

Subject-5.3 AUDITING

OMCA-5TH

Unit 1: Introduction, Meaning and Definition

Introduction to Auditing:

Auditing is an important and systematic process in the field of accounting. It involves the independent examination of financial information, records, and statements of an organization to ensure accuracy, transparency, and compliance with applicable laws and standards. Auditing helps in detecting errors or frauds and increases the reliability of financial statements for stakeholders like shareholders, investors, government authorities, and management.

Meaning of Auditing:

The term "auditing" comes from the Latin word "*audire*," which means "to hear." In earlier times, auditors used to hear oral reports of financial transactions. In the modern context, **auditing means examining the books of accounts and other financial records to ensure that they give a true and fair view of the organization's financial position.**

Definition of Auditing:

1. According to the Institute of Chartered Accountants of India (ICAI):

"Auditing is the independent examination of financial information of any entity, whether profit-oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon."

2. According to R.K. Mautz:

"Auditing is concerned with the verification of accounting data, determining the accuracy and reliability of accounting statements and reports."

1. Scope of Auditing:

The **scope of auditing** refers to the areas and extent covered during the audit process. It defines what is to be examined and verified by the auditor.

Key Areas Covered Under the Scope of Auditing:

1. **Examination of Books of Accounts:** Verification of ledger, journals, vouchers, receipts, and payments.
2. **Verification of Financial Statements:** Examining the accuracy of the Profit and Loss Account and Balance Sheet.
3. **Evaluation of Internal Controls:** Assessing the effectiveness of the internal control system in preventing and detecting errors or fraud.
4. **Compliance with Laws and Standards:** Ensuring that the organization follows applicable laws, rules, accounting standards, and regulatory requirements.

5. **Detection and Prevention of Errors and Frauds:** Identifying mistakes (intentional or unintentional) and weaknesses in the system that could lead to fraud.
6. **Expressing an Opinion:** Providing a professional and independent opinion on whether the financial statements show a true and fair view.
7. **Audit of Non-Financial Data (if needed):** In some audits, non-financial areas such as operational efficiency and system audits may also be covered.

2. Objectives of Auditing:

Auditing has two types of objectives — **primary** and **secondary (or subsidiary)**.

A. Primary Objective: To express an opinion on the truth and fairness of financial statements. The auditor examines financial records to form a professional opinion on whether the statements reflect the real financial position of the business.

B. Secondary (Subsidiary) Objectives:

1. **Detection and Prevention of Errors:** Errors can be clerical, technical, or procedural. The auditor checks for both unintentional mistakes and oversight.
2. **Detection and Prevention of Frauds:** Frauds are intentional acts like misappropriation of assets or manipulation of accounts. Auditors work to identify such misconduct.
3. **Checking the Proper Disclosure:** Ensuring that all necessary information is properly disclosed in the financial statements as per accounting standards.
4. **Verification of Assets and Liabilities:** Confirming that assets and liabilities shown in the balance sheet actually exist and are correctly valued.
5. **Assessment of Internal Controls:** Evaluating whether the existing control systems are efficient and reliable.

Types of Audit

Audits can be classified based on different criteria such as **purpose**, **conducting authority**, **time**, and **scope**. Below are the main types of audit commonly studied in auditing:

1. Statutory Audit

- **Meaning:** An audit required by law (statute) for certain organizations.
- **Examples:** Audit of companies under the Companies Act, 2013.
- **Objective:** To ensure compliance with legal requirements and give an opinion on the financial statements.
- **Compulsory?** Yes, for companies and certain institutions.

2. Internal Audit

- **Meaning:** An audit conducted by the internal staff or an appointed internal auditor of the organization.

- **Objective:** To evaluate internal controls, risk management, and operational efficiency.
- **Compulsory?** Not mandatory for all, but required for large companies as per Companies Act.

3. External Audit

- **Meaning:** An independent audit conducted by an external (third-party) auditor.
- **Objective:** To provide an unbiased opinion on the financial statements.
- **Compulsory?** Yes, for companies and public organizations.

