by internal auditor is not compulsory, because it is not required under statute. Unlike the external auditors who are appointed by shareholders in a general meeting and the audit of which is required under statute, the internal auditors, by virtue of the organizational pattern and behavior are appointed by the management for the smooth running of the business. It can be considered as a complementary to statutory auditing. Basically, Internal Auditing is a control that is concerned with examination and appraisal of other controls, in seeing that the assets of a business are properly protected and accounted for, that current transactions are promptly and completely recorded, that faulty inefficient or fraudulent operations are revealed, and that the business is adequately protected against waste, fraud and loss.

Continuous Audit: Continuous Audit, as its name implies, is an audit which is continuously done throughout the year. It involves detailed examination of transactions, book of accounts including different supporting vouchers and documents by audit staff continuously throughout the year or at regular intervals, say, fortnightly, monthly or quarterly. The auditor visits his client's offices at regular or irregular intervals during a financial year to check the transactions and books of account. At the end of the financial year, he takes up the final accounts for examination. Continuous audit enables completion of audit at the quickest possible time after closing of accounts. Continuous audit is also known as detailed audit or running audit.

Periodical Audit: Periodical Audit is also known as Annual Audit or Final Audit or Complete Audit. This type of audit is usually done at the end of the financial year when all the accounts have been balanced and Trading and Statement of Profit and Loss and the Balance Sheet have been prepared. The only thing is that the audit is completed in one continuous session. Under this audit, the auditor is in possession of the facts relating to accounts for the year under review. In the case of such an audit, the auditor visits his client only once a year and goes on checking the accounts until the audit work for the whole of the period is completed. Such type of audit is most suitable and satisfactory as well as practical for the small organizations. However, extensive examination of books of accounts is not possible under such audit.

Interim Audit: An audit conducted in between two annual audits is called Interim Audit. Whenever a Company wants to declare an interim dividend, it becomes necessary to get interim audit of the accounts done up to the date at which the Company wants to declare the interim dividend. For example, a Company may decide to declare interim dividend after the close of the half year. In other words, interim audit involves a complete audit of accounts for a part of the year i.e. from the date of the last Balance Sheet to the date of the interim accounting period.

Procedural Audit: It is an examination and appraisal of the procedures in maintaining the books of accounts of an organization. This can ensure the reliability for the preparation of Statement of Profit and Loss Account and Balance Sheet. It is not particular type of audit; rather it forms a part of the whole audit procedures.

Standard Audit: The term 'Standard' may be defined generally as the specimen by which ant thing is tested. But the extended meaning of the concept, standard may be described as that which is set-up and established by authority as a rule for the measurement of quantity, weight, extent, value or quality.

Occasional Audit: This type of audit is not commonly used. It is conducted ‘once in a while’ whenever necessary. The introduction of this type of audit depends on the sweet will of the client. In proprietary concerns (i.e. sole traders and partnership business), the use of occasional audit is found to exist.

Partial Audit: Commonly, this type of audit is not permitted under Company Law. Because the Companies Act provides that the auditor can neither restrict his duty by arrangement nor curtail his duty by agreement. It may also take the form of special audit where the auditor has to make an audit for some special purpose viz. the conduct of cash audit, the audit of Stock Account when some fraud is apprehended by the proprietor. It is interesting to note that the audit report must state clearly that the partial audit has been performed as per the instructions of the client.

Cost Audit: Cost audit plays a dynamic role in the achievement of social objects of business, i.e., production of quality goods at a reduced price and the attainment of higher productivity in all factors of production. Cost audit is the audit process or verification of the cost of the manufacturer or production of any article. The basis is the accounts relating to the use of material, labour and other items of cost maintained by the enterprise under audit, in accordance with the generally accepted principles of cost accounting.

Management Audit: Management audit is comparatively a recent modern thinking. It deals with the evaluation of the efficiency of the performance of management in an organization. Recently it has been thought that professional accountants should also concern themselves with the efficiency of their client-enterprises, rather than exclusively on the financial accounts and records prepared by these organizations. In the words of T.G. Tokhe, “Management audit has been defined as a comprehensive critical review of all aspects of process of management.”

Balance Sheet Audit: Balance sheet audit does not simply mean an audit of the balance sheet only. It is more than this. In fact, Balance Sheet Audit is a system of audit where balance sheet is first taken up for examination and the audit works backward to the Statement of Profit and Loss and books and records.

System Audit: System audit is a technique of auditing which examines the system in a particular organization, which generates accounts and financial statements. An in-depth analysis and examination is made of the system comprising of procedures, checks and controls connected with transactions, records and accounting by which the auditor can form an idea about the truth and fairness of the accounting output.

Complete Audit: A complete audit is an unrestricted audit for the entire financial year and for the whole organization. In complete audit, the auditor is free to check all the books and records of the organization. A statutory audit is of this type. In complete audit, even of a part of audit is allotted to some other auditor like branch audit, the report of the auditor doing part audit has to come under consideration of the main auditor for giving an audit report on the accounts of the entire organization.

Internal Audit: Internal Audit is an important form of audit. It involves a conduct of systematic examination of the records, procedures and operations of an organization. It is generally carried out by employees of the company with a view to:

(i) Confirming that the policies of management are being properly executed and drawing attention to those areas where policies appear to be inadequate, and

(ii) To verify that the information used by management to control the undertaking is both adequate and accurate.

External Audit: The examination of accounts of a business by an independent and external auditor having requisite professional qualifications is known as external or independent audit. The objective of such an audit is to certify the correctness and fairness of accounts of a business undertaking for a definite period and to give report on the financial position of the business. There is no personal interest of such an auditor in such organization. The remuneration etc. is fixed as per the contract between the auditor and the client or according to provisions of the Company Act in case of Joint Stock Company.

Cash Audit: Cash audit is an audit of cash transactions and the cash book only. It is a limited or partial audit. Only the cash receipts and payments are checked in this audit with the help of documentary evidence to ensure that they have been properly entered in the cash book. The genuineness of the cash balance as shown by cash book is also required to be established by physical examination of cash. The bank transactions also come under the purview of examination and so the genuineness of the bank balance is also required to be established from an examination of Bank balances as per Bank statements obtained from different Banks. Cash audit should also cover examination of petty cash transactions.

Propriety Audit: Propriety audit refers that kind of audit wherein the various actions and decisions of the management of an enterprise are examined in the light of public interest and standard of conduct. The conduct of propriety audit by an auditor requires a rare quality of prudence, wisdom and skills, since he has to examine the regularity prudence and impact of the various actions and decisions of the management. In propriety audit, the auditor has to find out the justification of the transactions, the amount of the expenditure incurred and the prudence of the sanctioning authority.

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