4. Government Audit

- **Meaning:** Audit conducted by government agencies like the **Comptroller and Auditor General (CAG)** of India.
- **Objective:** To ensure proper use of public funds and compliance with laws.
- **Applies to:** Government departments, public sector undertakings.

5. Tax Audit

- **Meaning:** An audit conducted to ensure compliance with income tax laws.
- **As per:** Section 44AB of the Income Tax Act, 1961.
- **Who conducts it:** A Chartered Accountant.
- **Applies to:** Businesses or professionals with turnover above prescribed limits.

6. Cost Audit

- **Meaning:** Audit of cost accounting records to verify the cost of production.
- **Applies to:** Certain companies engaged in manufacturing, as per the Companies (Cost Records and Audit) Rules.
- **Objective:** To ensure cost efficiency and proper costing.

7. Management Audit

- **Meaning:** Evaluation of managerial decisions, policies, and performance.
- **Objective:** To improve efficiency, productivity, and decision-making.
- **Focus:** Not financial, but operational and strategic effectiveness.

8. Social Audit

- **Meaning:** An assessment of a company's social responsibilities and impact on society.
- **Objective:** To measure social performance and accountability (e.g., environmental efforts, employee welfare).

9. Operational Audit

- **Meaning:** A detailed review of an organization's operations.

- **Objective:** To improve productivity, efficiency, and cost-effectiveness.

10. Performance Audit

- **Meaning:** Audit to assess whether objectives and goals are being met efficiently and economically.
- **Focus:** Mainly used in government and NGOs to ensure effectiveness.

11. Forensic Audit

- **Meaning:** A special audit focused on investigating fraud or criminal activity.
- **Use:** Often used as legal evidence in courts

Audit and Investigation

Though **audit** and **investigation** are both related to the examination of financial records, they differ significantly in their **purpose, scope, approach, and legal implications**.

1. Meaning of Audit:

- **Audit** is a systematic and independent examination of the financial statements of an entity.
- It is done to ensure that the financial records present a **true and fair view** of the financial position of the business.
- Generally conducted **annually** and required by **law** for certain organizations.

2. Meaning of Investigation:

- **Investigation** is a **special and detailed examination** of specific records or aspects of a business.
- It is done to find facts related to **fraud, embezzlement, financial irregularities**, or for special purposes like acquiring a business.
- It can be conducted at **any time** and is usually carried out as per the **specific objectives of the client**.

3. Differences Between Audit and Investigation:

Basis	Audit	Investigation
Purpose	To express an opinion on financial statements	To find facts or detect frauds, errors, or irregularities
Scope	General – whole financial statements	Specific – depends on the objective of the investigation
Nature	Routine and periodic	Detailed and specific
Time Period	Usually for one financial year	May cover several years or a specific period
Legal	Often compulsory (statutory)	Usually optional or ordered for

Requirement	audit)	specific needs
Conducted by	Chartered Accountants or statutory auditors	Chartered Accountants, forensic auditors, or experts
Approach	Based on audit standards and sampling	Thorough and in-depth checking of all relevant data
Report Format	Opinion on “true and fair view”	Factual report with evidence and findings

Functions of an Auditor

An **auditor** plays a crucial role in ensuring the accuracy, fairness, and compliance of an organization’s financial reporting. The functions of an auditor can be grouped into **primary**, **secondary**, and **additional** functions:

1. Primary Functions of an Auditor

These are the core responsibilities:

Function	Description
Examination of Financial Records	Checking books of accounts, vouchers, receipts, invoices, and documents.
Verification of Financial Statements	Ensuring that the Balance Sheet and Profit & Loss Account present a true and fair view .
Evaluation of Internal Controls	Assessing the effectiveness and reliability of the internal control system.
Forming an Audit Opinion	Providing an independent opinion on whether the financial statements are free from material misstatements.

2. Secondary Functions of an Auditor

These support the primary functions:

Function	Description
Detection of Errors	Identifying clerical or technical mistakes in accounts.
Detection of Frauds	Investigating manipulation or misappropriation of funds.
Ensuring Legal Compliance	Verifying whether the company complies with laws (e.g., Companies Act, tax laws).
Vouching	Examining vouchers to verify authenticity of business transactions.
Valuation of Assets and Liabilities	Ensuring correct valuation and proper disclosure in the financial statements.

3. Additional / General Functions of an Auditor

These functions vary depending on the nature of audit and the organization:

Function	Description
Reporting to Stakeholders	Preparing the audit report and presenting it to shareholders, management, or regulators.

Advisory Role (Non-Statutory)	Giving suggestions on accounting systems, internal control, or tax planning (without compromising independence).
Auditing Branches or Subsidiaries	Coordinating or conducting audits of different units or branches.
Compliance with Accounting Standards	Ensuring accounting is done according to prescribed standards and guidelines.

Auditor's Responsibilities and Duties

An auditor has both **legal** and **professional** responsibilities to ensure the integrity, accuracy, and transparency of an organization's financial reporting. These duties are defined by law (like the **Companies Act, 2013**) and by professional standards (like those issued by the **Institute of Chartered Accountants of India – ICAI**).

A. Responsibilities of an Auditor

These are broad obligations an auditor must fulfill while performing an audit:

Responsibility	Explanation
1. True and Fair View	Auditor must ensure that financial statements give a true and fair view of the company's financial position.
2. Independence	Must remain unbiased and independent while auditing, without any conflict of interest.
3. Professional Competence and Care	Must maintain professional knowledge and perform the audit with due diligence and care.
4. Compliance with Standards	Must follow applicable accounting and auditing standards issued by ICAI and other regulatory bodies.
5. Confidentiality	Must keep client information confidential unless legally required to disclose.
6. Reporting Irregularities	If any fraud or serious irregularities are found, the auditor must report them appropriately.
7. Legal Compliance	Must ensure that the company complies with relevant laws (e.g., Companies Act, Tax laws, etc.).

B. Duties of an Auditor (as per Companies Act, 2013)

Here are the specific legal duties under statutory audit obligations:

Duty	Description
1. Duty to Report	Auditor must report to shareholders whether the financial statements comply with law and accounting standards.
2. Duty to Enquire (Section 143(1))	Auditor must inquire into specific matters like loans secured by proper documents, proper valuation of assets, etc.
3. Duty to Sign the Audit Report	Auditor must sign the audit report and mention qualifications, if any.
4. Duty to Attend AGM	Auditor should attend the Annual General Meeting (AGM) where audit reports are discussed.
5. Duty to Maintain Audit Working Papers	Must maintain audit working papers for a minimum of 8 years .
6. Duty to Report Fraud (Section 143(12))	If any fraud is noticed during audit, the auditor must report it to the Central Government or Audit Committee , depending on the amount.

7. Duty Not to Render Certain Services	Auditor must not provide certain services like internal audit, bookkeeping, or management services to the same client (Section 144).
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Qualities of an Auditor

To perform their duties effectively and ethically, an auditor must possess certain personal and professional qualities. These qualities ensure the reliability, independence, and thoroughness of the audit process.

A. Personal Qualities of an Auditor

Quality	Explanation
1. Honesty and Integrity	An auditor must be truthful, transparent, and free from any bias or conflict of interest.
2. Objectivity	Must make fair and unbiased judgments, without being influenced by personal relationships or pressure.
3. Patience	Auditing involves going through detailed and lengthy records; hence, patience is essential.
4. Tactfulness	Should handle sensitive issues politely while dealing with clients or staff.
5. Alertness and Vigilance	Must stay alert to spot unusual or suspicious entries that may indicate errors or fraud.
6. Confidentiality	Should never disclose client information unless required by law.

B. Professional Qualities of an Auditor

Quality	Explanation
1. Technical Knowledge	Must have deep understanding of accounting principles, auditing standards, tax laws, and legal provisions.
2. Analytical Ability	Should be able to analyze complex financial data and detect inconsistencies or manipulations.
3. Knowledge of Business	Should understand the nature, operations, and environment of the client's business.
4. Sound Judgment	Must apply professional judgment in forming audit opinions and handling doubts.
5. Knowledge of Law	Should be familiar with legal frameworks like the Companies Act, Income Tax Act, GST, etc.
6. Familiarity with Technology	In today's digital world, an auditor must be comfortable using audit software and understanding computerized accounting systems.

Advantages of Auditing

Advantage	Explanation
1. Ensures Accuracy	Helps in detecting and preventing errors or frauds in accounting records.
2. Builds Credibility	Audited financial statements are more trusted by shareholders, investors, and banks.
3. Legal Compliance	Ensures that the organization is complying with applicable laws and regulations.
4. Facilitates Decision Making	Accurate and verified financial information helps management make informed business decisions.
5. Detects Weaknesses in	Audit helps in identifying and suggesting improvements

Internal Controls	in internal control systems.
6. Helps in Settlement of Disputes	Audited accounts serve as reliable evidence in courts or during disputes.
7. Useful for Tax Authorities	Tax authorities rely on audited accounts for assessing tax liability.
8. Enhances Business Reputation	A company with clean audit reports builds confidence among stakeholders.
9. Helps in Future Planning	Management can plan effectively based on accurate past financial data.
10. Essential for Mergers/Investments	Investors and acquirers depend on audit reports before investing or taking over a business.

Limitations of Auditing

Limitation	Explanation
1. Dependence on Samples	Auditors usually examine only selected transactions, which may cause some errors to go undetected.
2. Not a Guarantee Against Fraud	If fraud is well-planned or concealed, it may escape detection.
3. Historical Nature	Audit is usually done after the end of the financial year, so it does not prevent past errors.
4. Reliance on Management Representations	Auditors depend on explanations and data provided by the management, which could be misleading.
5. Subjectivity in Judgments	Auditor's opinion may vary based on personal judgment, especially in areas like asset valuation.
6. Limited Scope in Certain Audits	In internal or partial audits, the auditor's role and access may be restricted.
7. Expensive for Small Firms	For small businesses, the cost of audit may be relatively high.
8. May Create False Sense of Security	Users may believe that audited accounts are 100% correct, which is not always true.
9. Time-Consuming	Detailed audits may take time and delay financial reporting.

Unit 2: Audit Process and Audit Programme

Audit Process

The **audit process** is the complete sequence of activities an auditor undertakes, from accepting the assignment to issuing the audit report. It can be divided into **six major stages**:

Stage	Description
1. Appointment of Auditor	Auditor is appointed by shareholders, management, or legally under the Companies Act.
2. Understanding the Business	Auditor studies the nature of the business, its operations, industry, and accounting system.
3. Planning the Audit	Auditor designs an audit plan, assesses risk areas, and identifies what resources and procedures will be used.
4. Collection of Audit	Auditor gathers evidence by checking vouchers, documents,

Evidence	records, internal controls, etc.
5. Evaluation and Conclusion	Auditor analyses findings, evaluates the fairness of financial statements, and decides on an opinion.
6. Audit Report	Auditor prepares and submits the audit report, giving a professional opinion on the financial statements.

II. Audit Programme

An **audit programme** is a **written plan or list of procedures** to be followed during the audit. It acts as a guide for the audit staff and ensures systematic, thorough work.

Definition:

"An audit programme is a detailed plan of the auditing work to be performed, specifying procedures for verification, checking, and review."

Contents of an Audit Programme:

Component	Details
Objective of the Audit	What the audit aims to achieve.
Scope of the Audit	The areas and departments to be covered.
Detailed Procedures	Step-by-step checks (e.g., vouching of cash receipts, verification of fixed assets).
Time Schedule	Deadlines for each phase or section of audit work.
Allocation of Work	Assigning specific tasks to junior/senior audit staff.
Documentation and Working Papers	Instructions on maintaining evidence and notes.

Audit Notebook

Meaning:

An **audit notebook** is a diary or record maintained by junior audit staff to note down **important observations, queries, and points** that arise during the course of the audit.

Contents of an Audit Notebook:

Item	Description
Errors and irregularities noticed	E.g., missing vouchers, misstatements
Doubts or queries for senior auditors	Items needing clarification or approval
Important facts and figures	Unusual transactions, deviations from norms
Documents checked and observations	Summary of verification work
Points to be included in audit	Matters that may require reporting to management or

report	stakeholders
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Importance of Audit Notebook:

- Serves as **evidence** of work done
- Helps in **review** and supervision
- Acts as a **reference** in future audits
- Aids in **preparing the audit report**

◆ 2. Audit Files

📖 Meaning:

Audit files are folders or electronic records in which all **working papers, documents, and evidence** gathered during an audit are organized.

✓ Types of Audit Files:

Type	Contents
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A. Permanent Audit File - Company's incorporation documents (MOA, AOA)

Previous years' audit reports, List of officers and key personnel, Accounting policies and procedures, Internal control system details |

| **B. Current Audit File** | - Audit programme, Working papers of the current year, Trial balance, ledgers, financial statements, Queries and explanations received, Copy of current year's audit report |

📖 Importance of Audit Files:

- Help in **planning and execution** of audit, Provide a **basis for forming an opinion**, Used for **review and supervision**, Serve as **legal evidence** if disputes arise, Useful in **future audits**

◆ 3. Audit Evidence

Meaning:

Audit evidence is all the information and documentation collected by the auditor to support their findings and opinion on the financial statements.

✓ Types of Audit Evidence:

Type	Example
Documentary Evidence	Invoices, contracts, receipts, vouchers
Oral Evidence	Statements from company staff
External Evidence	Confirmations from banks, creditors
Internal Evidence	Internally prepared records and reports

Physical Evidence	Actual inspection of assets like inventory, equipment
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Internal Check and control:

Meaning:

Internal check is a system of accounting in which the work of one person is automatically checked by another person during the course of their duties, with the objective of preventing and detecting errors and frauds at an early stage. It ensures division of work in such a way that no single person handles a transaction completely from beginning to end.

Definition:

Spicer and Pegler define internal check as:

“Internal check is an arrangement of the duties of the members of the staff in such a manner that the work performed by one person is automatically checked by another, the object being the prevention or early detection of errors or fraud.”

Objectives of Internal Check

1. **Prevention of Errors and Frauds** – To avoid the occurrence of mistakes and frauds through continuous checking of work by another person.
2. **Early Detection** – To detect errors or frauds at the earliest stage possible.
3. **Proper Division of Work** – To allocate duties in such a way that no single person handles a transaction from start to finish.
4. **Fixation of Responsibility** – To make it easy to trace the person responsible in case of any irregularity.
5. **Efficiency in Work** – To improve the accuracy, speed, and quality of work performed.
6. **Relieving Auditor's Burden** – To reduce the extent of detailed checking required by the auditor.
7. **Establishing Accountability** – To ensure each staff member is accountable for their specific part of the work.
8. **Smooth Workflow** – To maintain continuity and avoid overlapping of duties.

Essentials of a Good Internal Check System

1. **Proper Division of Duties** – Work should be divided so that no one person controls all aspects of a transaction.
2. **Rotation of Duties** – Periodic shifting of duties to avoid collusion and familiarity with loopholes.
3. **Clear Instructions** – Staff should be given clear guidelines and instructions regarding their work.
4. **Cross Checking** – The work of one employee should be automatically checked by another without extra effort.

5. **Segregation of Accounting and Custody** – Persons handling cash or goods should not be involved in their recording.
6. **Qualified and Honest Staff** – Competent, trained, and trustworthy employees should be appointed.
7. **Supervision and Review** – Continuous monitoring by higher authorities.
8. **Use of Mechanical Devices** – Adoption of calculators, computers, and accounting software to reduce manual errors.
9. **Clear Documentation** – Proper maintenance of records, vouchers, and supporting documents.
10. **Flexibility** – The system should adapt to changes in business size and nature.

Advantages

1. **Prevention of Errors and Frauds** – Continuous checking reduces the chances of mistakes and frauds.
2. **Early Detection** – Irregularities are detected quickly before they become serious.
3. **Proper Division of Work** – Each employee performs a specific part of the work, reducing confusion.
4. **Fixation of Responsibility** – Easier to identify the person responsible for an error or fraud.
5. **Efficiency and Speed** – Work is done faster and more accurately due to specialization.
6. **Relieves Auditor's Workload** – Auditor can rely on a sound internal check system and reduce detailed checking.
7. **Increases Employee Confidence** – Staff feels secure knowing their work is monitored and guided.
8. **Continuity in Work** – Even if one employee is absent, another can continue the work without much difficulty.

Disadvantages

1. **Possibility of Collusion** – Employees may collude to commit fraud, bypassing the system.
2. **Costly Implementation** – Requires more staff and supervision, which increases expenses.
3. **Time-Consuming Setup** – Designing and implementing a good system takes time.
4. **Not Foolproof** – Clever manipulation or joint fraud may still go undetected.
5. **Over-Reliance by Auditor** – Auditor may rely too much on the system and miss certain checks.

6. **Unsuitable for Small Firms** – Small businesses may not have enough staff to divide duties effectively.
7. **Resistance by Staff** – Employees may feel over-monitored and resist the system.

Internal Control – Meaning and Definition

Meaning:

Internal control is a broad system of policies, procedures, and practices established by the management of an organization to ensure that operations are efficient, assets are safeguarded, records are accurate, and compliance with laws and policies is maintained. It includes all measures — financial and non-financial — that help in preventing and detecting errors and frauds, ensuring reliable financial reporting, and promoting operational efficiency.

Definitions:

1. American Institute of Certified Public Accountants (AICPA):

“Internal control comprises the plan of organization and all of the coordinated methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.”

🎬 **Safeguarding Assets** – To protect cash, goods, and other assets from theft, misuse, or loss.

🎬 **Accuracy of Records** – To ensure accounting records and reports are correct and reliable.

🎬 **Prevention and Detection of Errors and Frauds** – To minimize mistakes and identify irregularities quickly.

🎬 **Compliance with Policies and Laws** – To make sure employees follow management’s policies and legal requirements.

🎬 **Operational Efficiency** – To ensure resources are used effectively and wastage is minimized.

🎬 **Proper Authorization** – To ensure that transactions are carried out only with approval from authorized personnel.

🎬 **Fixation of Responsibility** – To clearly define duties so that accountability is established.

🎬 **Facilitating Audit** – To make internal and external audits easier and faster.

🎬 **Timely Reporting** – To ensure that financial and operational reports are prepared on time.

Difference Between Internal Control and Internal Check

Basis	Internal Control	Internal Check
Meaning	A broad system of all policies, procedures, and controls (financial & non-financial) adopted by management in such a way that the work of to safeguard assets, ensure accuracy of one person is automatically	A part of the internal control system in which work is divided

	records, and promote efficiency.	checked by another.
Scope	Wider in scope – covers all types of controls including administrative, operational, and accounting controls.	Narrow in scope – deals mainly with the division of duties and checking of work in accounting.
Objective	To ensure overall efficiency, safeguard assets, prevent fraud, and ensure compliance with policies and laws.	To prevent and detect errors and frauds in accounting through continuous checking.
Nature	Comprehensive system covering entire organization activities.	Sub-system within internal control focusing mainly on accounting processes.
Application	Applies to both financial and non-financial operations (e.g., production, HR, purchases).	Mostly applies to accounting and recording functions.
Responsibility	Responsibility lies with management to design and implement.	Responsibility lies with accounting staff as part of their daily work.
Examples	Authorization of payments, physical verification of inventory, approval procedures, budgetary controls.	Separation of duties for recording cash received and depositing it into the bank.
Relationship	Internal control includes internal check as one of its components.	Internal check is a part of internal control.

Unit 4: Vouching and verification of assets and liabilities

“Vouching is the examination of the evidence offered in support of the entries in the books of accounts with a view to testing the accuracy of such entries.”

In simple words, **vouching** is the process of checking entries in the books of accounts with the help of documentary evidence (vouchers) to verify their authenticity, accuracy, and proper authorization.

Features of Vouching

1. **Examination of Documentary Evidence** – Involves checking vouchers such as invoices, receipts, bills, etc.
2. **Verification of Entries** – Confirms that transactions are recorded correctly in the books of accounts.
3. **Test of Authenticity** – Ensures that transactions are genuine and supported by proper documents.
4. **Test of Authority** – Checks that transactions have been properly authorized by competent persons.

5. **Objective-Oriented** – Main purpose is to detect errors, frauds, or irregularities.
6. **Continuous Process** – Performed throughout the audit to cover all transactions.
7. **Covers Both Sides of Transactions** – Applied to both receipts and payments.
8. **Involves Professional Judgment** – Auditor uses skill and experience to evaluate the validity of documents.
9. **Relies on Proper Vouchers** – Accuracy of vouching depends on the reliability of vouchers and related evidence.
10. **Part of Detailed Audit Work** – One of the most important steps in the auditing process.

Meaning:

Verification is the process of confirming the existence, ownership, valuation, and proper disclosure of assets and liabilities appearing in the Balance Sheet. It is done to ensure that the items shown in the financial statements are real, correctly valued, and legally owned by the business. Verification is broader than valuation because it involves not only checking the monetary value but also the actual existence and legal rights of assets and liabilities.

Definitions:

1. Spicer & Pegler:

“Verification implies an inquiry into the value, ownership, title, existence and possession of assets, and also the correctness of liabilities.”

Objectives of Verification

1. **To Confirm Existence** – Ensure assets and liabilities shown in the Balance Sheet actually exist on the date of the statement.
2. **To Check Ownership and Title** – Confirm that the business has legal rights over its assets and liabilities are genuine.
3. **To Ensure Proper Valuation** – Verify that assets and liabilities are valued according to accounting standards and principles.
4. **To Detect Fraud and Errors** – Identify any misstatement, misappropriation, or manipulation in asset and liability figures.
5. **To Ensure Proper Disclosure** – Make sure assets and liabilities are disclosed in the correct format as per legal requirements.
6. **To Check Authorization** – Ensure that acquisition or disposal of assets and incurring of liabilities are properly authorized.
7. **To Safeguard Stakeholders’ Interests** – Give assurance to shareholders, creditors, and investors about the accuracy of the financial position.

Importance of Verification

1. **Ensures Accuracy of Financial Statements** – Helps in presenting a true and fair view of the company's financial position.
2. **Builds Credibility** – Increases trust among investors, creditors, and other stakeholders.
3. **Prevents Misstatement** – Reduces the chances of overstatement or understatement of assets and liabilities.
4. **Detects Fraud and Manipulation** – Uncovers fictitious assets, inflated valuations, or hidden liabilities.
5. **Ensures Legal Compliance** – Helps meet statutory and regulatory requirements regarding presentation of financial statements.
6. **Supports Audit Opinion** – Provides the auditor with sufficient evidence to give an informed opinion on the Balance Sheet.
7. **Protects Stakeholders' Interests** – Safeguards the interests of those who rely on financial statements for decision-making.

Procedure of Verification of Assets and Liabilities in auditing refers to the systematic steps an auditor follows to check the **existence, ownership, valuation, and disclosure** of an organisation's assets and liabilities.

1. Verification of Assets

The procedure generally involves the following steps:

1. **Physical Inspection** Personally inspect tangible assets like machinery, buildings, stock, etc., Confirm their condition, existence, and location.
2. **Examination of Ownership Documents** Verify title deeds, registration certificates, invoices, lease agreements, etc., Ensure assets are free from undisclosed charges or liens.
3. **Valuation** Check whether valuation is in accordance with accounting standards and company policy., Compare with previous year's values and revaluation reports if any.
4. **Confirmation from Third Parties** Obtain direct confirmations for assets kept with outsiders (e.g., bank balance confirmations, stock with consignees).
5. **Checking Proper Recording** Trace entries from asset registers to ledger accounts and financial statements.
6. **Compliance with Law and Standards** Ensure the assets comply with statutory requirements (e.g., depreciation as per Companies Act).

2. Verification of Liabilities

The procedure generally involves:

1. **Examination of Supporting Documents** Verify loan agreements, bills payable, creditors' invoices, and other related papers.

2. **Direct Confirmation** Send confirmation letters to creditors, lenders, and other liability holders.
3. **Reconciliation** Match creditors' statements with the company's books., Reconcile loan balances with bank statements or lender's records.
4. **Review of Subsequent Events** Check payments made after the balance sheet date to ensure liabilities were correctly recorded.
5. **Examine Contingent Liabilities** Review guarantees, pending lawsuits, and other off-balance sheet items for proper disclosure.
6. **Check Proper Classification** Ensure liabilities are classified correctly into current and non-current., Verify correct presentation in the balance sheet.

Unit 5: Audit Report

Meaning of Audit Report

An **audit report** is a formal statement issued by an auditor after examining a company's books of accounts, financial statements, and related information. It communicates the auditor's **opinion** on whether the financial statements present a **true and fair view** of the organisation's financial position and performance in accordance with applicable laws and accounting standards.

2. Definition of Audit Report

- **Spicer** and **Pegler**:
"An audit report is a statement in which an auditor expresses his opinion on the accounts examined by him."
- **The Institute of Chartered Accountants of India (ICAI)**:
"An audit report is the final product of audit process which communicates the auditor's opinion on the financial statements, in a prescribed format, to the persons interested in such report."

3. Features of an Audit Report

1. **Prepared by an Auditor** It is drafted and signed only by a qualified and independent auditor.
2. **Based on Examination of Records** It is prepared after thorough checking of accounting books, vouchers, and documents.
3. **Expresses Auditor's Opinion** Contains a professional opinion on the accuracy and fairness of financial statements.
4. **Written and Formal Document** Always in a written format as prescribed under law or auditing standards.
5. **Objectivity** Must be unbiased, factual, and based on evidence.
6. **Legal Requirement** For certain entities like companies, audit reports are mandatory under the Companies Act, 2013.

7. **Clarity and Simplicity** Language used should be clear and easily understandable to the readers.
8. **Types Based on Opinion** Can be **clean (unqualified)**, **qualified**, **adverse**, or **disclaimer** depending on audit findings.
9. **Dated and Signed** Must contain the date and signature of the auditor along with designation and membership number.

Purpose of Audit Report

The main purposes are:

1. **Communicate Auditor's Opinion** To inform shareholders, management, and stakeholders whether the financial statements give a true and fair view.
2. **Compliance with Legal Requirements** To fulfill statutory obligations (e.g., under the Companies Act, 2013).
3. **Assurance to Stakeholders** Provides confidence to investors, creditors, and other users about the reliability of accounts.
4. **Basis for Decision Making** Helps in making investment, credit, and policy decisions.
5. **Detect Weaknesses** Highlights accounting or internal control weaknesses found during audit.
6. **Safeguard Auditor's Responsibility** Acts as written evidence of the auditor's professional opinion and work.

2. Types of Audit Report

Audit reports are classified according to the **opinion expressed**:

1. **Unqualified Report (Clean Report)** Auditor concludes that financial statements are true, fair, and free from material misstatement.
2. **Qualified Report** Auditor agrees overall but mentions certain exceptions or reservations.
3. **Adverse Report** Auditor states that financial statements do **not** present a true and fair view.
4. **Disclaimer of Opinion** Auditor refuses to give an opinion due to lack of sufficient evidence or limitations in scope.

3. Format of an Audit Report

(As per **SA 700** issued by ICAI – *Forming an Opinion and Reporting on Financial Statements*)

1. **Title** Should clearly mention "*Independent Auditor's Report*".
2. **Addressee** Usually addressed to shareholders or members.
3. **Opinion Paragraph** States the auditor's opinion on the financial statements.

4. Basis for Opinion Explains the audit was conducted as per Standards on Auditing (SAs) and that sufficient evidence was obtained.

5. Key Audit Matters (*if applicable*) Highlights important matters that required significant auditor attention.

6. Management's Responsibility for Financial Statements States that management is responsible for preparation and fair presentation.

7. Auditor's Responsibility Describes auditor's role in obtaining reasonable assurance and expressing opinion.

8. Other Legal and Regulatory Requirements Additional reporting points as per law (e.g., Companies Act, CARO report).

9. Signature Signed by the auditor with name, membership number, and firm details.

10. Place and Date Indicates where and when the report was signed.